

THE INDONESIA CORPORATE GOVERNANCE MANUAL

First Edition

IFC Advisory Services in Indonesia
In Partnership with:



THE INDONESIA **CORPORATE GOVERNANCE MANUAL**

First Edition

Jakarta, January 2014

Disclaimer

IFC, a member of the World Bank Group, creates opportunity for people to escape poverty and improve their lives. We foster sustainable economic growth in developing countries by supporting private sector development, mobilizing private capital and providing advisory services.

The Indonesia Corporate Governance Manual (CG Manual) was commissioned by IFC as part of the Indonesia Corporate Governance Program that IFC is implementing in Indonesia since 2012.

This manual is distributed with the understanding that neither the authors, nor the organizations, countries they represent, nor the publisher are engaged in rendering legal or financial advice. The material in this Manual is set out in good faith for general guidance, and no liability can be accepted for any possible loss or expense incurred as a result of relying on the information contained herein.

This publication is not intended to be exhaustive. It should not be relied upon as a basis for formulating business decisions. On all financial issues and questions, an accountant, auditor, or other financial specialist should be consulted. A lawyer should be consulted on all legal issues and questions. As the laws in the Republic of Indonesia are constantly changing, legal rules referred to herein may be obsolete or superseded by new legislation at the moment of the publication of this Manual.

All references to the male gender throughout this Manual apply to both sexes, unless otherwise indicated.

The conclusions and judgments contained in this report should not be attributed to, and do not necessarily represent the views of IFC or its Board of Directors or the World Bank or its Executive Directors, or the countries they represent. IFC and the World Bank do not guarantee the accuracy of the data in this publication and accept no responsibility for any consequences of their use.

This Manual is distributed subject to the condition that it shall not, by way of trade or otherwise, be lent, sold, hired out, or otherwise circulated on a commercial basis without International Finance Corporation's prior consent.

In today's globalized environments, companies are facing challenges and competition in global market place. Thus, the role of good corporate governance has become more important.

By strengthening the role and the responsibilities of their boards, increasing the amount and quality of disclosure and enhancing accountability of corporate executives, good corporate governance helps companies formalize business and decision making processes and establish the appropriate checks and balances. This, in turn, improves performance and builds trust between businesses and investors, employees, clients and the community as a whole.



Sarvesh Suri

Sarvesh Suri
IFC, Country Manager,
Indonesia

IFC, a member of the World Bank Group, advocates and promotes good corporate governance practices in any market where it operates by helping its clients and partners address key challenges and achieve impactful results. In Indonesia, IFC set up a Corporate Governance Program in Indonesia in 2012 with the aim of improving market standards and creating an environment conducive to transparent, accountable and responsible practices.

As part of this Program, IFC has established a formal cooperation with *Otoritas Jasa Keuangan (OJK)*. A key product of this cooperation between IFC and OJK is the development of this Indonesia Corporate Governance Manual, which serves as a learning instrument to benchmark existing standards and practices in Indonesia with internationally recognized best practices.

In this respect, this Corporate Governance Manual should be considered as a major tool for Corporate Governance in Indonesia as it targets a wide spectrum

of stakeholders, such as directors and commissioners, academics, policymakers, corporate governance experts and more generally, individuals and institutions interested to know about the corporate governance framework in Indonesia.

IFC is happy to be part of this initiative with OJK and remains committed to helping raise governance standards across the market and contribute to a sustainable private sector in Indonesia.



A stylized, handwritten signature in black ink, consisting of several loops and a long horizontal stroke.

Muliaman D. Hadad
Chairman of
the Board of
Commissioners of OJK

Indonesia has experienced financial crisis in 1997/1998 in which one of the causes of the crisis is the weak implementation of corporate governance. We have also learnt that recent global financial crisis is due to poor corporate governance practices. Thus, the need for developing and improving corporate governance, in compliance with national regulations and in alignment with international best practices, is unavoidable.

Indonesia Financial Services Authority (OJK) is committed to promote corporate governance practices in Indonesia as part of financial stability efforts. Therefore, OJK highly appreciates the initiative of IFC in developing the Indonesia Corporate Governance Manual for companies in Indonesia.

OJK believes that the Indonesia Corporate Governance Manual will benefit to all companies in Indonesia in developing their robust corporate governance practices. Through the manual, company could benchmark its current governance implementation with best practices and identify the weaknesses that may contribute to a company's financial vulnerability and make improvement accordingly. The improvement may cover the role of the Board of Commissioners, the role of the Board of Directors, shareholder rights, material corporate transaction, disclosure and transparency, and internal control.

As Indonesia will enter the Asian Economic Community, it is inevitable that Indonesian company should improve its corporate governance practices that benchmarked on international best practices to improve

its competitiveness. These will increase investor confidence, reduce the cost of capital, and create sustainable company performance.

OJK hopes that the Indonesia Corporate Governance Manual will serve as a cornerstone for the implementation of good corporate governance in Indonesia so as to create conducive, stable and attractive financial sector which contribute to sustainable economic growth.

Jakarta, January 2014

How to Use this Manual

This Manual is divided into 15 chapters:

- Chapter 1: An Introduction to Corporate Governance
- Chapter 2: The General Governance Structure of a Company
- Chapter 3: The Internal Corporate Documents
- Chapter 4: The Board of Commissioners
- Chapter 5: The Board of Directors
- Chapter 6: The Role of the Corporate Secretary
- Chapter 7: An Introduction to Shareholder Rights
- Chapter 8: The General Meeting of Shareholders
- Chapter 9: Corporate Governance Implications of the Charter Capital
- Chapter 10: Dividends
- Chapter 11: Corporate Governance Implications of Corporate Securities
- Chapter 12: Material Corporate Transactions
- Chapter 13: Information Disclosure
- Chapter 14: Control and Audit Procedures
- Chapter 15: Overview of the Corporate Governance Framework of State Owned Enterprises (SOEs)

The 15 chapters of the Manual focus on the key corporate governance issues. All issues are closely examined through Indonesian law and regulations and when applicable, interationally recognized best practices. While it is recommended to read the entire Manual to gain a full understanding of the corporate governance framework in Indonesia, it is not necessary to read all the chapters in chronological order. the reader is encouraged to begin with a topic of interest and follow the links and references included in the text for guidance to other chapters.

Examples, illustrations, and checklists are included to make the Manual clear and useful. The following tools will reappear at various intervals in the text:



The Chairman's Checklist

The Chairman's Checklist is intended to help the Chairman of the Board of Directors focus Board discussions on key corporate issues faced by the companies.



Best Practices

Best Practices summarizes OECD Principles of Corporate Governance, as well as leading national standards from other countries.



Comparative Practices

Comparative Practices illustrates how other countries currently approach corporate governance issues. It highlights red flags, i.e. common corporate governance abuses as well as model company practices in good corporate governance.



Company Practices



Mini-Case:



Mini-Case 1

- Mini-cases illustrate abstract concepts and show the real problems that companies face.
- Figures, tables, and other illustrations are included to illustrate key concepts.
- Detailed references to law and regulations refer the reader to original texts.

Acknowledgement

The preparation and publication of the Indonesia Corporate Governance Manual (the Indonesia CG Manual) involved the participation and efforts of a significant number of dedicated people. The Indonesia CG Manual was prepared based on the other CG manuals published by various IFC's Corporate Governance Programs and adapted to Indonesia's corporate governance legal framework and practices.

The Indonesia CG Manual was produced as part of IFC's Corporate Governance Program in Indonesia. The Manual's text was adapted under the direction of Mr Moez Miaoui with major contributions from Mr Stefanus Handoyo, IFC, and Mrs Evi Sofiati, and IFC consultant. The development of the Manual was also contributed to by Mr Cornelius B. Juniarto, Partner, Hermawan Juniarto, and his team.

The development of the Manual received significant contributions from Otoritas Jasa Keuangan, OJK, the Indonesia Financial Services Authority. OJK's Chairman Mr Muliaman Hadad and Mrs Nurhaida, Commissioner, as well as OJK's Capital Market department provided continuous and strong commitment towards the development and publication of this Manual.

The Komite Nasional Kebijakan Governance, KNKG, or National Committee on Governance, also provided insightful comments and contributed significantly to the review of the latest drafts of the Manual, with in particular a strong involvement of Mr Mas Achmad Daniri and Mr Binhadi.

TABLE OF CONTENTS

Table of Contents

Foreword from IFC	iii
Foreword from OJK	v
How to Use this Manual	vii
Acknowledgement	ix

CHAPTER 1. An Introduction to Corporate Governance 26

A. Corporate Governance Explained 30

1. Defining Corporate Governance 30
2. The Role of Stakeholders 32
3. A Brief History of Corporate Governance 33
4. The International Scope of Corporate Governance 39
5. Distinguishing Corporate Governance 40

B. The Business Case for Corporate Governance 42

1. Stimulating Performance and Improving Operational Efficiency 43
2. Improving Access to Capital Markets 44
3. Lowering the Company's Cost of Capital and Raising the Value of Assets 45
4. Building a Better Reputation 47

C. The Cost of Corporate Governance 49

D. The Corporate Governance Framework in Indonesia 51

1. Specifics of Corporate Governance in Indonesia 51
2. The Legal and Regulatory Framework 52
3. The Corporate Governance Regulations Applicable to Listed Companies in Indonesia 58
4. The Institutional Framework 59

CHAPTER 2. The General Governance Structure of a Company **61**

A. What is a Limited Liability Company?	65
1. The Definition of a Limited Liability Company	65
2. Listed and Non-Listed Companies	66
3. The Advantages and Disadvantages of Limited Liability Public Companies over Other Legal Forms	68
B. The Governance Structure of a Limited Liability Company	71
1. The General Meeting of Shareholders	72
2. The Board of Commissioners	72
3. The Board of Directors	74
4. Board Committees	75
5. External Auditor	75
6. The Internal Auditor	76
7. The Corporate Secretary	76

CHAPTER 3. The Internal Corporate Documents **77**

A. The Company Articles of Association (AoA)	82
1. Articles of Association Provisions	82
2. Form of the Articles of Association	82
3. When to Amend the Articles of Association?	83
4. Who can Amend the Articles of Association?	83
5. How to Amend the Articles of Association?	84
6. Objection to the Amendments of the Articles of Association	84
7. Acknowledgement and Approval from the Minister of Law and Human Rights (MOLHR) to the Amendment of the Articles of Association Amendments	85

8. When does the Amendment of Articles of Association become Effective?	85
9. Disclosure of the Articles of Association	86
B. The Internal Regulations of a Company	87
1. Types of Internal Regulations	87
2. How to Adopt and Amend Internal Regulations?	89
C. Company Codes of Corporate Governance	90
1. What is a Company Code of Corporate Governance?	90
2. Indonesian Company Code of Corporate Governance	92
D. Company Code of Ethics	95
1. What is a Code of Ethics?	95
2. Why Adopt a Code of Ethics?	95
3. How to Implement a Code of Ethics?	96
4. Indonesian Code of Business Ethics	97

CHAPTER 4. The Board of Commissioners 99

A. The Board of Commissioners' Authority	111
1. When to Establish a Board of Commissioners?	111
2. An Overview of the Board of Commissioners' Authority	112
B. The Election and Dismissal of Commissioners	123
1. The Election and Term of Commissioners	123
2. The Removal of Commissioners	126
C. The Composition of the Board of Commissioners	128
1. The Number of Commissioners	128
2. Who Can Be a Commissioner?	129
3. Qualifications of Commissioners	131
4. Categories of Commissioners	134

D. The Structure and Committees of the Board of Commissioners	140
1. President Commissioner	140
2. Committees Established by a Board of Commissioners	142
3. The President of Supporting Committee of a Board of Commissioners	147
E. The Working Procedures of the Board of Commissioners	148
1. The President and Board of Commissioners Meetings	148
2. The Board of Commissioners Meetings	149
3. The First Board of Commissioners Meeting	150
4. The Schedule of Board of Commissioners Meetings	151
5. Who Has the Right to Convene a Board of Commissioners Meeting?	152
6. Proper Notice for Board of Commissioners Meetings	152
7. The Quorum for Board of Commissioners Meetings	154
8. How Commissioners Can Participate in Board of Commissioners Meetings	154
9. The Consideration of Written Opinions (Absentee Ballots)	156
10. Board of Commissioners Decisions	156
11. The Minutes of Board of Commissioners Meetings	157
12. The Corporate Secretary and Board of Commissioners Meetings	158
F. The Duties and Liabilities of Commissioners	160
1. The Duty of Care	160
2. The Duty of Loyalty	161
3. Commissioner Access to Information	165
4. Liabilities of Commissioners	166
5. When Are Commissioners Relieved from Liability and Responsibility in Respect of the Company Losses?	166
6. Who Can File a Claim against Commissioners?	167

7. The Minutes of Board of Commissioners Meetings and Commissioner Liability	167
8. Protection from Liability for Commissioners	168
G. Evaluation and Education of the Board of Commissioners	170
1. Self-Evaluation by the Board of Commissioners	170
2. Education and Training	171
H. The Remuneration of Commissioners	173
I. Summary Checklist to Determine the Board of Commissioners’ Effectiveness	177

CHAPTER 5. The Board of Directors **179**

A. The Board of Directors and Their Authorities	185
1. The Authority of the Board of Directors	187
B. The Composition of the Board of Directors	191
1. Who Can Be a President Director or a Board of Directors’ Member?	191
2. Qualifications of the President Director and Board of Directors’ Members	192
3. The Composition of the Board of Directors	194
C. The Formation and Termination of the Board of Directors	195
1. The Election and Term of the Board of Directors’ Members	195
2. The Termination of the Authority of the Board of Directors	199
D. The Working Procedures of the Board of Directors	200
1. The President of the Board of Directors	200
2. The Board of Directors’ Meetings	201
3. The Right to Call a Board of Directors’ Meeting	201
4. Meeting Notification	202
5. The Quorum of the Board of Directors’ Meetings	202

6. Voting During the Board of Directors' Meetings	203
7. The Minutes of the Board of Directors' Meetings	203
E. The Duties and Liabilities of the Members of Board of Directors	205
F. Performance Evaluations	206
G. The Remuneration and Reimbursement of the Board of Directors	207
1. Remuneration Policy	208
2. Employment Contracts for Directors	210
3. Severance Payments to the President Director and Board of Directors' Members	212

CHAPTER 6. The Role of the Corporate Secretary 214

A. The Role of the Corporate Secretary	218
1. The Need for and Importance of the Corporate Secretary	218
2. The Qualifications of a Corporate Secretary	220
3. The Independence of the Corporate Secretary	222
4. The Appointment of the Corporate Secretary	223
B. The Authority of the Corporate Secretary	226
1. General Provisions	226
2. Developing Corporate Governance Policies and Practices	228
3. Legal and Organizational Support of the Board of Directors	228
4. Protecting Shareholder Rights	232
5. Providing for Information Disclosure and Transparency	233
C. Professional Associations of Corporate Secretaries	236

A. General Provisions on Shareholder Rights	242
1. Reasons for Being a Shareholder	242
2. Classification of Shares	243
3. Types of Shareholder Rights	245
B. Specific Shareholder Rights	249
1. The Right to Vote	249
2. The Right to Appeal Decisions of the General Meeting of Shareholders	254
3. The Right to Receive Information about the Company	255
4. The Right to Freely Transfer Shares	256
5. Pre-Emptive Rights	257
6. The Right to Demand the Redemption of Shares	260
7. Shareholder Rights during the Liquidation of the Company	261
8. The Right to Review the Shareholder List	262
9. The Right to File a Claim on Behalf of the Company	263
10. The Right to Receive Dividends	264
11. The Right to Summon a General Meeting of Shareholders	264
12. The Right to Nominate Candidates to be Elected as Members of the Board of Commissioners and the Board of Directors	265
13. Restrictions on Founding Shareholders	265
C. The State as a Shareholder	266
1. The State as an Ordinary Shareholder	266
2. The State as the Holder of Privileged Rights	266
3. Exercising the Rights of the State as a Shareholder	267

D. The Shareholder Register	268
1. The Company Share Register - Register Book of Shareholders	268
2. Registration for Obtaining the Effective Statement	269
3. Registration with Business Registrar	270
E. The Protection of Shareholder Rights	271
1. Guarantees in the Indonesian Company Law	271
2. Judicial Protection	271
3. Non-Governmental Organizations for the Protection of Shareholder Rights	272
4. Company Articles of Association	272
5. Shareholder Activism and Collective Action	273
6. Shareholder Agreements	275
F. Responsibilities of Shareholders	277
1. Obligation to Make Full Payment for their Subscribed Shares	277
2. Obligation to be Liable to Debt and other Liabilities of the Company	277
3. Other Obligations	278

CHAPTER 8. The General Meeting of Shareholders **279**

A. General Provisions	285
1. Types of General Meetings of Shareholders	285
2. The Authority of the General Meeting of Shareholders	286
B. Preparing for the Annual General Meeting of Shareholders	290
1. Drafting the Agenda	291
2. Making Preliminary Decisions	293
3. Preparing the Shareholder List	294
4. Providing Proper Notice	298

5. Approving the Agenda - Shareholders' Rights to Amend the Agenda	304
6. Preparing Draft Resolutions on Each of the Items on the Agenda	309
C. Conducting the General Meeting of Shareholders	310
1. Shareholder Participation Options	312
2. Shareholder Registration	312
3. Verifying and Announcing the Quorum	314
4. Opening the General Meeting of Shareholders	315
5. Electing the Voting Committee	316
6. Inviting Outside Guests as Observers	316
7. Presenting the Agenda and the Rules of Order	317
8. Discussing Agenda Items	317
9. Voting	318
10. Counting and Documenting Votes	320
11. Announcing the Voting Results and Decisions	321
12. Closing the General Meeting of Shareholders	321
13. Archiving Voting Ballots	321
14. Preparing the General Meeting of Shareholders Minutes	321
15. Documents of the General Meeting of Shareholders	322
D. An Overview of the Extraordinary General Meeting of Shareholders	324
1. When to Conduct an Extraordinary General Meeting of Shareholders	324
2. Preparatory Procedures	324
3. Circular Resolution of the Shareholders	326
E. Decisions of the General Meeting of Shareholders	328
1. Decisions Requiring a Simple Majority Vote	328
2. Decisions Requiring a Supermajority Vote	328

3. Decisions Requiring a Unanimous Vote	329
4. Filing Lawsuit Against GMS Decision	329

CHAPTER 9. Corporate Governance Implications of the Charter Capital	331
--	------------

A. General Provisions Related to the Charter Capital	335
1. The Definition of Charter Capital	335
2. Legal Capital or Minimum Charter Capital	335
3. Charter Capital and Share Capital	336
4. Full Payment for Shares	337
5. Contributions to the Charter Capital	338
B. Increasing the Charter Capital	341
1. Methods of Increasing the Charter Capital	341
2. Methods of Placement	344
3. Internal Sources for Increasing the Charter Capital	344
4. Ownership Rights Protection When Increasing the Charter Capital	345
5. Procedural Guarantees for Increasing the Charter Capital	346
C. Protecting the Charter Capital	349
1. Overview of Decreasing the Charter Capital	350
2. Share Buybacks	354
3. Reciprocal Shareholdings	358
D. Statutory and Voluntary Reserves	359
1. The Statutory Reserve	359
2. Other Funds	359
3. Additional Paid-In Capital	360

CHAPTER 10. Dividends 361

A. General Provisions on Dividends	365
1. The Definition of Dividends	365
2. Distributable Profit	365
3. Dividend Rights	366
4. Types of Dividends	366
5. Forms of Dividend Payments	367
6. Decision-Making Authority Regarding Dividends	368
7. The Amount of Dividends	368
8. The Importance of Receiving Stable Dividends	369
B. Procedures for Declaring and Paying Dividends	370
1. How Dividends are Declared	370
2. The Shareholder List for Dividends	372
3. When Declared Dividends are Paid	372
4. When the Company Cannot Declare Dividends	373
5. When the Company Cannot Pay Declared Dividends	373
C. The Disclosure of Information on Dividends	375
D. Dividend Policy	377

CHAPTER 11. Corporate Governance Implications of Corporate Securities 379

A. An Overview of Corporate Securities	383
1. Basic Types of Securities - Shares and Bonds	383
3. Securities in Paper and Paperless Forms	386
3. Domestic Issuers on International Markets	386

B. Types of Securities	388
1. Shares	388
2. Bonds	389
C. Issuing Securities	395
1. Making the Decision to Place Securities	397
2. Registering the Decision to Issue Securities	398
3. Granting the Certificate for Public Offering of Securities	400
4. Public Offer of Securities	404
D. The Conversion of Securities	410
E. Derivatives	411
F. Raising Capital in International Markets	413

CHAPTER 12. Material Corporate Transactions **414**

A. Extraordinary Transactions	419
1. Definition	419
2. Valuing Extraordinary Transactions	422
3. Procedure for Approving Extraordinary Transactions	423
4. How Shareholders Can Protest Extraordinary Transactions	425
5. Disclosure Requirements	425
B. Affiliated (Related Party) Transactions	427
1. Definition	427
2. Approving Affiliated Transactions	433
3. Identifying Affiliated Transactions	434
4. Disclosure Requirements	435
5. Invalidation of Affiliated Transactions	437
6. Liability for the Violation of Procedural Requirements	437

CHAPTER 13. Information Disclosure**438**

A. An Introduction to Information Disclosure	443
1. Definition and Rationale	443
2. Principles of Disclosure	443
3. Confidential Information (Business Secret)	445
4. Inside Information and Insider Dealing	447
5. Disclosure in Listed and Public Non-listed Companies	448
6. Disclosure Versus Transparency	449
7. Personal Liability for Non-Disclosure	449
B. Disclosure Items	451
1. Financial and Operating Results	454
2. Company Objectives	461
3. Major Share Ownership and Voting Rights	462
4. Information on Commissioners and Directors	467
5. Material Foreseeable Risk Factors	470
6. Employees and Other Stakeholders	470
7. Corporate Governance Structures and Policies	470
8. Disclosure During the Placement of Securities - Prospectus	473
C. Voluntary Disclosure	474
1. Corporate Websites	474
2. Mass Media	475

CHAPTER 14. Control and Audit Procedures**477**

A. The Board Of Commissioners	484
--------------------------------------	------------

B. The Independent External Auditor	485
1. When an Annual Audit is Required	485
2. The Rights and Duties of the External Auditor	485
3. The Rights and Duties of the Company	487
4. The Appointment of the External Auditor	488
5. Compensation	491
6. Reporting	492
7. The External Auditor’s Liability	493
C. The Audit Committee of the Board of Commissioners	495
1. Functions	497
2. Composition	498
3. Meetings	499
4. Access to Information and Resources	500
D. Internal Control Function	501
1. Internal Control Principles	502
2. Elements of the Internal Control System	503
3. Bodies and Persons Responsible for Internal Control	505
4. The Internal Auditor	506

CHAPTER 15. Overview of the Corporate Governance Framework of State Owned Enterprises (SOEs)	510
---	------------

A. Introduction	512
1. The Origin of Indonesian SOEs	512
2. Turnaround	515

B. The Structure and Challenges for the Governance of Indonesian SOEs	515
1. The Legal and Regulatory Framework	515
2. The Position of the State as an Owner of SOEs	517
3. Equitable Treatment of Shareholders	520
4. Stakeholders Relations	521
5. Transparency and Disclosure	523
6. The Boards of SOEs (Responsibilities and the Appointment)	526
C. Summary	529
Bibliography	530

Chapter **1**

AN INTRODUCTION TO CORPORATE GOVERNANCE

Table of Contents

A. CORPORATE GOVERNANCE EXPLAINED	30
1. Defining Corporate Governance	30
2. The Role of Stakeholders	32
3. A Brief History of Corporate Governance	33
4. The International Scope of Corporate Governance	39
5. Distinguishing Corporate Governance	40
B. THE BUSINESS CASE FOR CORPORATE GOVERNANCE	42
1. Stimulating Performance and Improving Operational Efficiency	43
2. Improving Access to Capital Markets	44
3. Lowering the Company’s Cost of Capital and Raising the Value of Assets	45
4. Building a Better Reputation	47
C. THE COST OF CORPORATE GOVERNANCE	49
D. THE CORPORATE GOVERNANCE FRAMEWORK IN INDONESIA	51
1. Specifics of Corporate Governance in Indonesia	51
2. The Legal and Regulatory Framework	52
3. The Corporate Governance Regulations Applicable to Listed Companies in Indonesia	58
4. The Institutional Framework	59



The Chairman's Checklist

- ✓ Do all Director and other company organs understand the concept of corporate governance and its significance to the company and its shareholders?
- ✓ Has the Board of Directors developed a clear and explicit governance policy, and a plan to improve the company's governance practices? Have steps been taken to implement this plan?
- ✓ Are key officers familiar with the OECD Principles of Corporate Governance, legal framework of Corporate Governance in Indonesia, and the Corporate Governance Code applicable to companies in Indonesia (the CG Code)¹? Does the company follow the requirements of the CG Code and disclose information on compliance to shareholders and stakeholders in its annual report? Has the company adopted its own Corporate Governance Code? Has the company included in financial reports a report on the corporate governance structure and practice?
- ✓ Is the company familiar with the main institutions active in the field of corporate governance that can serve as external resources for the company?

1 Corporate Governance Code published by The National Committee on Governance (KNKG)

Corporate governance has become a familiar and increasingly popular term in Indonesia. With the introduction of ICL 1995², the role of the private sector in economic development and job creation in Indonesia began to accelerate. The following two decades brought increasingly sophisticated domestic production, private enterprise growth and increased global competition. The downside to these developments has been the occurrence of major corporate scandals. While various domestic and international efforts have made corporate governance a household name, few Indonesian companies appear to truly appreciate the depth and complexity of this topic.

Indeed, corporate governance reforms are often introduced superficially and used as a public relations exercise, rather than as a tool to introduce the internal structures and processes that enable a company to hold the trust of its shareholders, increase the company's ability to access capital and reduce vulnerability to financial crises. But to successfully introduce these structures and processes, a company must fully and continually commit to the principles of fairness, transparency, accountability and responsibility.

This chapter defines corporate governance, makes a business case for its implementation, and provides an overview of the legal, regulatory and institutional frameworks for corporate governance in Indonesia today.

2 ICL adopted by the Indonesia House of Representatives dated 7 March 1995, as repealed and replaced by the Company Law adopted by the House of Representatives dated 16 August 2007.

A. Corporate Governance Explained

1. Defining Corporate Governance

There is no single definition of corporate governance that can be applied to all situations and jurisdictions. The various definitions that exist today largely depend on the institution or author, country and legal tradition.

IFC defines corporate governance as “the structures and processes for the direction and control of companies.” The Organization for Economic Cooperation and Development (OECD), which in 1999 published its Principles of Corporate Governance, offers a more detailed definition of corporate governance as:

“The internal means by which corporations are operated and controlled [...], which involve a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders, and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.”³

Most definitions that center on the company itself (an internal perspective) do, however, have certain elements in common, which can be summarized as follows:

- **Corporate governance is a system of relationships, defined by structures and processes:** For example, the relationship between shareholders, management and stakeholder(s) that consists of the relationship between the capital provider, stakeholder (s) and the management to achieve certain rate of return and profit on their (shareholders’) investment. Board of Directors in turn are to provide shareholders with financial and operational reports on a regular basis and in a transparent manner. Shareholders also elect a supervisory body, often referred to as the Board of Commissioners, to represent their interests. This company organ essentially provides strategic direction to, and control over the company’s Board of Directors. Board of Directors are accountable to this Board of Commissioners, which in turn is accountable to shareholders

3 OECD Principles of Corporate Governance. (see also: www.oecd.org)

through the General Meeting of Shareholders (GMS). The structures and processes that define these relationships typically center on various management performance and reporting mechanisms.

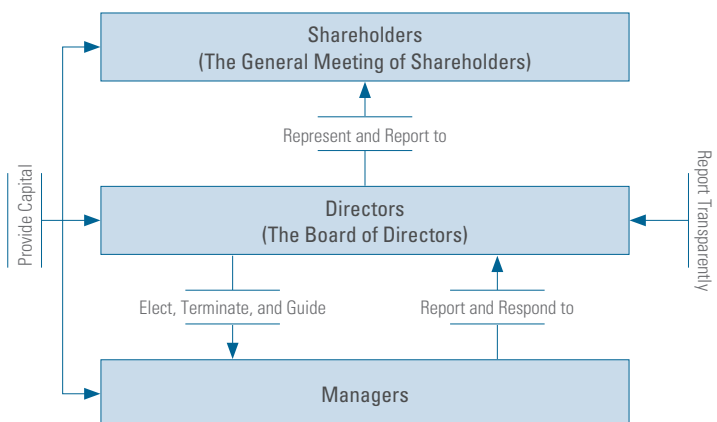
- **These relationships may involve parties with different and sometimes contrasting interests:** Differing interests may exist between the organ of the company, i.e. the GMS, the Board of Directors, and/or Board of Commissioner (or other executive bodies). Contrasting interests exist most typically between owners and Board of Directors, and are commonly referred to as the principal-agent problem.⁴ Conflicts may also exist within each governing organ, such as between shareholders (majority vs. minority, controlling vs. non-controlling, individual vs. institutional) and Company's Organ (executive vs. non-executive, outsiders. inside, independent vs. dependent). Each of these contrasting interests needs to be carefully observed and balanced.
- **All parties are involved in the direction and control of the company:** The GMS, representing shareholders, takes fundamental decisions, for example the distribution of profits. The Board of Commissioner is generally responsible for guidance and oversight, accepting company strategy and controlling the Board of Director. Board of Director, finally, run the day-to-day operations, such as implementing strategy, drafting business plans, managing human resources, developing marketing and sales strategies, and managing asset.
- **All this is done to properly distribute rights and responsibilities—and thus increase long-term shareholder value:** For example, how outside, minority shareholders can prevent a controlling shareholder from gaining benefits through related party transactions, tunneling or similar means.⁵

4 The principal-agent problem is defined as follows by the Oxford Dictionary of Economics: “The problem of how Person (A) can motivate Person (B) to act for (A’s) benefit rather than following his self-interest.” In a company setting, Person (A) is the investor (or principal) and (B) the manager (or agent). Managers at times may follow different goals than investors (e.g. building business empires rather than creating shareholder value), act dishonestly and, at times, even in an incompetent manner. This essentially creates three types of agency costs: (i) divergence costs (i.e. managers that do not maximize the investors’ wealth); (ii) monitoring costs (investors have to develop and implement control structures), including replacement costs; and (iii) incentive costs (costs incurred by investors to remunerate and incentivize their managers). The core role of a corporate governance system is to reduce total agency costs, thus maximizing the value of the company to investors.

5 Corporate Governance: A Framework for Implementation, the World Bank. See also: http://www-wds.worldbank.org/external/default/main?pagePK=64193027&piPK=64187937&theSitePK=523679&menuPK=64187510&searchMenuPK=64187283&siteName=WDS&entityID=000094946_00082605593465

The basic corporate governance system and the relationships between the governing bodies are depicted in Figure 1.

Figure 1. The Corporate Governance System



Source: IFC, March 2004

The external aspect of corporate governance, on the other hand, concentrates on relationships between the company and its stakeholders. Stakeholders are those individuals or institutions that have an interest in the company. Such an interest may arise through legislation or contract, or by way of social or geographic relationships. Stakeholders include investors, but also employees, creditors, suppliers, consumers, regulatory bodies and state agencies, and the local community in which a company operates. Some commentators also include consideration of the environment as an important entry on the list of stakeholders.

2. The Role of Stakeholders

Many international codes, including the OECD Principles, discuss the role of stakeholders in the governance process. The role of stakeholders in governance has been debated in the past, with some arguing that stakeholders have no claim on the company other than those specifically set forth in law or contract. Others have argued that companies fulfill an important social function, have a societal impact and, accordingly, must act in the broad interests of society. This view recognizes that companies should, at times, act at the expense of shareholders. Interestingly, there is a consensus that modern

companies cannot effectively conduct their businesses while ignoring the concerns of stakeholder groups. However, there is also agreement that companies which consistently place other stakeholder interests before those of shareholders cannot remain competitive over the long run.



Best Practices

A key aspect of corporate governance is ensuring the flow of external capital to firms. Corporate governance is also concerned with finding ways to encourage stakeholders to undertake socially efficient levels of investment in firm-specific human and physical capital. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of resource providers including investors, employees, creditors and suppliers. Corporations should recognize that stakeholders' contributions constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating co-operation among stakeholders. The governance framework should acknowledge that the interests of the corporation are served by recognizing the interests of stakeholders and their contribution to the long-term success of the corporation. Therefore, it is in the interest of the company to stimulate productive co-operation with the stakeholders, establish a governance framework to acknowledge the existence of these interests and recognize their importance for the long-term success of the company.

3. A Brief History of Corporate Governance

Corporate governance systems have evolved over centuries, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England. Similarly, much of the securities law in the U.S. was put in place following the stock market crash of 1929. There has been no shortage of other crises, such as the secondary banking crisis of the 1970s in the U.K., the U.S. savings and loan debacle of the 1980s, the 1998 financial crisis in Russia, the 1997-1998 financial crisis in Asia

(especially in Indonesia, South Korea and Thailand) and the current global financial crisis which started in 2008 and has not shown signs of ending at the time of this book.

The history of corporate governance has also been punctuated by a series of well-known company failures. The early 1990s saw the Maxwell Group raid the pension fund of the Mirror Group of newspapers and witnessed the collapse of Barings Bank. The new century likewise opened with a bang, with the spectacular collapse of Enron in the U.S., the near-bankruptcy of Vivendi Universal in France, the scandal at Parmalat in Italy, the trading fraud which hit Société Générale and the most recent Madoff multi-billion dollar ponzi scheme, make other scandals pale in comparison. Each of these corporate failures, often occurring as a result of incompetence or outright fraud, was swiftly met by new governance frameworks, most notably the many national corporate governance codes, the Sarbanes-Oxley Act and the current trend towards imposing stricter regulatory oversight on banking and financial activities in various countries.

In Indonesia, the financial crisis in 1997-1998 has had dramatic social, economic and political effects. That event brought the Rupiah down by almost 80% and dramatically increased poverty. As noted by Furman and Stiglitz:⁶ "The depth of the collapse in Indonesia, if not unparalleled, is among the largest peacetime contractions since at least 1960, excluding the experience of the transition economies"⁶. According to several experts, the recession in Indonesia was fuelled by many institutional weaknesses, among which the lack or inadequate enforcement of the central bank's regulations along with irregular banking practices and the extremely poor financial regulation⁷.

Since then, it is fair to say that, although there is still plenty of room for improvement, the awareness, enthusiasm as well as legal and regulatory framework on corporate governance in Indonesia has changed and improved dramatically in recent years.

Indonesia had done a lot of initiatives and efforts to implement good corporate governance, both from government side as well as private. Those initiatives and efforts include establishment of corporate governance institutions, adoption of new laws and amendments of existing ones to support corporate governance implementation process in the country. More specifically, Indonesia has taken several steps towards improving corporate governance standards and enhancing legislation. A national committee for Good Corporate Governance has been established in 1999 under the supervision of the Coordinating Minister for Economic Affairs and issued the first Indonesia's Code

6 J. Furman and J. Stiglitz: "Economic Crises: Evidence and Insights from East Asia". Paper prepared for the Brookings Panel on Economic Activity, Washington, D.C. November 1998.

7 D. Hartono and D. Hermann: "The Indonesian economic crisis and its impact on educational enrolment and quality". Institute of Southeast Asian Studies, Number 7, May 2001.

of Good Corporate Governance in 2001, which was then amended in 2006⁸. The Capital Market and Financial Institutions Supervisory Body (currently has merged into OJK)⁹ has continued to introduce and amend its regulation and enforced them, which resulted in improved investors' protection. Corporate governance rules for banks were introduced in 2006 and Bank Indonesia has actively monitored and enforced their implementation. A number of other legislation reforms may also be cited such as: the Law on Foreign Investment¹⁰, adopted in 1967, and amended in 2007, ICL adopted in 1995¹¹, and amended in 2007, the Law on Insurance Business adopted in 1992¹², and the Competition Law adopted in 1999¹³. All these are but some examples of the many positive changes to the legal and regulatory framework.

More specifically, the following major initiatives and/or laws and regulations may be considered:

- Establishment of National Committee on Corporate Governance in 1999 by decree of the Coordinating Minister of Economy, Finance and Industry.
- The National Committee on Corporate Governance was then changed to National Committee on Governance in 2004 to accommodate governance not only for corporate but to include public sector as well.
- Adoption of the Indonesian Company Law No. 1 of 1995 which superseded in 2007 with Law No. 40 of 2007 concerning the same.
- Law No. 8 of 1995 on Capital Market.
- Law No. 25 of 2007 on Investment, which supersedes the previous Law No. 1 of 1967 on Foreign Investment.
- Law No. 31 in 1999 on Corruption Eradication Commission, which by this law, Corruption Eradication Commission was established. Later, the Law was amended with Law No. 30 of 2002.
- Law No. 5 in 1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition. As an implementation of that law, the Commission for The Supervision of Business Competition (KPPU - *Komisi Pengawas Persaingan Usaha*) was established on 1999.
- Law No. 30 of 1999 on Arbitration and Alternative Dispute Resolution.

8 KNKG has been replaced by the National Committee on Governance, NCG, on 30 November 2004. <http://www.knkgindonesia.com/>

9 Based on Article 55, paragraph (2) of Law No. 21 of 2011, as of 31 December 2013 function duty and authority of the Capital Market and Financial Institution Supervisory Board (Bapepam-LK) as capital market supervisory and regulatory board was diverted to Financial Service Authority (OJK).

10 The FIL adopted by the Indonesia House of Representatives dated 10 January 1967

11 The Law on Limited Liability Company adopted by the Indonesia House of Representatives dated 7 March 1995 and replaced by a new law concerning the same dated 16 August 2007

12 The LIB adopted by the Indonesia House of Representatives dated 11 February 1992

13 The LOC adopted by the Indonesia House of Representatives dated 5 March 1995

- Establishment of Center for Reporting and Financial Transaction Analysis (PPATK - *Pusat Pelaporan dan Analisis Transaksi Keuangan*), which was mandated by the Law No. 15 in 2002 on Money Laundering. The Law was then amended with Law No. 25 of 2003.
- Regulation on obligation to implement GCG in SOE through the decree of the Minister of SOEs Kep-117/M-MBU/2002 in Implementation of GCG in SOEs.
- Law No. 19 of 2003 on State-Owned Enterprise.
- Law No. 3 of 2004 on Bank Indonesia superseding the Law No. 23 of 1999 concerning the same.
- Law No. 7 of 2009 on Deposit Insurance Corporation (LPS - *Lembaga Penjamin Simpanan*), superseding the Law No. 24 of 2004 concerning the same.
- Regulation on obligation to implement GCG in banking sector through Central Bank regulation PBI No. 8/4/PBI/2006 on GCG Implementation for Banks.
- Other Regulations which elaborate GCG principles to public companies through Capital Market and Financial Institutions Supervisory Agency (*Otoritas Jasa Keuangan*-OJK) regulations, such as regulations on disclosure, independent Commissioners, corporate secretary, audit committee, protection of minority shareholders and etc.

The adoption of the CG Regulations, although not heavy in detail, certainly must be hailed as another positive step for Indonesia corporate governance, providing the first ever set of corporate governance guidelines for companies in Indonesia, in general and listed companies in particular.

Figure 2 illustrates some highlights in the history of corporate governance, largely from the western world and Indonesia.

Figure 2. A Brief History of Corporate Governance

1600s	The East India Company introduces a Court of Directors, separating ownership and control (U.K., the Netherlands).
1776	Adam Smith in the "Wealth of Nations" warns of weak controls over and incentives for management (U.K.).
1844	First Joint Stock Company Act (U.K.).
1931	Berle and Means publishes its seminal work "The Modern Corporation and Private Property" (U.S.).
1933/34	The Securities Act of 1933 is the first act to regulate the securities markets, notably registration disclosure. The 1934 Act delegates responsibility for enforcement to the SEC (U.S.).
1967	The House of Representatives adopts Law Number 1 of 1967 concerning Capital Investment.

Figure 2. A Brief History of Corporate Governance (cont'd)

1968	The EU adopts its first company law directive (EU).
1987	The Treadway Commission reports on fraudulent financial reporting, confirming the role and status of audit committees and develops a framework for internal control, or COSO, published in 1992 (U.S.).
Early 1990s	Polly Peck (£1.3billion in losses), BCCI and Maxwell (£480million) business empires collapse , calling for improved corporate governance practices to protect investors (U.K.).
1992	The Cadbury Committee publishes the first code on corporate governance and in 1993, companies listed on the U.K.'s stock exchanges are required to disclose governance on a "comply or explain" basis (U.K.).
	The House of Representatives adopt Law Number 2 of 1992 concerning Insurance Business.
1994	Publication of the King Report (S. Africa).
1994, 1995	Rutteman (on Internal Controls and Financial Reporting), Greenbury (on Executive Remuneration), and Hampel (on Corporate Governance) reports are published (U.K.).
1995	Publication of the Vienot Report (France).
	The House of Representatives adopts Law Number 1 of 1995 concerning Limited Liability Company.
	Adoption of Law on Capital Market No. 8 of 1995 (Indonesia).
1996	Publication of the Peters Report (the Netherlands).
1998	Publication of the Combined Code (U.K.).
1999	OECD publishes the first international benchmark, the OECD Principles of Corporate Governance .
	Publication of the Turnbull guidance on internal controls (U.K.).
	The House of Representatives adopts the law Number 5 of 1999 concerning Prohibition of Monopolistic Practices and Unfair Business Competition.
	Establishment of National Committee on Corporate Governance (Indonesia) which was then changed to National Committee on Governance in 2004.
	Establishment of Corruption Eradication Commission by Law No. 31 of 1999 which was superseded by Law No. 3 of 2004.
	Establishment of The Commission for The Supervision of Business Competition with Law No. 5 of 1999.
2000	Adoption of Law No. 23 of 1999 on Bank Indonesia which then supersedes by Law No. 3 of 2004.
2000	The National Committee on Corporate Governance publishes the first Indonesian Code of Good Corporate Governance (Code of 2000).
2001	Enron Corporation , then the seventh largest listed company in the U.S., declares bankruptcy (U.S.).

Figure 2. A Brief History of Corporate Governance (cont'd)

2001	The Lamfalussy Report on the Regulation of European Securities Markets (EU) is published.
	The National Committee in Corporate Governance publishes its second Indonesian Code of Good Corporate Governance, an improvement of the previous version of the code (CG Code 2001).
2002	Publication of Regulation on obligation to implement GCG in SOE through the decree of the Minister of SOE Kep-117/M-MBU/2002 in Implementation of GCG in SOEs.
	Publication of the German Corporate Governance Code (Germany).
	The Enron collapse and other corporate scandals lead to the Sarbanes-Oxley Act (U.S.); the Winter Report on company law reform in Europe is published (EU).
2003	The Higgs Report on non-executive Directors is published (U.K.).
	Establishment of Center for Reporting and Financial Transaction Analysis (PPATK - <i>Pusat Pelaporan dan Analisis Transaksi Keuangan</i>), which was mandated by the Law No. 15 in 2002 on Money Laundering. The Law was then amended to become Law no. 25 of 2003.
	The House of Representatives adopts the Law No. 19 of 2003 concerning State Owned Enterprise.
2004	Adoption of Law No. 24 in 2004 on Deposit Insurance Corporation establishment (LPS - <i>Lembaga Penjamin Simpanan</i>).
	The Parmalat scandal shakes Italy, with possible EU-wide repercussions (EU).
2006	Regulation on obligation to implement GCG in banking sector through Central Bank regulation PBI No 8/4/PBI/2006 on GCG Implementation for Banks.
	The National Committee on Corporate Governance publishes its third Indonesian Code of Good Corporate Governance, a revision of CG Code 2001.
2007	The House of Representatives adopts (i) Law Number 40 of 2007 concerning Limited Liability Company, which replaces the ICL 1995; and (ii) Law Number 25 of 2007 concerning Investment, replacing the 1967 Foreign Investment Law.

4. The International Scope of Corporate Governance

Numerous codes of best practices and corporate governance principles have been developed over the last 10 years. Worldwide, more than 200 codes have been written in some 72 countries and regions.¹⁴ Most of these codes focus on the role of the Board of Commissioners or Board of Directors in a company. A handful is international in scope.¹⁵

Among these, only the OECD Principles address both policymakers and businesses, and focus on the entire governance framework (shareholder rights, stakeholders, disclosure and board practices). The OECD Principles have gained worldwide acceptance as a framework and reference point for corporate governance. Published in 1999 and revised in 2004, they were developed to provide principle-based guidance on good governance.

The OECD corporate governance framework is built on four core values:

- **Fairness:** The corporate governance framework should protect shareholder rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violations of their rights.
- **Responsibility:** The corporate governance framework should recognize the rights of stakeholders as established by law, and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
- **Transparency:** The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the company, including its financial situation, governance structure, performance and ownership.
- **Accountability:** The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the Board, and the Board's accountability to the company and shareholders.

Many national corporate governance codes have been developed based on the OECD Principles. Indonesia's CG Code was also developed based on the OECD Principles and contains certain principles which conform to international best practices. For instance, the CG Code states that (i) they were developed to “. . . help ensuring the sustainable development of the securities market and contributing to a cleaner and healthier

14 For a complete list of country codes of corporate governance, see the website of the European Corporate Governance Institute at www.ecgi.org.

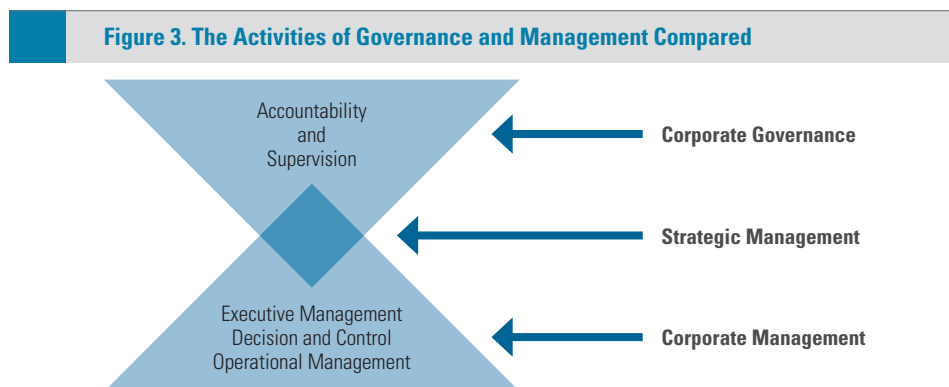
15 Corporate governance codes of international scope include the OECD Principles of Corporate Governance (www.oecd.org), the International Corporate Governance Network's Statement on Global Corporate Governance Principles (ICGN - www.icgn.org), and the Commonwealth Association of Corporate Governance (CACG - www.commonwealthfoundation.com).

economy”, that (ii) “[The] regulations set out the basic rules of corporate governance with a view to protecting legitimate rights and obligations of shareholders, establishing standards for professional acts and morality of the Board of Directors, Board of Commissioner and the managers of the listed company”, and that (iii) “the regulations also serve as the basis for assessing the implementation of corporate governance of a listed company”.

Although they represent a good start in the right direction, the CG Regulations are much simpler in form in comparison to other national codes of corporate governance. The CG Regulations are also likely to add more in volume over time, when corporate governance is taken more seriously by Indonesian companies. The OECD Principles can serve as an excellent reference point for international practices and are recommended reading for those interested in understanding some of the principles that underlie national standards.

5. Distinguishing Corporate Governance

Corporate governance must not be confused with corporate management. Corporate governance focuses on a company’s structure and processes to ensure fair, responsible, transparent and accountable corporate behavior. Corporate management, on the other hand, focuses on the tools required to operate the business. Corporate governance is situated at a higher level of direction that ensures that the company is managed in the interests of its shareholders. One overlapping area is strategy, which is dealt with at the corporate management level and is also a key corporate governance element. Figure 3 illustrates the difference between corporate governance and corporate management.



Source: Robert I. Tricker, Corporate Governance, 1984

Corporate governance must also not be confused with public governance, which deals with the governance structures and systems within the public sector. Corporate governance must further be distinguished from good corporate citizenship, corporate social responsibility and business ethics. Good corporate governance will certainly reinforce these important concepts. But while companies that invest in socially responsible projects, run charitable foundations or do not pollute often benefit with a superior reputation, public goodwill and even better profitability, corporate governance is and remains distinct from these concepts.

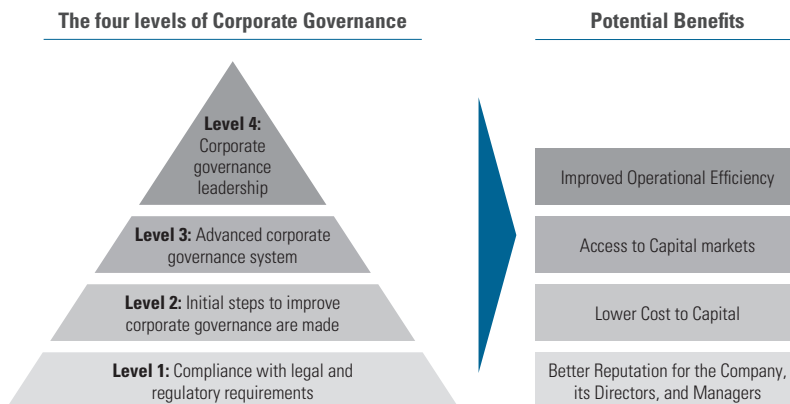
B. The Business Case for Corporate Governance

Good corporate governance is important on a number of different levels. At the company level, well-governed companies tend to have better and cheaper access to capital, and tend to outperform their poorly governed peers over the long-term. Companies that insist upon the highest standards of governance reduce many of the risks inherent to an investment in a company. Companies that actively promote robust corporate governance practices need key employees who are willing and able to devise and implement good corporate governance policies. These companies will generally value and compensate such employees more than their competitors that are unaware of, or ignore, the benefits of these policies and practices. Such companies, in turn, tend to attract more investors who are willing to provide capital at lower cost.

Generally, well-governed companies are better contributors to the national economy and society. They tend to be healthier companies that add more value to shareholders, workers, communities, and countries in contrast with poorly governed companies that may cause job and pension losses, and even undermine confidence in securities markets.

Some of the building blocks, or levels, and specific benefits of good governance are depicted in Figure 4 and discussed in further detail below.

Figure 4. Levels and Potential Benefits of Good Corporate Governance



Source: IFC, March 2004

1. Stimulating Performance and Improving Operational Efficiency

There are several ways in which good corporate governance can improve performance and operational efficiency, as illustrated in Figure 5.

Figure 5. Advantages of Corporate Governance



Source: IFC, March 2004

An improvement in the company's governance practices leads to an improvement in the accountability system, minimizing the risk of fraud or self-dealing by the company's officers. Accountable behavior, combined with effective risk management and internal controls, can bring potential problems to the forefront before a full-blown crisis occurs. Corporate governance improves the management and oversight of executive performance, for example by linking executive remuneration to the company's financial results. This creates favorable conditions not only for planning the smooth succession and continuity of the company's executives, but also for sustaining the company's long-term development.

Adherence to good corporate governance standards also helps to improve the decision-making process. For example, Board of Commissioners, Board of Directors and shareholders are all likely to make more informed, quicker and better decisions when the company's governance structure allows them to clearly understand their respective roles and responsibilities, as well as when communication processes are regulated in an effective manner. This, in turn, should significantly enhance the efficiency of the financial and business operations of the company at all levels. High quality corporate governance streamlines all the company's business processes, and this leads to better operating performance and lower capital expenditures,¹⁶ which, in turn, may contribute to the growth of sales and profits with a simultaneous decrease in capital expenditures and requirements.

¹⁶ Paul A. Gompers, Joy L. Ishii and Andrew Metrick, Corporate Governance and Equity Prices, NBER Working Paper No. w8449, August 2001.

An effective system of governance practices should ensure compliance with applicable laws, standards, rules, rights, and duties of all interested parties. Furthermore, it should allow companies to avoid costly litigation, including costs related to shareholder claims and other disputes resulting from fraud, conflicts of interest, corruption and bribery, and insider trading. A good system of corporate governance will facilitate the resolution of corporate conflicts between minority and controlling shareholders, executives and shareholders, and between shareholders and stakeholders. Also, company officers will be able to minimize the risk of personal liability.

2. Improving Access to Capital Markets

Corporate governance practices can determine the ease with which companies are able to access capital markets. Well-governed firms are perceived as investor friendly, providing greater confidence in their ability to generate returns without violating shareholder rights.

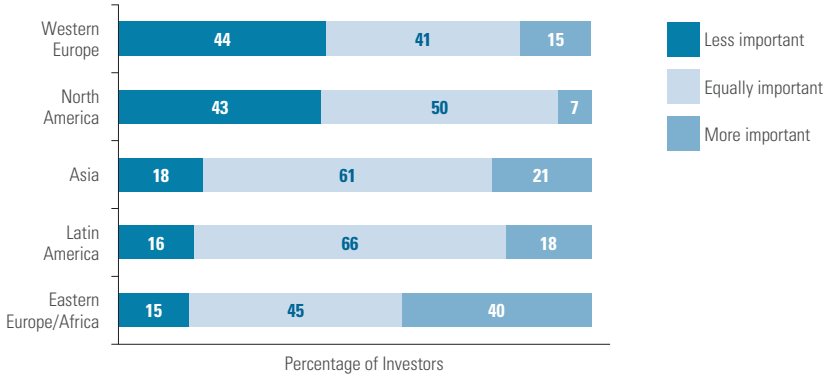
Good corporate governance is based on the principles of accessibility, accuracy, completeness, efficiency, timeliness and transparency of information at all levels. With the enhancement of transparency in a company, investors benefit from being provided with an opportunity to gain insight into the company's business operations and financial data. Even if the information disclosed by the company is negative, shareholders will benefit from the decreased risk of uncertainty.

Of particular note are the observable recent trends among investors to include corporate governance practices as a key decision-making criterion in investment decisions. The better the corporate governance structure and practices, the more likely that assets are being used in the interest of shareholders and not being tunneled or otherwise misused by managers. Figure 6 illustrates that corporate governance practices can take on particular importance in emerging markets where shareholders do not always benefit from the same protections available in more developed markets.

Finally, new listing requirements on many stock exchanges around the world require companies to adhere to increasingly strict standards of governance. Companies wishing to access both domestic and international capital markets will need to adhere to specific corporate governance standards.

Figure 6. The Importance of Governance Compared to Financial Statements

How important is corporate governance relative to financial issues, e.g., profit performance and growth potential, in evaluating which companies you will invest in?



Governance remains important compared to financials, particularly in emerging markets.

Source: McKinsey & Company, Global Investor Opinion Survey, July 2002

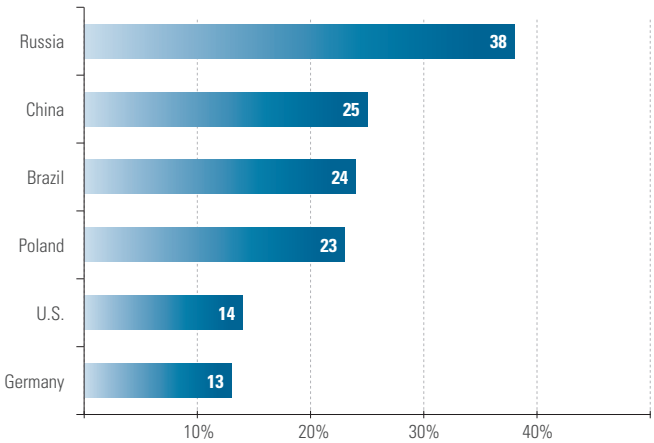
3. Lowering the Company's Cost of Capital and Raising the Value of Assets

Companies committed to high standards of corporate governance are typically successful in obtaining reduced costs when incurring debt and financing for operations. As a result, they are able to decrease their capital costs. The cost of capital depends upon the level of risk assigned to the company by investors—the higher the risk, the higher the cost of capital. These risks include investor rights violations. If investor rights are adequately protected, the cost of equity and debt capital may decrease. It should be noted that investors providing debt capital, i.e. creditors, have recently tended to include a company's corporate governance practices (for example, a transparent ownership structure and appropriate financial reporting) as a key criterion in their investment decision-making process. Thus, the implementation of a good corporate governance system should ultimately result in the company paying lower interest rates and receiving longer maturity on loans and credits.

The level of risk and cost of capital also depend on a country’s economic or political situation, institutional framework and enforcement mechanisms. Corporate governance at a particular company thus plays a crucial role in emerging markets, which often do not have as good a system of enforcing investors’ rights as countries with developed market economies.

This holds particularly true in countries such as Indonesia where the legal framework is still not well implemented, and where courts do not always provide investors with effective recourse when their rights are violated. This means that even modest improvements in corporate governance relative to other companies can make a large difference for investors and decrease the cost of capital.¹⁷ Figure 7 tellingly demonstrates that a significant percentage of investors are willing to pay a premium for a well-governed company (for example, this premium amounts to 25% for Chinese companies).

Figure 7. A Premium for Better Corporate Governance



Source: McKinsey & Company, Global Investor Opinion Survey, July 2002

At the same time, there is a strong relationship between governance practices and how investors perceive the value of company assets (such as fixed assets, goodwill, human capital, product portfolios, receivables, and research and development).

17 Leora F. Klapper, Inessa Love, Corporate Governance, Investor Protection and Performance in Emerging Markets, World Bank Policy Research Working Paper 2818, April 2002.

4. Building a Better Reputation

In today's business environment, reputation has become a key element of a company's goodwill. A company's reputation and image effectively constitute an integral, if intangible, part of its assets. Good corporate governance practices contribute to and improve a company's reputation. Thus, those companies that respect the rights of shareholders and creditors, and ensure financial transparency and accountability, will be regarded as being an ardent advocate of investors' interests. As a result, such companies will enjoy more public confidence and goodwill.

This public confidence and goodwill can lead to greater trust in the company and its products, which in turn may lead to higher sales and, ultimately, profits. A company's positive image or goodwill is known to play a significant role in the valuation of a company. Goodwill in accounting terms is the amount that the purchase price exceeds the fair value of the acquired company's assets. It is the premium one company pays to buy another.



Best Practices

The following principles of corporate conduct are fundamental guidelines underlying the formation, operation and enhancement of a company's system of corporate governance:

1. Corporate governance practice should provide shareholders with a real opportunity to exercise their rights in relation to the company.
2. Corporate governance practice should provide for the equitable treatment of all shareholders. Shareholders should have access to effective recourse in the event of a violation of their rights.
3. Corporate governance practice should provide for the Board of Commissioners' direction and control of the Board of Directors of the company and for the accountability of the Board of Directors to shareholders.
4. Corporate governance practice should ensure that the Board of Directors manage the day-to-day activities of the company without undue interference, in good faith and solely in the interests of the company, and ensure that the Board of Directors report in full and on a timely basis to the Board of Commissioners and shareholders.

5. Corporate governance practice should, in particular, provide for the full, timely and accurate disclosure of all material information (including information about a company's financial position, financial indicators, and ownership and management structure) in order to enable shareholders and investors to make informed decisions.
6. Corporate governance practice should ensure compliance with applicable laws as related to the statutory or contractual rights of all stakeholders. Corporate governance practice should, more generally, encourage the consideration of stakeholders' interests, including employees, even when they are not expressly set forth in law, and support active co-operation between the company and stakeholders with a view to increasing the assets and value of the company and creating new jobs.
7. Corporate governance practice should provide for the effective control of financial and business operations of the company to protect the rights and lawful interests of shareholders.

C. The Cost of Corporate Governance

Good governance entails real costs. Some of the costs include hiring dedicated staff, such as corporate secretaries, experienced and independent Board of Directors and Board of Commissioner, internal auditors or other governance specialists. It will likely require the payment of fees to external counsel, auditors, and consultants. The costs of additional disclosure can be significant as well. Furthermore, it requires considerable Board of Directors time, especially in the start-up phase. These costs tend to make implementation considerably easier for larger companies that may have the resources to spare than smaller companies whose resources may be stretched thin.



Best Practices

Corporate governance is most, if not solely, applicable to larger, open joint stock companies that are publicly traded on an exchange. A large, dispersed shareholder base, where controlling shareholders and Directors can wield extraordinary powers and potentially abuse shareholder rights, often defines such companies. Large companies are, moreover, important elements of a country's economy and thus require close public scrutiny and attention.

Notwithstanding, corporate governance is beneficial to all companies, irrespective of size, legal form, number of shareholders, ownership structure or other characteristics. Of course, a one-size-fits-all approach should be avoided and companies should carefully apply corporate governance standards. For example, smaller companies may not require a full set of Board committees or a full-time Corporate Secretary. On the other hand, even a small company may benefit from an advisory body.

A company will not always see instant improvements to its performance due to better corporate governance practices. However, returns, while sometimes difficult to quantify, generally exceed the costs, in particular over the long term. This is especially true when one takes into account potential invested capital, job and pension loss risks and the disruption

that may be caused to communities when companies collapse. In some cases, systemic governance problems may undermine faith in financial markets and threaten market stability.

Finally, it must be noted that corporate governance is not a one-time exercise, but rather an ongoing process. No matter how many corporate governance structures and processes the company has in place, it is advisable to regularly update and review them. Markets tend to value long-term commitment to good governance practices rather than a single action or “box-ticking” exercises.

D. The Corporate Governance Framework in Indonesia

1. Specifics of Corporate Governance in Indonesia

All countries have a unique history, culture, legal and regulatory framework, each of which influences a company's corporate governance framework. The following is a list of features that characterize Indonesia's corporate sector.

The role of SOEs: Since the early 1990s and especially in the last 20 years, several SOEs have been equitized and converted into partly privatized companies through public stock offerings and/or strategic alliances, in which the State may still hold a majority interest. Despite that fact, many important sectors in Indonesia's economy remain either State monopolies, or largely dominated by wholly State-owned enterprises, such as those in the banking, electricity, mining, oil and gas, post and telecommunications, railways and shipbuilding sectors. In numerous equitized SOEs, the State retains a majority interest of 51% and exercises its control via the GMS and the Commissioners appointed by the State to the company's Board Of Commissioners.

Concentrated ownership: Many private companies in Indonesia start out as small private companies owned either by a single controlling shareholder, members of a family, or a small group of shareholders. Although many have expanded significantly, the controlling shareholders have not changed. This concentrated ownership structure often entails a lack of proper documents (such as the company charter or financial regulations) and a lack of supervisory activities and proper book-keeping. This impedes the ability of outsiders to become shareholders and leaves room for minority shareholder abuses. Such insider dominance and weak protection of external shareholders/investors has resulted in failed deals and the underdevelopment of the capital markets in Indonesia. A trend, albeit nascent, towards initial public offerings (IPOs) and thus more dispersed ownership can, however, be witnessed. Whether these majority shareholders are truly willing to reduce or even exit their investments remains to be seen.

Little separation of ownership and control: Most controlling shareholders also act as the company's President Director and sit on the Board of Directors. Those companies that separate ownership and control often do so only on paper. It is not uncommon to find joint stock companies in which the President Director acts concurrently as the President Commissioner. Failure to separate ownership and control typically results in weak accountability and control structures (effectively, the majority/controlling shareholders

oversee themselves in their function as Commissioners and Directors), abusive related party transactions, and poor information disclosure (insiders have access to all information and are unmotivated to disclose to outsiders or minority shareholders).

Unwieldy holding structures: Some major business groups, especially large SOEs, are set up in the form of parent companies controlling subsidiary companies. While holding structures can serve legitimate purposes, cross-shareholdings and lack of transparency have the tendency to create opaque ownership structures. This could make a company difficult to understand for shareholders and investors. Such structures could be used to expropriate and circumvent the rights of individual shareholders. Poor consolidated accounting, or even the absence thereof, is a further corporate governance issue that has yet to be tackled.

Inexperienced and inadequate corporate bodies: Parts of Indonesia's current concept of Board of Commissioners and Board of Directors were first introduced in ICL 1995 and the Law on SOEs in 2003. However, these concepts were not taken seriously until recently, when companies began to draft and adhere to elaborate AoA with company rules and regulations. However, in reality, it is still common for Boards of Directors to attempt to bypass the supervision mechanisms put in place by the AoA (such as internal auditors or the Board of Commissioners), and to limit direct contact to the controlling shareholder (to the extent they are not one and the same). The role of the Board of Commissioner, as well as its Committees, the President Director and the Board of Directors as a whole, as well as the Corporate Secretary often remain unclear in the day-to-day company operations. The members of all these bodies are supposed to be experienced and capable, but in reality they lack awareness of their responsibilities, due to a historical lack of general good practice in their areas. A lack of experience in the field of corporate governance is a big obstacle for further economic development. Unfortunately, strong, vigilant and independent corporate bodies remain a rarity.

2. The Legal and Regulatory Framework

The legal and regulatory framework in Indonesia has some unique characteristics resulting from Indonesia's history and the development of Indonesia's economy. Indonesia first regulates the Limited Liability Company on 1848 in Chapter 3 of Indonesia Commercial Code (*Kitab Undang-Undang Hukum Dagang*). On the other hand, the foreign investment in Indonesia first introduced through the 1967 Foreign Investment Law. *The introduction of the Foreign Investment Law in 1967 brought the first concepts of corporatization to Indonesian economy. Throughout the 1970s and up until now, FICs (Foreign Investment Companies) have been growing fast in both number and size. Most FICs have some corporate governance structure in place.*

As mentioned, the first comprehensive piece of legislation for domestic companies was approved in 1968 with the Domestic Investment Law. In 1995, Indonesia established the ICL 1995. In 2007, there are significant changes in legal and regulatory framework for companies and investment in Indonesia where the government issued Investment Law and ICL. Over the past 5 years, Indonesia's legal and regulatory framework for corporate governance has improved dramatically, but actual implementation and adherence by Indonesian companies to corporate governance practices is still in its improving stages).

Impact of World Trade Organization (WTO) commitments: As a member of WTO, Indonesia has adopted its commitments made when it joined WTO as a positive reference in accelerated its efforts to get its legal framework comply with the WTO requirements.

Application of industry-specific laws and regulation: In Indonesia, companies are required to comply with ICL and other laws and regulations which govern the specific industry and activities carried out by such companies. Thus, a company in the insurance business is subject to ICL and the Law on Insurance Business. Similarly, a bank is subject to ICL and the Law on Banks. In addition to these two laws, a listed bank is also subject to the Law on Capital Market¹⁸ and so on.

ICL: As an example, ICL allows (i) the GMS of a limited liability company to elect members of the Board of Commissioners and the Board of Directors, and (ii) the GMS to elect the President Director and President Commissioner respectively.¹⁹ However, banking regulations require that the appointment and dismissal of the President Director, the Chairman and members of the Board of Commissioners, and members of the Board of Directors of a limited liability commercial bank be approved by the Governor of Bank of Indonesia (BI).²⁰ Similarly, insurance regulations require that the appointment and dismissal of the President Director, the President Commissioner and the members of the Board of Directors of an insurance company be approved by the OJK.²¹ This is one of many examples of how there are different legal requirements which are relevant to the corporate governance of a company.

ICL expressly provides that “In special cases where the establishment, organization, management and operation of an enterprise are regulated by a specialized law, the provisions of such law shall prevail”. However, in practice, there are numerous cases where the distinctions are not clear-cut, and the overlapping laws and regulations have created confusion, ambiguities and uncertainties to the companies trying to follow the

18 Law on Capital Market No. 8 of 1995

19 Law on Central Bank (Bank Indonesia) No.3/2004

20 Law on Central Bank (Bank Indonesia) No.3/2004

21 Law on Capital Market No.8 of 1995

laws and implement good corporate governance practice. These also create the danger of inconsistencies in the implementation of these laws by Ministries, the courts and other law enforcement bodies.

Thus, it is prudent that whilst companies should use this Manual for reference for corporate governance practice, they should also review other laws and regulations which may be applicable to their line of business, and comply with such laws and regulations. Where it encounters what seems to be some inconsistency or ambiguity of different legislation, a company should try to clarify such an inconsistency or ambiguity, either by engaging the company's in-house legal department, internal compliance department, advice from the company's external legal counsel and clarification from law enforcement agencies or law-making agencies, to achieve full compliance with the law and best corporate governance practice.

Applicable laws and legal framework: All commercial enterprises, regardless of their legal form, are subject to a comprehensive set of laws, regulations, and governmental decrees as illustrated in Figure 8. In addition to the general legal and regulatory framework, there are Decrees, Circulars and Decisions from the Government, Ministries and other law enforcement bodies that deal with specific corporate issues in Indonesia in more detail for SOEs, limited liability companies (LLCs) and other corporate entities.

Figure 8. Principal Laws and Regulations Impacting on Corporate Governance

Law/Regulation	Applicability	Comments
Law No. 40 of 2007 concerning Limited Liability Company (Indonesian Company Law hereinafter refer to as ICL)	All limited liability company activities	Establishment of limited liability company, capital and shares, company organs (GMS, BOD, BOC), AoA of the company, merger, acquisition, and dissolution, work program, annual report, and use of profit, liquidation, expiry of company.
Law No. 25 of 2007 concerning Investment (" Investment Law ")	All investment activities (domestic and foreign)	Form of business entity for investment, treatment of investor, manpower plan, business sector for investment, rights and obligations and liabilities of investor, investment facilities.
Law No. 13 of 2003 concerning Manpower (" Manpower Law ")	Manpower in companies	Manpower management, rights and obligations of employee, rights and obligations of the company, and all related manpower plan for business activities.
Law No. 8 of 1995 concerning Capital Market (" Capital Market Law ")	All listed company activities	Capital market supervisory board (OJK), stock exchange, clearing and guarantee corporation, central securities depository, investment fund, securities company, securities company representatives, and investment advisors, capital market supporting institutions and professionals, issuers and public companies, public documents and reporting to OJK.
Presidential Regulation No. 36 of 2010 concerning Concerning Lists of Business Fields that are Closed To Investments and Business Fields that are Conditionally Open for Investments (" Negative List ")	Business fields for foreign investment activities	List of business fields that are open and closed for foreign investment.
Head of BKPM Regulation No. 12 of 2009 concerning Procedures and Guidelines of Investment Application (" BKPM Reg. 12/2009 ")	Foreign investment activities	One stop service of permit application, procedure and mechanism to conduct foreign investment in Indonesia, transfer of foreign shares, fiscal and non fiscal facilities, regional incentives, foreign workers manpower plan (RPTKA), Producer Importer Identification Number (API-P), tax facilities, custom.

Figure 8. Principal Laws and Regulations Impacting on Corporate Governance (cont'd)

Law/Regulation	Applicability	Comments
Ministry of Manpower and Transmigration Decree No. 40 of 2012 concerning Certain Positions that are Prohibited for Foreign Workers (" MMT Reg. 40/2012 ")	Company with foreign workers	List of positions in a company that are restricted for foreign workers.
Indonesian Code of Good Corporate Governance 2006 (" GCG Code ")	All company practices	Code of conduct and business ethics, company organs, shareholders, stakeholders, good corporate governance principles, implementation of the good corporate governance.
All related regulations in OJK Capital Market	Capital market activities	Capital market supervisory board (OJK), stock exchange, clearing and guarantee corporation, central securities depository, investment fund, securities company, securities company representatives, and investment advisors, capital market supporting institutions and professionals, issuers and public companies, sanctions, public documents and reporting to OJK.

As discussed previously in this Chapter, ICL applies to all corporate entities in Indonesia, and in addition to this general rule, companies in the banking, investment, and insurance industries need to comply with specific legislation. The Law on Capital Market and its implementing regulations applies to activities relating to the issuance, offering, sale and purchase of securities, securities-related services and information disclosure by corporate entities, shareholders and investors.

Indonesian companies are also subject to other accounting, anti-corruption, auditing, bankruptcy, commerce, competition, construction, labor, tender process and taxation laws. Where appropriate, this Manual refers to these laws and other legal documents.

The list of legal acts in Figure 8 is far from complete. Moreover, Indonesian legislation continues to change as it develops and improves. For example, as mentioned previously, ICL has amended several times to eliminate inconsistencies in provisions that regulate the activities of governing bodies, securities issuance, the exercise of shareholder rights and other matters. Most of the laws and regulations that have an impact on corporate governance and will be used in this Manual have been enacted in the last few years, although they may have evolved from past laws.

Finally, all Indonesian companies are being encouraged to adhere to the corporate governance rules included in the CG Regulations, although these provisions are only mandatory for listed companies.



Best Practices

Corporate governance frameworks typically comprise elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of country specific circumstances, history and tradition. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc. in this area will vary from country to country. As new experiences accrue and business circumstances change, the content and structure of this framework needs to be adjusted.²² Companies will need to carefully monitor such adjustments on a regular basis and update their governance systems accordingly.

22 OECD Principles of Corporate Governance, Annotations to the OECD Principles of Corporate Governance, ensuring an effective corporate governance framework. See also: www.oecd.org

3. The Corporate Governance Regulations Applicable to Listed Companies in Indonesia

The CG Regulations were adopted by the OJK and draw upon generally accepted principles of corporate governance, including the OECD Principles.



Best Practices

Good corporate governance practices are focused on respect for the lawful interests of all participants in corporate activities. They can improve the quality of a company's operations by means of, among other things, increasing the value of corporate assets, creating jobs and enhancing the financial stability and profitability of a company. Trust among all those involved in corporate activities is at the root of the effective operation of a company and the ability to attract investment. The OECD Principles are aimed at the creation of trust in relations arising in connection with corporate governance.

The CG Regulations comprise the following three categories of rules:

- 1. Legal requirements:** The rules that refer to mandatory legal requirements; these provisions are mandatory not because they are part of the CG Regulations, but because they overwrite or rephrase legal requirements. Legal requirements in the CG Regulations can be recognized by using words "must", "is obliged to", "cannot", etc.
- 2. Comply or explain rules:** These rules are to be followed. Listed companies are compelled to disclose and explain all deviations from these rules in the declaration of compliance with the corporate governance principles, comply or explain rules allow companies to deviate from certain rules only when the deviation is justifiable. The comply or explain rules of the CG Regulations are marked in the text by the use of the word "shall".
- 3. Suggestions:** These rules are recommendations in their nature. Non-compliance with these rules requires neither disclosure nor explanation. For these rules the CG Regulations use terms such as "should" or "can".

4. The Institutional Framework

There are numerous institutions that make-up the institutional framework for corporate governance in Indonesia today, too many to list exhaustively. The following institutions have at least one core activity focusing on corporate governance.

Table 1. Corporate Governance Related Institutions in Indonesia

Courts	
Corruption Court (<i>Pengadilan Tipikor</i>)	www.kpk.go.id
Supreme Court	www.mahkamahagung.go.id
District Courts	<i>Please refer to the specific province</i>
High Court of Indonesia	
Military Court of Indonesia	
Tax Court of Indonesia	
Religious Court of Indonesia	
Arbitration Center	
Indonesian National Board of Arbitration	http://www.bani-arb.org
Public Sector Institutions	
People Representatives (DPR)	www.dpr.go.id
The Government of Indonesia	www.indonesia.go.id
Ministry of Law and Human Rights	www.depkmham.go.id
Ministry of Finance	www.depkeu.go.id
Indonesian Financial Supervisory Authority (OJK)	www.ojk.go.id
BAPPENAS	www.bappenas.go.id
Indonesia Stock Exchange	www.idx.co
National Police (POLRI)	www.polri.go.id
Corruption Eradication Commission (KPK)	www.kpk.go.id
Securities Depository (KSEI)	www.ksei.co.id
Central Bank of Indonesia	www.bi.go.id
Chamber of Commerce and Industries (KADIN)	www.kadin-indonesia.or.id
National Committee on Governance (KNKG)	www.knkg-indonesia.com

Table 1. Corporate Governance Related Institutions in Indonesia (cont'd)

Courts	
Indonesian Advocates Association (PERADI)	www.peradi.or.id
Indonesian Institute on Corporate Directorship (IICD)	www.iicd.org
Indonesian Transparency Society (MTI)	www.mti-its.or.id
Forum for Corporate Governance in Indonesia (FCGI)	www.fcgi.or.id
International Organizations	
Global Corporate Governance Forum (GCGF)	www.gcgf.org
International Finance Corporation (IFC)	www.ifc.org
Organization for Economic Cooperation and Development (OECD)	www.oecd.org
The World Bank	www.worldbank.org

Chapter **2**

**THE GENERAL
GOVERNANCE
STRUCTURE OF
A COMPANY**

Table of Contents

A. WHAT IS A LIMITED LIABILITY COMPANY?	65
1. The Definition of a Limited Liability Company	65
2. Listed and Non-Listed Companies	66
3. The Advantages and Disadvantages of Limited Liability Public Companies over Other Legal Forms	68
B. THE GOVERNANCE STRUCTURE OF A LIMITED LIABILITY COMPANY	71
1. The General Meeting of Shareholders	72
2. The Board of Commissioners	72
3. The Board of Directors	74
4. Board Committees	75
5. External Auditor	75
6. The Internal Auditor	76
7. The Corporate Secretary	76



The Chairman's Checklist

- ✓ What is a Limited Liability Company (*Perseeroan Terbatas - PT*)?
- ✓ Why do we need PT?
- ✓ What are the key advantages of Limited Liability Company PT over other legal forms? What is the dividing line between public and private PT?
- ✓ What is the significant governance difference between public and private companies?
- ✓ In addition to the GMS, Board of Commissioners, Board of Directors, has the company established Audit Committee, Human Resources Committee, Development Policy Committee, Remuneration Committee and an Internal Audit Function?
- ✓ Have these bodies been given the appropriate structures and proper resources to be effective?
- ✓ Does the company need to have a Corporate Secretary?

The Indonesian Company Law No. 40 of 2007 defines a Limited Liability Company (*Perseroan Terbatas* - PT) as a company's status and provides for the structure of its governing bodies. The CG Code further includes recommendations to establish additional governing bodies for listed companies, for example the Board Committees and Corporate Secretary. This chapter discusses the concept and governance structure of Limited Liability Company (*Perseroan Terbatas* - PT) as they are defined by the Limited Liability Act and as recommended by the CG Code. The authorities, functions and structures of the governing bodies are described in more detail in other chapters of this Manual.

A. What is a Limited Liability Company?

1. The Definition of a Limited Liability Company

Under the ICL, a Limited Liability Company (*Perseroan Terbatas* - PT), hereinafter called a “Company”, is defined as a legal entity which constitutes an alliance of capital established pursuant to a contract in order to carry on business activities with an authorized capital all of which is divided into shares and which fulfils the requirements stipulated in the ICL and its implementing regulations.

Under the ICL, a Company is a legal entity which has the following characteristics:

- limited liability of shareholders
- independent legal status and can enter into contracts in its own name
- adopt two-tiered system
- may sue and be sued
- its capital structure is divided into authorized capital and issued and paid-up capital. Minimum of authorized capital is IDR 50 million (Rp 10 billion for FICs), and the paid-up and issued capital must be 25% from its authorized capital
- the Company Organs consist of the Board of Directors, Board of Commissioners, and General Meeting of Shareholders
- may issue shares and bonds.

A PT is the only legal entity that can issue shares. Shares in a PT may include (i) ordinary shares, (ii) shares with or without voting shares, (iii) shares with special right to nominate members of the Board of Directors and/or members of the Board of Commissioners (iv) shares which after a certain period of time will be withdrawn or exchanged with other shares’ classification, (v) shares which provide priority rights to their owner to receive dividends over the other shareholders from different shares’ classification for the distribution of dividend cumulatively or non-cumulatively, (vi) shares which provide priority rights to their owner to receive allocation of the remainder of the Company’s assets in liquidation over the other shareholders with different shares’ classification, and (vii) other preference shares as determined in the AoA of the company.¹

¹ ICL, Article 53 paragraph (4)

Shareholders of a PT are not personally liable for any agreement made on behalf of the PT, and are not liable for the PT's losses in excess of their respective shareholding;²

The ICL, however, contains certain specific exceptions to the limited liability principle, including:

- a. Under the ICL, founding shareholders are together obliged to subscribe at least 25% of the authorized capital.
- b. An ordinary shareholder would be personally responsible if it commits any of the following acts in the name of the company:³
 - (i) directly or indirectly exploits the company in bad faith in his/her personal interest.
 - (ii) involve in illegal acts committed by the company.
 - (iii) directly or indirectly illegally uses the company's assets with the result that the company's assets become insufficient to pay off the company's debt.

2. Listed and Non Listed Companies

Indonesian law distinguishes clearly between listed and non listed companies. In general, listed company is defined as a public company or a company undertaking an initial public offering. Listed companies require higher paid-up capital, and are subject to stricter and more complex rules regarding their governance and disclosure. Law on Capital Market⁴ defines a public company as a company which has reached 300 shareholders and its paid-up capital has reached IDR 300 billion. It is possible for a private company to voluntarily transform itself into a public company and vice-versa by following legal requirements, in accordance with the Law on Capital Market. Procedurally, this has to be done by amending the company's AoA and business registration certificate and is not considered to be a conversion of the business organization's legal form. If a company is intended to conduct a public offering, the said public company must first be registered in OJK. Listed companies are generally better suited for larger and growing companies that might wish to raise money in the equities markets.

2 ICL, Article 3

3 ICL, Article 3 paragraph (2)

4 Law on Capital Market 1995, Article 1 point 22

Figure 1. Comparison of Listed and Non Listed Companies

	Listed Companies	Non Listed Companies
Characteristics	<ul style="list-style-type: none"> • Public offerin • Listing shares • 300 shareholders or more and paid-up capital of IDR 3 billion or more⁵ 	<ul style="list-style-type: none"> • No • 2 or more persons and authorized capital of IDR 50 million or more⁶
Minimum Capital Measurement	Paid-up capital at least in the amount of IDR 3 billion.	Authorized capital at least in the amount of IDR 50 million or more.
Issuance of Shares	Open subscription. A closed subscription is subject to the approval of the OJK. ⁷	Closed subscription (only among founders or other pre-determined groups of people). Cannot issue shares through an open subscription.
Transferability of Shares	No restrictions allowed (except for voting preference shares and shares held by founding shareholders). Neither the consent of other shareholders nor the company is required.	Potentially restricted. Transferability of shares is unrestricted, except for voting preference shares and shares held by founding shareholders and some kind of restriction which may be included in the AoA of the company.
Corporate Secretary	Mandatory for listed companies ¹⁰	Unregulated
Disclosure	The company must disclose a wide range of information regarding its financial position, operations and governance. ¹¹	No legal requirements to publicly disclose information.

5 Article 1 paragraph 22 of Law of Capital Market 1995

6 Article 32 of the ICL

7 Article 5 of the Capital Market Law

8 Article 58 of the ICL

9 Article 58 of the ICL

10 Head of OJK Decree KEP-63/PM/1996

11 Article 86 of the Capital Market Law

3. The Advantages and Disadvantages of Limited Liability Public Company over Other Legal Forms

a. Legal Forms of Commercial Entities

Indonesian law allows for the establishment of the following types of commercial entities:

- Civil Partnership (*Maatschap*)¹²
- Firma (*Vennootschap onder firma*)¹³
- CV (*Commanditair Vennootschap*)¹⁴
- PT
- Cooperatives
- Foundation



Company Practices in Indonesia

PT is the most popular form of commercial entity in Indonesia, which according to the latest economic survey (business/company listing result) 2006, there were 22,7 million entities in operation.¹⁵ There were 458 public companies and among them 451 were listed companies.¹⁶

¹² Article 1618 – 1652 of ICC

¹³ Article 16-35 of ICC

¹⁴ Article 16-35 of KUHD

¹⁵ Economic Survey 2006 by Central Statistical Bureau (*Badan Pusat Statistik - BPS*)

¹⁶ IDX and OJK as of end of July 2012

b. Advantages of Listed Companies Compared to Non Listed Companies and CV/Partnership

Listed company offers many advantages, including:

- **Access to investors:** Listed companies have greater opportunities to attract investment at lower cost. In comparison with other commercial entities, listed companies are more transparent to potential investors due to information disclosure obligations. A better market position improves their availability to attract investment under privileged conditions. Furthermore, the scale of capital-intensive companies, such as banking, is so large that few individual lenders or equity investors can provide the needed capital.
- **Free transferability of shares:** Shares of the company can be transferred without the consent of other shareholders, the company, or its management in accordance with legal requirements.
- **Limitation on the risks to shareholders:** The risks carried by shareholders are limited to the value of their investment and duties set by Indonesian legislation. Shareholders are not normally liable for the legal and financial obligations of the company.
- **Diversification of risks:** The risks of a public company are spread over a large number of shareholders.

c. Disadvantages of Listed Companies

The principal economic advantage of the listed company form is the ease with which it can access financial markets. However, this special access is not without disadvantages. A number of organizational, legal and regulatory hurdles must be cleared for a company to have the right to offer its securities to investors. A listed company requires:

- **Compliance with securities regulations:** private companies are generally outside the purview of such regulation.
- **A complex organizational structure:** It is designed to protect shareholders from abuse and allow professional directors to run the company. The company bears the costs associated with supporting its governing bodies.
- **Compliance with disclosure and other regulations:** A public company must ensure appropriate level of transparency and publicity through timely, accurate and complete disclosure of all important events

that are significant for determination of legal and financial position of the company. Disclosure obligations encompass the business report of the company, financial reports and audit report, as well as other reports and information that are important for the company, in accordance with the securities market regulations. Therefore, a public company must comply with more rigorous legislation and regulations, and should follow codes and standards designed to protect shareholder rights. It must ensure the proper registration of issued shares.

- **Shareholders willing to invest in the company:** The company should be able to attract shareholders willing to accept the risk of investing in the company and at the same time maintain good investor relations once shares have been floated. These activities imply significant costs for the company. Some of them are associated with marketing an offer to investors and maintaining continuous communication with shareholders after the IPO.
- **Professional Management:** The separation of ownership and control provides investors with the possibility to hire professional Directors who devote their efforts and skills to run the company. The separation of ownership and control also provides professional directors with access to the capital needed to manage the company. Finding, developing and retaining trustworthy professional directors are, however, a difficult task.
- **Higher minimum charter capital:** This is more than other normal legal requirements.

B. The Governance Structure of a Limited Liability Company

Legislation provides companies with substantial flexibility in establishing their governance structure. The bodies required by ICL do not depend on how many shareholders the company has or the amount of charter capital. The only distinction which has legal consequences for the governance structure of the company is the one between public and private companies.

Non-Listed Companies

A non-listed company must have the following bodies:¹⁷

- GMS
- Board of Commissioners
- Board of Director

Listed Companies

In addition to the bodies required for non listed companies, listed companies must have:

- Internal Auditor¹⁸
- External Auditor¹⁹
- Audit Committee²⁰
- Corporate Secretary²¹

In addition, it may establish the following Board Committees at its discretion:²²

- Risk Policy Committee²³
- Corporate Governance Committee²⁴
- Nomination and Remuneration Committee²⁵
- Other Board Committees

17 ICL, Article 1 paragraph 2

18 Head of OJK Decree No. Kep- 496/BL/2008

19 ICL, Article 68, The position of the External Auditor is appointed by the GMS and it is not in the company's structure

20 Head of BAPEPAM –LK Decree No. KEP-29/PM/2004

21 Head of BAPEPAM –LK Decree No. KEP-63/PM/1996

22 Corporate Governance Code Article 3.7

23 Corporate Governance Code Article 4.3

24 Corporate Governance Code Article 4.4

25 Corporate Governance Code Article 4.2

1. The General Meeting of Shareholders

The GMS of a limited liability company is, a company organ given the authority which is not granted to the Board of Directors and Board of Commissioners within the limits determined by the ICL and/or the AoA. All ordinary shareholders have the right to participate in the GMS and have the number of votes corresponding to the respective ordinary shares held by them. The GMS approves nominations for the Board of Commissioners and the Board of Directors membership. In addition, it approves the annual report and the financial statements, the distribution of profits and losses (including the payment of dividends), amended authorized capital, amendments of the AoA, re-organization and dissolution, and extraordinary transactions.²⁶

→ *See Chapter 8.*

2. The Board of Commissioners

The Board of Commissioners plays a central role in the corporate governance framework. The Board of Commissioners is responsible to supervise the management policy and its implementation and also to advise the Board of Directors. The CG Code provides that a Board of Commissioners shall have the capability and integrity in order to perform its responsibilities and to ensure that the company activities are in compliance with the applicable laws and regulations.²⁷

²⁶ ICL, Article 88 and 89

²⁷ CG Code, Part IV, Subpart C.2



Indonesian companies are not able to choose between different corporate governance frameworks, depending on the structure of the company's Board. Essentially, two opposite board models have been developed in Europe, the one-tier board (unitary board system) and the two-tier board (dual system). The tendency in Europe is towards an increase in flexibility, allowing companies to choose between the different systems and adapt them to the different business environments:

- The **one-tier, or unitary board system** is characterized by a single board that governs the company, and includes both executive and non-executive members. In such a setting, the supervisory body is often called the Board of Directors. This governance structure can facilitate strong leadership structures and efficient decision-making. Non-executive and independent directors, however, play a crucial role in monitoring managers and reducing agency costs. This system is typical for companies based in countries with a common law tradition, for example the U.S. and the U.K.
- The **two-tiered, or dual system**, on the other hand, is characterized by the existence of distinct supervisory and management bodies. The former is commonly referred to as the Supervisory Board, the latter as the Executive Board. Under this system, the day-to-day management of the company is handed down to the Executive Board, which is then controlled by the Supervisory Board (which in turn is elected by the GMS). These two bodies have distinct authorities and their composition cannot be mixed, i.e. members of the Executive Board cannot sit on the Supervisory Board and vice-versa. The advantage of the two-tiered system is a clear oversight mechanism, but it has been criticized for inefficient decision-making. This system is most famously represented in Germany.
- Besides the one-tiered and the two-tiered systems, many countries recognize a third governance structure, **the hybrid system**, which is essentially an amalgam of the two abovementioned models.

Regardless of which system a country allows, the following must be kept in mind:

1. There is always a trade-off between efficiency and control. When the agency problem and conflict of interests is high, shareholders may choose the two-tiered system, but must realize that a tight monitoring governance system could tie managers' hands and render business operations and decision-making inefficient. On the other hand, when shareholders and managers trust each other and the company needs better efficiency to explore more business opportunities, the company may choose a more pro-management oriented, one-tier board system.
2. While all systems have many elements in common, important differences do exist and these will affect the board's authority, structure and operations, and consequently the duties and obligations of directors.

3. The Board of Directors

Every company must have a Board of Directors who is responsible for day-to-day management of the company.²⁸ The Board of Directors is the legal representative of the company unless the company's AoA appoints certain member of the Board of Directors to this position²⁹. The Board of Directors is accountable to the General Meeting of Shareholders (GMS)³⁰. ICL and the company's AoA regulate the authority of the Board of Directors and also their election and dismissal process.

→ See Chapter 5, Section A.

28 ICL, Article 92 paragraph (1)

29 ICL, Article 98 paragraph (2)

30 ICL, Article 66

4. Board Committees

A Board Committee has the duty to oversee and supervise as well as advise the Board of Directors and the Board of Commissioners. The CG Code recommends the establishment of certain Board Committees such as an Audit Committee, Risk Policy Committee, Nomination and Remuneration Committee. The primary task of these committees is to assist the Board of Directors functions. The discussion in this Manual as to the authority, composition, and functions of individual Board Committees is mostly based on recommendations of the CG Code and Best Practices.

→ *See Chapter 4, Section C.*

5. External Auditor

ICL provides that an annual, independent audit shall be conducted by a certified independent External Auditor (licensed and accredited audit company/organization)³¹. It is an obligation for a company that is:

- a) Considered to be a compliance-audited company (a SOE, FIE, commercial bank, credit institution, financial institution, insurance company, and listed companies);
- b) A controlling company that makes consolidated financial statements;
- c) Issuing securities or other financial instruments traded on the organized market.

For listed companies, the External Auditor is a separate body of the company, elected by the GMS within the list of auditors authorized by the MOF to conduct the audit of financial statements of listed companies, prepare the report of the auditor and submit to the Board of Directors.

→ *See Chapter 14, Section B.*

31 ICL, Article 66

6. The Internal Auditor

According to the OJK regulation³², Indonesian listed companies are obligated to establish an Internal Auditing function. The role of Internal Auditors is increasingly becoming more important in strengthening corporate governance of many listed companies.

→ *See Chapter 14, Section D.*

7. The Corporate Secretary

Pursuant to Head of OJK Decree, the task of a Corporate Secretary is to follow the development of regulations on Capital Market; ensure the availability of information of the company to be accessed by public; advising the Board of Directors of Issuers or Public Company to comply with Capital Market Law and its implementing regulations; and acting as a contact person between Issuers or Public Company with OJK and the public.

→ *See Chapter 6.*

32 Head of OJK Decree Kep.496/BL/2008

Chapter **3**

**THE INTERNAL
CORPORATE
DOCUMENTS**

Table of Contents

A. THE COMPANY ARTICLES OF ASSOCIATION (AoA)	82
1. Articles of Association Provisions	82
2. Form of the Articles of Association	82
3. When to Amend the Articles of Association?	83
4. Who can Amend the Articles of Association?	83
5. How to Amend the Articles of Association?	84
6. Objection to the Amendments of the Articles of Association	84
7. Acknowledgement and Approval from the Minister of Law and Human Rights (MOLHR) to the Amendment of the Articles of Association	85
8. When does the Amendment of the Articles of Association become Effective?	85
9. Disclosure of the Articles of Association	86
B. THE INTERNAL REGULATIONS OF A COMPANY	87
1. Types of Internal Regulations	87
2. How to Adopt and Amend Internal Regulations?	89
C. COMPANY CODES OF CORPORATE GOVERNANCE	90
1. What is a Company Code of Corporate Governance?	90
2. Indonesian Company Code of Corporate Governance	92

Table of Contents

D. COMPANY CODE OF ETHICS	95
1. What is a Code of Ethics?	95
2. Why Adopt a Code of Ethics?	95
3. How to Implement a Code of Ethics?	96
4. Indonesian Code of Business Ethics	97



The Chairman's Checklist

- ✓ Does the company have valid Articles of Association, in compliance with Article 15 of the ICL?
- ✓ Are the Articles of Association freely available to interested parties and accessible on the internet?
- ✓ Has the company adopted internal regulations? Is adopting internal regulations a legal obligation of the company? Is it possible for a company to be incorporated without having internal regulations? Does the company regularly consult and follow its internal regulations?
- ✓ Has the company adopted its own corporate governance code? If so, does the company code touch upon the principles of fairness, responsibility, transparency, and accountability? Does the company code provide recommendations on the relationship between the corporate bodies, notably the interaction between the Board of Commissioners and the Board of Directors?
- ✓ Has the company identified a core set of values? Does the company have a code of ethics based on these values?

The deed of establishment of a company, as the company founding document, consists of the Articles of Association (AoA) and other information related to the establishment of the company.¹ No company can be established without an AoA. A deed of establishment establishes the company, determines its structure and purpose as well as its capital structure. It is fundamental to the company's system of corporate governance, ensuring the protection and equitable treatment of shareholders, distribution of authority between the governing bodies, and disclosure and transparency of the company's activities. It also plays an important public role in relation to third parties since it provides information about the company. The amendment of the AoA is subject to the Minister of Law and Human Rights (MOLHR) approval² or only to be acknowledged by the MOLHR.³

In addition to the AoA, the company may adopt internal regulations for different purposes, such as internal regulations containing working terms of the worker and the code of conduct of the company.⁴ Certain internal regulations are compulsory for a number of specific types of companies. For instance, a credit institution and an insurance company are required to adopt financial regulations which provide the framework for the financial administration of the company and aim to maintain the integrity of the company's financial system. Listed companies (which include listed banks and listed insurance companies) are required to adopt a corporate governance code which ensures that a company is effectively operated and controlled in the interests of shareholders and related persons.⁵ A corporate governance code is useful in regulating detailed procedures for the company's governing bodies and can help avoid an unwieldy AoA that is difficult to understand. This internal regulation, however, must be consistent with the AoA.

The company-level corporate governance code and code of conduct allow the company to make its governance structure more transparent while demonstrating the company's commitment to good corporate governance and good business practices.

This chapter explains when and how the AoA are amended, and how the amendments are registered. This chapter further touches upon the important role that company-level corporate governance and code of conduct play.

1 ICL, Article 8 paragraph (1). Other information as referred to in.

2 ICL, Article 21 paragraph (1) and (2)

3 ICL, Article 21 paragraph (3)

4 Manpower Law, Article 108 paragraph (1)

5 CG Code Introduction B.7

A. The Company Articles of Association (AoA)

1. Articles of Association Provisions

The AoA must include the following minimum provisions:⁶

- Name and domicile of the company;
- Company activities and purposes;
- Terms of the Company' establishment;
- Capital structure: the amount of the authorized capital, subscribed capital, and paid up capital;
- the number of shares and classifications of the shares including number of shares for each classification
- Name, title and number of the board of Director and board of Commissioner
- Determination of the place and procedure to conduct the GMS;
- Procedures for the appointment, replacement, and dismissal of members of the Board of Directors and Board of Commissioners;
- the procedure for the use of profits and allocation of dividends.

In addition to the foregoing mandatory provisions, the company's AoA may set forth other matters as agreed by the shareholders, but may not be inconsistent with provisions of the law.⁷

2. Form of the Articles of Association

The deed of establishment of the company and the AoA of the company in Indonesia must be made in a form of notary deed made in Bahasa Indonesia.⁸

⁶ ICL, Article 15 paragraph (1)

⁷ ICL, Article 15 paragraph (2)

⁸ ICL, Article 7 paragraph (1)

3. When to Amend the Articles of Association?

The AoA should be amended when changes occur that affect any provisions. For example, a decision of the company to expand its business scope, amendment of the amount of the authorised capital, change its corporate name or its registered office, and other changes as stated in Article 21 of the ICL.

The amendment of the AoA which falls into the qualification of Article 21 paragraph (2) of the ICL, the amendment is subject to the MOLHR approval.

4. Who can Amends the Articles of Association?

Pursuant to Article 19 of the ICL, only the GMS has the authority to stipulate the amendment of the AoA. The minimum requirements and thresholds set out in the ICL for the GMS regarding the amendments of the AoA are as follows:⁹

Matters	Notice	Quorum	Voting
Amendment of AoA (1st meeting)	14 days prior notice	At least 2/3 of the total number of shares with legal voting rights.	At least 2/3 of the total number of votes legally cast at the meeting.
Amendment of AoA (2nd meeting)	7 days prior notice. The GMS may be convened within 10-21days after the preceding GMS	At least 3/5 of the total number of shares with legal voting rights.	At least 2/3 of the total number of votes legally cast at the meeting.
Amendment of AoA (3rd meeting)	7 days prior notice. The GMOS may be convened within 10-21days after the preceding GMS.	Based on the decision of the Chairman of the District Court.	Not expressly prescribed under the ICL, however, undercurrent interpretation governed by Article 87(2) of the ICL, namely, more than ½ of the total number of votes legally cast at the meetin.

For public listed company, Article 83 of the ICL provides that the company is required to make an announcement in relation to the proposed GMS, at least 14 days prior to the date of GMS invitation.

⁹ ICL, Article 88

5. How to Amend the Articles of Association?

The amendment of the AoA may only be conducted through a GMS, stating clearly the agenda items regarding the amendments of the AoA in invitations to a GMS.¹⁰ A special treatment is applicable for a company which has been declared as bankrupt, the amendment of said company being subject to the approval of its receiver.¹¹



Best Practices

It is accepted practice that the company, through its legal counsel/ department, prepares the AoA amendments in cooperation with external legal consultants and with the participation of the Corporate Secretary. The President Director should closely follow the process, in order to ensure that provisions of the AoA are formulated in accordance with the Board's guidelines. The final text of the draft proposal must be evaluated and accepted at the Board of Directors meeting. That text will be submitted to the GMS as a proposal.

6. Objection to the Amendments of the Articles of Association

The amendment of the AoA is stipulated by the GMS. If there are any objections to the matters for the amendment, it has to be resolved by in the GMS. In addition, pursuant to Article 27 of the ICL, the amendment of the AoA must be rejected if it is contrary to the provisions regarding the procedures for amendment of the AoA, the content of the amendment are contrary to the provisions of legislative regulations, public order and/or morality, or there is any objection from the creditor upon the GMS decision regarding the decrease of the capital.

¹⁰ ICL, Article 19

¹¹ ICL, Article 20

7. Acknowledgement and Approval from the Minister of Law and Human Right (MOLHR) to the Amendment of the Articles of Association

The amendment of the AoA has to be acknowledged or obtain approval from the MOLHR. Article 21 paragraph (2) of the ICL stipulates that several amendments have to be approved by the MOLHR for the following matters:¹²

- a. name of the company and/or the domicile of the company;
- b. activities and purpose of the company;
- c. terms of the company;
- d. the amount of the authorized capital;
- e. decrease of the paid-up and issued capital; and
- f. change of the status of the company from a private company to a public company or vice versa.

For any amendment other than those stated above, only an acknowledgment from the Minister is required.

8. When does the Amendment of the Articles of Association Become Effective?

The amendment of the AoA which requires an approval from the MOLHR becomes effective as of the issuance date of approval, meanwhile for such amendments which only need to be acknowledged, they become effective as of the issuance date of the acknowledgement letter by the MOLHR. However, in regards to the change of status of the Company and in the context of a merger and acquisition, they shall apply the provisions as stated in Article 25 and 26 of the ICL.

In accordance to the Article 25 of the ICL, amendments to the AoA regarding a change in a Company's status from a Private Company to a Public Company come into effect on:

- a. the date on which the statement of registration submitted to the capital markets supervisory institution enters into effect for a Public Company; or

¹² ICL, Article 21

- b. public offering is made by a Company submitting a declaration of registration to the capital markets supervisory institution to make a public offering of shares in accordance with the capital markets legislative regulations provisions.

9. Disclosure of the Articles of Association

The AoA are an important source of information for shareholders and potential investors. The original AoA document, as well as all its amendments, should be kept at the registered office of the company. Shareholders of the company are entitled to inspect and copy the AoA and its amendments.

The register of Companies shall be open to the public.¹³ According to Article 30 of the ICL, the MOLHR publishes the deed of establishment. The MOLHR shall announce in the Supplement to the State Gazette of the Republic of Indonesia¹⁴:

- a. deeds of establishment of Companies together with the MOLHR's Decree
- b. deeds of amendment to Companies' AoA together with the MOLHR's Decrees
- c. deed of amendment to AoA notification which has been received by the MOLHR

The announcement above shall be made by the MOLHR no later than 14 (fourteen) days as from the date of the issuance of the MOLHR's Decrees or as from the receipt of the notification.

¹³ ICL, Article 29 paragraph (5)

¹⁴ ICL, Article 30

B. The Internal Regulations of a Company

1. Type of Internal Regulations

Internal regulations are internal company documents that specify the AoA provisions and may contain any provision for managing the business and regulating the affairs of a company.

Internal regulations may be an optional or compulsory subject to each type of internal regulations and each type of company. In any case, the company's internal regulations must be consistent with the AoA and cannot conflict with legislation. As between the AoA and internal regulations, the AoA are the dominant instrument so far as their provisions are mutually conflicting, the AoA prevail.

The company has no obligation to register its internal regulations with the business registration authority for the purpose of establishment. In other words, the company may be formed and may exist without the internal regulations. The application for the formation of the company does not have to be accompanied by the internal regulations.

There are various types of company internal regulations:

- Corporate governance internal rules which are required for listed companies. *(see section C of Chapter 3 below)*
- Internal labor rules which are compulsory for all companies with 10 or more employees. According to the Article 1 point 20 of the Manpower Law, a company regulation is defined as written regulations made by the company and containing the working terms of the worker and the company's code of conduct. It is an obligation for companies employing at least 10 workers.¹⁵ The obligation to establish a company regulation is not applicable for companies who already owned a collective working agreement (*perjanjian kerja bersama*). The Manpower Law stated in Article 111 that a company regulation must at least contain several things as follows:
 - a. rights and obligations of the entrepreneur/company;
 - b. rights and obligations of the workers;
 - c. working requirements;
 - d. code of conduct of the company; and
 - e. validity period of the company regulation.

¹⁵ Manpower Law, Article 108

Other internal regulations such as financial regulations, rules on allocating responsibilities,¹⁶ rules on insurance underwriting, assessment and compensation, investment regulations, or regulations on internal control and audit which are compulsory for insurance companies.



Best Practices

Although certain provisions must be stipulated in the AoA¹⁷, internal regulations have several advantages:

- Internal regulations do not need to be registered with the business registration authority, saving the company resources by avoiding registration fees and bureaucratic procedures
- In comparison with the AoA, the procedure for amending internal regulations is simplified, making it easier to adjust to changing circumstances
- Internal regulations contribute to the protection of shareholders' rights. In particular, internal regulations set out a sound and proper framework for the administration and operations of the company. Internal regulations also assist shareholders to understand the implementation of the AoA provisions in practice.

16 Credit institutions are also required to establish financial regulations (Article 29 of Decree 146 of the Government dated 23 November 2005 on financial regimes applicable to credit institutions).

17 In Indonesia, a charter is the equivalent of the Articles of Association.

2. How to Adopt and Amend Internal Regulations?

By law, the President Director has the right to suggest and the Board of Directors has the right to decide internal regulations of the company.¹⁸ It is a statutory presumption that the Board of Directors has the authority to adopt or change the internal regulations.

However for company regulation which is governed under the Manpower Law, in adopting the company regulation, the company must consider inputs and considerations from the representative of the workers in the company. It is also applied for the amendment of the company regulation, where the Manpower Law stated in Article 113 that the amendment of the company regulation may only be conducted based on mutual consent between company and workers and must be registered and authorized by the MMT. A company regulation must be renewed every 2 (two) years.

18 LOE, Articles 108.2(k) and 116.3(d). Although the term “internal management rules” is not defined by law, it could be interpreted to include all internal regulations set out in B(1) above given that such internal regulations are relevant to the management of the company.

C. Company Codes of Corporate Governance

1. What is a Company Code of Corporate Governance?

A company-level corporate governance code is a principle-based statement on the company's corporate governance practices. It is intended to make the company's governance structure more transparent and demonstrate the company's commitment to good corporate governance by developing and furthering:

- Responsible, accountable and value-based management
- An effective Board of Commissioners and Board of Directors that act in the best interests of the company and its shareholders, including minority shareholders and seek to enhance shareholder value in a sustainable manner
- Appropriate information disclosure and transparency, as well as an effective system of risk management and internal control.

By adopting, following and updating a company-level corporate governance code on a regular basis, the company confirms its desire to demonstrably lead and promote good corporate governance. To foster the confidence of its shareholders, employees, investors and the public, a company-level corporate governance code should, however, go beyond the established legal and regulatory framework and embrace both nationally and internationally recognized best corporate governance practices.



Best Practices

Many companies in countries with well-developed corporate governance practices have voluntary corporate governance codes or guidelines in addition to their AoA. Most codes are brief and simple statements of principle that generally reflect the desire of the Board of Commissioners and the Board of Directors to conduct company operations in an honest, fair, legal and socially responsible manner.

Company codes and guidelines may cover a vast number of topics including :

- **General Issues of Corporate Governance**
 - Goals and objectives of the company
 - Relationship between the shareholders and the Board of Directors
 - Relationship between the Board of Commissioners and the Board of Directors
 - Relationship between controlling and minority shareholders.
- **Good Board Practices**
 - Composition, including the number of Directors and independent Commissioners
 - Number and structure of committees
 - General working procedures
 - Remuneration of non-executive Directors.
- **Good Board of Directors Practices**
 - Director remuneration
 - Interaction and relationship with the Board of Directors.
- **Good Board of Commissioners Practices**
 - Composition, including the qualifications of the Board of Commissioners members
 - Responsibilities and working procedures of the Board of Commissioners
 - Relationship between the Board of Commissioners and the Board of Directors, the GMS and shareholders
 - Mechanism to ensure the independence of the Board of Commissioners when conducting its responsibilities
 - Remuneration of the Board of Commissioners members.
- **Shareholder Rights**
 - Proposing to convene a GMS
 - Minority shareholder protection
 - Disclosure of related party transactions
 - The company's dividend policy.

- **Disclosure and Transparency Issues:**
 - Internal control function, including risk management
 - Policy on the use of audit and consulting services and External Auditor rotation
 - Accounting policies and standards
 - Disclosure of financial reports and important information about the company
- **Accountability of the Company to Stakeholders:**
 - Communications and relations with investors and other parties that have an interest in a company

Topics to be covered will depend upon the issues of greatest relevance to the company.

As a rule, company codes are approved by the Board of Directors, communicated to shareholders and investors, and published on the company's website. Company codes or guidelines must be consistent with legislation, as well as the AoA, and should generally follow the provisions of the relevant corporate governance code. They cannot, however, replace the AoA.

2. Indonesian Company Code of Corporate Governance

Codes of corporate governance are important sources for corporate governance in many economies ranging from advanced to transitional economies. The framework for corporate governance in Indonesia is already in a quite advanced stage of development, both for companies in general as well as for listed companies.

The first Indonesia Code of Good Corporate Governance was developed in 1999 by The National Committee on Corporate Governance (NCCG) which was established by Decree of the Coordinating Minister for Economy, Finance and Industry Number: KEP/31/M.EKUIIN/08/1999. The committee was then replaced to be The National Committee for Governance (NCG) by Decree of the Coordinating Minister for Economic Affairs Number: KEP/49/M.EKON/11/2004 consisting of Public Sub-Committee and Corporate Sub-Committee as the Government has become more aware

that for CG Code to be successfully implemented, it needs to have the public support and the existence of good public governance.

The Code has been revised several times and the latest being the 2006 Code. The CG Code is published on the basis of ethics-based approach. As a Code it does not have legal binding but providing reference for business community in implementing the CG Code.

The CG Code describes steps to be taken in creating checks and balances process, enforcing transparency and accountability, as well as promoting corporate social responsibility toward the company long-term survivability.

The CG Code, hereinafter called the CG Code, is a living instrument offering standards as well as guidance for companies to implement CG with the purpose of:

- achieving sustainable growth of the company through a management system based on the principles of transparency, accountability, responsibility, independence and fairness.
- empowering the function and independence of each company organ, namely, the Board of Commissioners, the Board of Directors and the General Meeting of Shareholders
- encouraging shareholders, members of the Board of Commissioners and members of the Board of Directors to take decisions and actions based on high moral values and compliance with the law and regulations.
- stimulating the company awareness of social responsibilities in particular the environmental and societal interests of the communities in which a company operates.
- optimizing the value of a company for its shareholders by also taking into consideration the interests of other stakeholders.
- enhancing the competitiveness of a company, both nationally and internationally, in order to enhance market confidence which may promote investment flow and a sustainable national economic growth.

The CG Code constitutes the reference points for all companies in Indonesia including companies operating on the basis of sharia. The CG Code which encompasses the basic principles and provisions on the implementation of CG Code is a minimum standard that will be further elaborated in sectoral code of the respective sectors of industry to be issued by NCG. The code can be adapted to the specific circumstances of the individual companies into a more detailed manual for its operations.

Publicly listed companies, state-owned enterprises, province and region-owned company, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment,

are expected to become the pioneer in implementing the CG Code. Regulator/policy makers are also expected to use the CG Code as a reference for developing related regulations and applicable sanctions.¹⁹

Using the national code as its reference, an individual company is encouraged to develop their own corporate governance code and must cover at least the following:

- Order and procedures for convening and voting at shareholders' meetings
- Order and procedures for nominating, standing for election, electing and dismissing Directors
- Order and procedures for holding Board of Directors meetings
- Order and procedures for co-ordination between the Board of Commissioners and the Board of Directors
- Rules on assessing activities, rewarding and disciplining members of the Board of Commissioners and the Board of Directors.

A listed company must announce information on its corporate governance status at the annual shareholders' meeting and in annual reports of the company. Such information must at least consist of:²⁰

- Members and structure of the Board of Commissioners and the Board of Directors
- Activities of the Board of Commissioners and the Board of Directors
- Activities of Independent Commissioners
- Activities of Board Committees
- A plan to increase the efficiency of the company's activities
- Remuneration and expenses for the Commissioners and Directors
- Information about transactions of the company's shares by the Commissioners, Directors and major shareholders; and about other transactions by the Commissioners and Directors and their affiliated persons
- The number of the Commissioners and Directors attending training courses on corporate governance
- Actions not yet undertaken, but required by the corporate governance code, the reasons and proposed solutions.

19 CG Code, Preamble

20 Rules No. X.K.6

D. Company Code of Ethics

1. What is a Code of Ethics?

A code of Ethics (also referred to as a Code of Conduct, or Ethics or Responsibility Statement) is a basic guide of conduct that imposes duties and responsibilities on a company's officers and employees towards its stakeholders, including colleagues, customers and clients, business partners (e.g. suppliers), government and society.

2. Why Adopt a Code of Ethics?

A Code of Ethics:

- **Enhances the company's reputation/image:** A company's reputation and image constitutes an integral, if intangible, part of its assets. Establishing a Code of Ethics is an effective way to communicate the value a company places on good business practices.
- **Improves risk and crisis management:** A Code of Ethics can bring potential problems to management's and Directors' attention before a full-blown crisis occurs, as it sensitizes and encourages employees to react to ethical dilemmas.
- **Develops a corporate culture and brings corporate values to the forefront:** A Code of Ethics developed by and widely distributed to the company's officers and employees can help build a cohesive corporate culture, based on a shared set of values, that helps guide employees in their daily work.
- **Advances stakeholder communications:** A Code of Ethics also has a strong demonstration effect towards the company's stakeholders during times of crisis, communicating the company's commitment to ethical behavior and underlining that possible transgressions are exceptions rather than the rule.
- **Avoids litigation:** A Code of Ethics, in combination with an effective ethics program, can help minimize litigation risks resulting from fraud, conflict of interest, corruption and bribery, and insider trading.

3. How to Implement a Code of Ethics?

Every company is different in terms of size and industry, and each has a different business culture, set of values, and ethically sensitive operational areas. A Code of Ethics should reflect these differences.

A company's Code of Ethics should go beyond simple rules and, instead, focus on core values. Before drafting a Code of Ethics, it is fundamental that a company has identified and formulated its values.²¹

Drafting a Code of Ethics goes beyond paper. Developing a Code of Ethics is a process as much as an outcome. In assessing the need for a Code of Ethics, the company should begin by studying its internal ethics climate, the amount and type of ethical guidance its employees and officers receive, and the risk the company faces without such a Code.²² As a second step, the company should seek buy-in from every part of the organization, from senior management to workers, if the Code of Ethics is to truly guide the company's ethical practice. Most importantly, the company should ensure that a broad consultative process takes place within the company.²³ By the time the Code of Ethics is submitted for the Board of Directors' approval, every employee should be familiar with it and have played a role in drafting it, a process that ensures buy-in and helps with implementation.

The company must also recognize that the "tone at the top" matters, and that public and demonstrable commitment by senior management and Directors is a key component to the implementation of a Code of Ethics.

A Code of Ethics should be user-friendly (i.e. provide practical guidance to the company's management and employees on how to handle ethics problems that may arise in the day-to-day course of business). In support of a Code of Ethics, the company may wish to establish an ethics training program, as well as appoint an ethics officer and create an ethics office and/or establish a Board of Directors' Ethics Committee to advise and educate officers and employees, and provide guarantees for confidential counseling.

21 For more information on how to design, manage and implement Code of Ethics, see Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise* (Washington, D.C.: U.S. Department of Commerce, 2004). See also: http://www.trade.gov/goodgovernance/business_ethics/manual.asp

22 Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, Chapter 3, pp. 45-46 and Chapter 5, pp. 93-97.

23 Many companies can choose to establish a working group or task force to produce a first draft of the company's Code of Ethics for the Board of Directors' approval, consisting of representatives from every level. See also: Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, pp. 57-61.

The Code of Ethics should be subject to continuous change, revision and renewal by the Board of Directors' Ethics Committee.

4. Indonesian Code of Business Ethics

Indonesia through the National Committee on Governance (NCG) has adopted a general Code of Ethics applicable to Indonesian companies. However, certain specific types of companies (such as banks, insurance companies and securities companies) are required to adopt professional ethics rules that establish the most important principles and rules of business ethics.

Business Ethics and Code of Conduct was also developed by The NCG as Part III of the CG Code. It stated that “to attain success in the long term, CG implementation needs to be based on high integrity. Hence, a code of conduct that can be used as a reference for a company’s organs and its employees in applying the values and business ethics is required so that it may become a part of the company’s culture.

For that reason, a company must employ the following principles:

1. each company must have company values describing morals of the company in conducting its business.
2. materialize the moral attitude in conducting business, a company must formulate its business ethics that has been agreed by company’s organs and all employees. A continuous implementation of business ethics will constitute a company culture which is a manifestation of the company’s values.
3. the values and business ethics shall be further elaborated in a code of conduct to enable proper understanding and application.

Provisions covered by the Code are as follows:

1. Company Values

- 1.1. Company values constitute the moral basis in achieving the company’s vision and mission. Therefore, before formulating the company values, it is necessary for the company to formulate its vision and mission.
- 1.2. Although the company values are basically universal, however the formulation needs to take into account each respective business sector and character as well as the geographic location of a company.
- 1.3. Company values that are universal include reliability, fairness and honesty.

2. Business Ethics

- 2.1. Business ethics shall serve as a reference for a company in conducting business including in interacting with its stakeholders.
- 2.2. Sustainable implementation of a company values and business ethics will promote the creation of the company culture.
- 2.3. Each company must formulate its business ethics and elaborated it further in the code of conduct.

3. Code of Conduct

- 3.1. Function of Code of Conduct
 - a. Code of conduct is a translation of the company values and business ethics that is useful as guidance for the company organs and all employees of the company in conducting business activities.
 - b. The code of conduct covers guidance regarding conflicts of interest, presenting and receiving gifts and donations, compliance with laws and regulations, confidentiality of information, and reporting of unethical behavior.

Chapter **4**

**THE BOARD OF
COMMISSIONERS**

Table of Contents

- A. THE BOARD OF COMMISSIONERS' AUTHORITY** **111**
 - 1. When to Establish a Board of Commissioners? 111
 - 2. An Overview of the Board of Commissioners' Authority 112

- B. THE ELECTION AND DISMISSAL OF COMMISSIONERS** **123**
 - 1. The Election and Term of Commissioners 123
 - 2. The Removal of Commissioners 126

- C. THE COMPOSITION OF THE BOARD OF COMMISSIONERS** **128**
 - 1. The Number of Commissioners 128
 - 2. Who Can Be a Commissioner? 129
 - 3. Qualifications of Commissioners 131
 - 4. Categories of Commissioners 134

- D. THE STRUCTURE AND COMMITTEES OF THE BOARD OF COMMISSIONERS** **140**
 - 1. President Commissioner 140
 - 2. Committees Established by a Board of Commissioners 142
 - 3. The President of Supporting Committee of a Board of Commissioners 147

Table of Contents

E. THE WORKING PROCEDURES OF THE BOARD OF COMMISSIONERS	148
1. The President and Board of Commissioners Meetings	148
2. The Board of Commissioners Meetings	149
3. The First Board of Commissioners Meeting	150
4. The Schedule of Board of Commissioners Meetings	151
5. Who Has the Right to Convene a Board of Commissioners Meeting?	152
6. Proper Notice for Board of Commissioners Meetings	152
7. The Quorum for Board of Commissioners Meetings	154
8. How Commissioners Can Participate in Board of Commissioners Meetings	154
9. The Consideration of Written Opinions (Absentee Ballots)	156
10. Board of Commissioners Decisions	156
11. The Minutes of Board of Commissioners Meetings	157
12. The Corporate Secretary and Board of Commissioners Meetings	158
F. THE DUTIES AND LIABILITIES OF COMMISSIONERS	160
1. The Duty of Care	160
2. The Duty of Loyalty	161
3. Commissioner Access to Information	165
4. Liabilities of Commissioners	166
5. When are Commissioners Relieved from Liability and Responsibility in Respect of the Company Losses?	166

Table of Contents

6. Who Can File a Claim against Commissioners?	167
7. The Minutes of Board of Commissioners Meetings and Commissioner Liability	167
8. Protection from Liability for Commissioners	168
G. EVALUATION AND EDUCATION OF THE BOARD OF COMMISSIONERS	170
1. Self-Evaluation by the Board of Commissioners	170
2. Education and Training	171
H. THE REMUNERATION OF COMMISSIONERS	173
I. SUMMARY CHECKLIST TO DETERMINE THE BOARD OF COMMISSIONERS' EFFECTIVENESS	177



The Chairman's Checklist

The Board of Commissioners' Authority:

- ✓ Is the Board of Commissioners' focus on protecting the interests of the company and its shareholders? Do all Board of Commissioners members understand the role and priorities of the Board of Commissioners? Does the Board of Commissioners have sufficient powers according to the AoA and the internal regulations to fulfill its oversight duties? Have these authorities been properly communicated? Does the Board of Commissioners use its powers in practice?
- ✓ What is the Board of Commissioners role with respect to the company's governance, organization of the GMS, protection of company assets, resolution of conflicts, and supervision of internal controls and risk management? How effective is the Board of Commissioners in guiding and setting strategy? Does the Board of Commissioners have the tools to properly oversee the operational and financial performance of the company? Is a succession plan in place, in particular for the President Commissioner?
- ✓ Is the Board of Commissioners' authority distinct from Board of Director's, both on paper and in practice?

The Board of Commissioners' Election:

- ✓ Who nominates candidates to the Board of Commissioners? Is sufficient information provided to shareholders about nominees? How does the Board of Commissioners influence the nomination process?

- ✓ Does the Board of Commissioners ensure that all shareholders understand how cumulative voting works?

The Board of Commissioners' Composition:

- ✓ Has the Board of Commissioners designed, articulated, and implemented policies relating to its size, composition and mix-of-skills, breadth of experience and other pertinent qualities?
- ✓ Is the Board of Commissioners' composition, considering its competencies and mix-of-skills, suited to its oversight duties and the development of its strategy?
- ✓ How effectively does the Board of Commissioners work as a team? Does the company have independent Commissioner? Is the Board of Commissioners constituted of a majority of Commissioner?
- ✓ How effective is the Board of Commissioners' leadership, both at the Board and committee level?
- ✓ Is the number of Commissioners consistent with the needs of the company? Does the company have enough commissioners to establish Board of Commissioners committees?

The Board of Commissioners' Structure and Committees:

- ✓ Does the Board of Commissioners have Human Resources, Development Policy, Remuneration and Audit committees or other Board committees in accordance with legal requirements and sound corporate governance practices? What are the costs and benefits of these or other committees? Are there sufficient independent

commissioners to chair and sit on these committees?
Do Board of Commissioners committees have sufficient resources, both human and financial, to properly fulfill their functions?

- ✓ How well informed are non-committee members about the committee's deliberations? Is the information prepared by the committee for the Board of Commissioners adequate for effective decision-making?
- ✓ Do Board of Commissioners Committee members have sufficient expertise on issues relevant to delegated competence? Do they have access to information from the External Auditor, Internal Auditor and the executive bodies involved in the financial, economic and other activities of the company?

The Board of Commissioners' Working Procedures:

- ✓ Has the Board of Commissioners identified, prioritized and scheduled key issues that should be reviewed on a regular basis? Has the Board identified the information it requires to properly analyze these key issues?
- ✓ Does the President Commissioner take an active role in organizing the work of the Board of Commissioners? Does the Board of Commissioners meet regularly in accordance with a fixed schedule?
- ✓ Does the President Commissioner encourage a free and open exchange of views?
- ✓ Are procedures in place that ensure the proper preparation and conduct of Board of Commissioners meetings, e.g. advance notification on agenda issues, distribution of

materials and documents, proper determination of the quorum, voting through absentee ballots and preparation of the minutes? How efficient are Board of Commissioners meetings in practice? Is the information provided to commissioners focused, succinct and to the point, allowing for effective decision-making? Are key issues and risks highlighted? Do the materials contain annexes with further relevant details?

- ✓ How does the Board of Commissioners ensure that it properly oversees the Board of Directors? Does it receive periodic reports and updates from the the Board of Directors? Does the Board of Commissioners invite members of the Board of Directors to Board meetings to inform its members on key issues? How well does the Board of Commissioners interact with Board of Directors, including the President Director? Does the Board of Commissioners provide wise counsel and clear direction to members of the Board of Directors? Does it challenge the Board of Directors sufficiently? How does it balance oversight against micro-management?

The Board of Commissioners' Duties and Liabilities:

- ✓ Do all Board of Commissioners members understand their duties to act reasonably and in good faith in the best interests of the company and its shareholders? Do Board members properly prepare themselves for Board meetings? Does the Board of Commissioners give proper consideration to the interests of other stakeholders?
- ✓ Does the company have contracts with commissioners? Do such contracts describe their duties and liabilities?

The Board of Commissioners' Self-Evaluation and Training:

- ✓ Does the Board of Commissioners conduct annual self-evaluations? Has the Board developed performance indicators or benchmarks for its work? Is this process credible and are the results made available to shareholders?
- ✓ Does the Board of Commissioners conduct regular training events on corporate governance and other issues of importance for improving the future work of this corporate body? Do all commissioners attend training sessions? Does the company hold induction training for new Board members to acquaint them with the company's strategy, future plans and operations, as well as the previous work of the Board of Commissioners?

The Board of Commissioners' Remuneration:

- ✓ Is the remuneration of commissioners competitive? Are all commissioners paid the same amount? Is the remuneration structured in a manner that provides incentives to take on additional responsibilities. For example, the chairmanship of a committee? Does the remuneration package jeopardize a commissioner's independence? Does the total remuneration package constitute a significant portion of a commissioner's total annual income?
- ✓ Does the Board of Commissioners and its Human Resource Committee and Remuneration Committee periodically review the remuneration paid to commissioners? Is the remuneration of commissioners disclosed on an individual basis?
- ✓ Does the company have a policy in place that prohibits personal loans or credits to its commissioners?

As stipulated in the Indonesia's CG Code, the management of a limited liability company in Indonesia is adopting a two board system, namely the Board of Commissioners and the Board of Directors, each of which has a clear authority and responsibility based on their respective functions as mandated by the articles of association and laws and regulations. Yet, they both have the responsibility to maintain the company sustainability in the long term. Accordingly, the Board of Commissioners and the Board of Directors must have the same perception regarding the company's vision, mission and values.

The Board of Commissioners as an organ of the company shall function and be responsible collectively for overseeing and providing advices to the Board of Directors and ensuring that the Company implements the GCG. However, the Board of Commissioners is prohibited from participating in making any operational decision.¹

An effective, professional and independent Board of Commissioners is essential for good corporate governance. The Board of Commissioners acts in the best interests of the company and its shareholders. It sets the strategy of the company, protects shareholder rights, and oversees the Board of Directors and financial operations of the company.

While the Board of Commissioners cannot change the economic environment in which a company operates, it can influence the performance of the company through its strategic oversight and control over management. The Board of Commissioners' activities may go entirely unnoticed when an economy is strong, share prices are rising and everything appears to be going well. On the other hand, when things go badly, the Board of Commissioners becomes the center of attention and the importance of the Board of Commissioners becomes clear.

1 Indonesia's CG Code Part IV B



Mini Case

Certainly, the catastrophic collapse of Enron in the U.S. served to focus public and government attention on boards and corporate governance. The following illustration shows some of the shortcomings of the Enron Board that contributed to the company's downfall, the loss of many thousands of jobs and pensions, and ultimately a loss in faith in U.S. financial markets. On 7 May 2002, the U.S. Senate concluded the following with respect to the role of the Board in Enron's collapse and bankruptcy:²

- **Fiduciary Failure:** The Enron Board failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the U.S.
- **Lack of Independence:** Financial ties between the company and certain Board members compromised the independence of the Enron Board.
- **Conflicts of Interests:** Despite clear conflicts of interests, the Enron Board approved an unprecedented arrangement allowing Enron's Chief Financial Officer to establish and operate private equity funds that transacted business with Enron and profited at Enron's expense.
- **Excessive Compensation:** The Enron Board approved excessive compensation for company executives, failed to monitor the cumulative cash drain caused by Enron's financial year 2000 annual bonus and performance unit plans, and failed to monitor or halt a company-financed, multi-million dollar, personal credit line.
- **High-Risk Accounting:** The Enron Board knowingly allowed Enron to engage in high risk accounting practices.
- **Extensive Undisclosed Off-the-Book Activity:** The Enron Board knowingly allowed Enron to conduct billions of dollars in off-the-book activity to make its financial condition appear better than it was, and failed to ensure adequate public disclosure of material off-the-books liabilities that contributed to Enron's collapse.

2 107th Congress, 2nd Session, Report by the Permanent Subcommittee on Investigations, The Role of the Board of Directors in Enron's Collapse, 8 July 2002. See also: <http://f11.findlaw.com/news.findlaw.com/hdocs/docs/enron/senpsi70802rpt.pdf/>

The CG Code further states that the duty of the President Commissioner as *primus inter pares* is to coordinate the activities of the Board of Commissioners. For the Board of Commissioners to be able to effectively exercise its duties, the following principles shall be observed:³

1. the composition of the Board of Commissioners shall enable it to make effective, right and timely decision and to act independently;
2. the members of the Board of Commissioners must be professional that possess the integrity and capability to enable them to carry out their function properly including to ensure that the Board of Directors shall observe the interest of all stakeholders;
3. the oversight and advisory function of the Board of Commissioners includes the acts of prevention, improvement, and suspension.

The legal regime of the Board of Commissioners is characterized by mandatory requirements, but is also accompanied by a degree of flexibility enabling companies to tailor their internal organization to their own needs and circumstances. This chapter describes the authority, election and dismissal, composition, structure, working procedures, duties and liabilities, evaluation, and remuneration of the Board of Commissioners. It also discusses corporate governance principles and standards found in the CG Regulations and other best practices.

3 Indonesia's CG Code Part IV C

A. The Board of Commissioners' Authority

1. When to Establish a Board of Commissioners?

A limited liability company must establish a Board of Commissioners.⁴

A company that has a Board of Commissioners will want to take the following steps illustrated in Figure 1:

Figure 1. Five Steps in Developing a Board of Commissioners



⁴ ICL, Article 1 paragraph (2)

2. An Overview of the Board of Commissioners' Authority

The ICLICL defines the Board of Commissioners' authority.⁵ The Board of Commissioners is responsible for supervising management policies, the running of the management in general with regard to both the company and the company's business and provide advice to the Board of Directors. In essence, the role of the Board of Commissioners is to supervise and not to manage. The article of association can assign additional powers to the Board of Commissioners as well.

An AoA of a limited liability company stipulate the general duties of the Board of Commissioners as follows:

- conduct supervision over the management (that is, the Board of Directors) of the company;
- perform any duty specifically provided for by the AoA, prevailing laws and regulations and/or the resolutions of the GMS;
- perform their duties, authorities and responsibilities in accordance with the AoA of the company and the resolutions of the GMS;
- act in the interest of the company and be accountable to the GMS;
- examine and review the annual report prepared by the Board of Directors and sign it.

In relation to the duties of the Board of Commissioners as mentioned above, the Board of Commissioners has to:

- supervise the implementation of the working plan and the budget of the Company;
- follow the development of the Company's activities and in the event of a turmoil, report to the GMS as soon as possible and also give advice on the recovery steps that have to be taken;
- propose to the GMS the appointment of the external auditor;
- perform other supervisory activities determined by the GMS;
- assess the Board of Directors' periodic report and, at any time, give a response on the performance of the company and report the implementation of its duties to the Shareholder in a timely manner;
- review or approve the working plan and the annual budget of the Company prepared and submitted by the Board of Directors at the latest on the thirtieth (30th) day of the first month after the new financial year commences;
- if until the end of the given period, the Board of Commissioners has not given its review or approval, then the working plan and the annual budget submitted for the current financial year will prevail.

⁵ ICL, Article 108 Paragraph (1)

In addition, ICL Article 116, 117 and 118 of the ICL states that the Board of Commissioners shall:

- a) Take minutes of meetings of the Board of Commissioners and keep copies thereof;
- b) Report to the Company regarding share ownership by them and/or their families in the Company and other Companies; and provide the GMS with reports concerning the performance of their supervisory task during the past financial year exercise.
- c) Based on the AoA grant of authority to the Board of Commissioners, the latter may approve or assist the Board of Directors in the performance of certain legal actions.
- d) Pursuant to the articles of association or a GMS resolution, a Board of Commissioners may perform management activities in specified situations for a specified period of time.

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



Best Practices

When additional powers and authorities are granted to the Board of Commissioners in the articles of association, these should correspond with the typical functions of the Board of Commissioners to avoid ambiguity with respect to the division of powers between the GMS, Board of Commissioners, President Director and/or Board of Directors.

Figure 2. Board of Commissioners' Authority to the Law on Enterprises and the CG Regulations



Strategic, Oversight, and Control	Control, Disclosure, and Transparency	Shareholder Rights
<ul style="list-style-type: none"> Decides on medium-term development strategies and plans, and annual business plans of the company Decides on investment plans and investment projects within its authority Decides on solutions for market expansion, marketing and technology Approves contracts for purchase, sale, borrowing, lending and other contracts valued at 50% as referred to in the charter Appoints, dismisses or removes, and signs or terminates contracts with the President Director and other key managers of the company Appoints an authorized representative to exercise ownership rights in other companies, and to make decisions on the level of remuneration and other benefits of such persons Supervises and directs the President Director and other management personnel Decides on organizational structure of the company Decides on the establishment of subsidiaries, the establishment of branches and representative offices and the purchase of shares from other enterprises Proposes the re-organization or dissolution of the company Creates Board committees with respect to listed companies Appoints or dismisses the Corporate Secretary Adopts internal management documents (and corporate governance code of listed companies) 	<ul style="list-style-type: none"> Review and sign the annual financial reports before submitted to the GMS Proposes the adoption of financial reports, managing reports, auditor reports (and Corporate Governance Reports of listed companies) to the GMS Adopts the report on important events for the public companies Establishes internal control and risk management mechanisms 	<p>The GMS</p> <ul style="list-style-type: none"> Organizes the GMS Approves the agenda Organizes to obtain written opinions in order for the GMS to pass decisions
	<p>Charter Capital and Assets</p> <ul style="list-style-type: none"> Proposes classes of shares and total number of shares of each class to be offered Decides on offering new shares within the number of shares of each class which may be offered Decides on raising additional funds in other forms Decides on prices for offering shares and bonds of the company Decides on redemption of shares of no more than 10% of the sold shares within each 12 month period 	<p>Dividends</p> <p>Recommends the GMS dividend to be paid, time-limit and procedures for payment of dividend.</p>
	<p>Conflict Resolution</p> <ul style="list-style-type: none"> Approves related party transactions valued at 50% or more of the total value of assets recorded in the latest financial statements of the company (or such smaller percentage as may be stipulated in the charter) Resolves corporate conflicts 	



The Board of Commissioners sets⁶ the company's strategic direction in the context of the market environment, its financial position and other factors. It is very important for the Board of Commissioners to determine the amount and type of risks the company is ready to take in accomplishing its goals.

The strategic and business plans of the company should be reviewed and evaluated at least on an annual basis. The evaluation should also cover production, marketing and planned investments. Finally, the Board of Commissioners should approve a single document that contains financial projections for one year.

When the GMS appoint new members of the Board of Commissioners, the Corporate Secretary should inform new members about the strategy and business plan of the company.

Good corporate governance principles also suggest that:

- The President Director and the member of the Board of Directors seek the approval of the Board of Commissioners for transactions that fall outside the scope of the financial and business plan (non-standard operations).
- The company develop internal regulations with detailed procedures for the President Director and the Board of Directors for obtaining the approval of operations that fall outside the scope of the financial and business plan.
- The Board of Commissioners be given the right to veto the decision of the President Director and the Board of Directors to implement any non-standard operations, provided such veto can be justified.
- The company internal regulations determine rights and duties of the executive bodies, as well as the responsibility for acting not in accordance with these limitations.

6 In Indonesia, this relates to the Board of Commissioners.



Best Practices

It is common practice internationally for the Board of Commissioners' Remuneration Committee,⁷ chaired and comprised of independent Commissioners, to set the remuneration of the President Director and other senior managers. Criteria for determining the level of compensation should include the tasks of the Executive Board member, the economic (financial) situation of the company, the performance outlook compared to competing companies, evaluation of the member's past performance as well as the performance of the Executive Board as a whole, making connections between the future results of that member and his/her remuneration and professional opinions.

→ For more information on executive remuneration, see Chapter 5, Section G.



Best Practices

The Board of Directors normally report to the Board of Commissioners. Most shareholders, in particular minority shareholders, are not able to effectively supervise management. This is the reason why this task is the responsibility of the Board of Commissioners, which oversees the Board of Directors on behalf of all shareholders.

When establishing and selecting a Board of Directors, an appropriate balance must be struck between exercising oversight over the President Director and allowing him/her sufficient autonomy to conduct corporate affairs. The dangers of weak oversight are well known. Board of Directors can operate in their own personal interests and defraud shareholders. There are, on the other hand, dangers associated with excessive oversight. These include

⁷ Remuneration Committee which is responsible to review and give recommendation regarding remuneration of Director and Board of Commissioner.

micro-management and the politicization of managerial decision-making. Both weak and excessive oversight can lead to economic inefficiencies and legal problems. As a consequence, charters, internal regulations and other policy documents should be developed with a view towards dividing responsibilities among the governing bodies of the company on the basis of what body is best suited for a particular task. Managerial tasks should, clearly, be left to professional managers. Oversight tasks should be carried out by oversight bodies, such as the Supervisory Board, Internal Auditor or Audit Committee and GMS.



Best Practices

The Board of Commissioners must understand what to monitor. A number of key issues every Board of Commissioners will want to closely monitor should include the:

- Company's overall performance, especially in comparison to competing companies.
- Board of Directors' compliance with law and internal procedures, including on corporate governance, risk management and internal control, as well as ethics.
- Board of Directors' performance, both at the team and individual levels.
- Implementation of the company's strategy.
- Company's marketing and sales targets.
- Company's financial results.
- Relations with key stakeholders, including the company's shareholders, as well as employees, suppliers and customers.



Best Practices

The Board of Commissioners can create competent committees in order to manage the company more efficiently and resolve complex problems. Creating the committee is of extreme importance if the Board of Commissioners consists of a large number of members or when the significant number of executive members is at the same time on the Board of Commissioners.

→ *For more information on the Corporate Secretary, see Chapter 6.*



Best Practices

International corporate governance practices shows that the Board of Commissioners can approve a number of internal documents dealing with a company's:

- Dividend policy.
- Information policy.
- Ethical standards.
- Control and revision service.
- Risk management.
- Audits of the financial and business activity of the company.
- Corporate Secretary.

→ *For more information on who can request a GMS, see Chapter 8, Section D.*



Best Practices

A key Board of Commissioners function is to establish a system of compliance with corporate procedures. The Board of Commissioners' responsibility is to take all necessary steps to prevent and resolve conflicts that may arise between shareholders and the company. It may appoint officers to implement systems of enforcement. The Board of Commissioners may also form a Conflict Resolution Committee to this end.



Best Practices

A listed company is required to make a public disclosure on the corporate governance of the company at the annual GMS.⁸ The Board of Commissioner is obliged to prepare the annual management and operation report of the company which should include the Corporate Governance Report of the company and submit it to the annual GMS.⁹ The Corporate Governance Report should enclose all important elements of the corporate governance structure and practice in the company.¹⁰ In that report the Board of Commissioners has to disclose how the company follows corporate governance principles and to explain any discrepancy from the CG Regulations. Finally, the Board of Commissioners is supposed to suggest improvements in the current corporate governance practice in the company.¹¹

8 CG Regulations, Article 28.1.

9 LOE, Article 128.

10 CG Regulations, Article 28.1.

11 CG Regulations, Article 28.1(i).



Risk management is an important function of the Board of Commissioners. The Board of Commissioners should ensure that systems are established that enable the company to assess and control risks. Among other things, the Board of Commissioners should:

- Approve risk management procedures and ensure compliance with such procedures (these procedures should provide that the company and its employees notify the Board of Commissioners promptly of any substantial deficiency in risk management mechanisms).
- Analyze, evaluate and improve the effectiveness of the internal risk management procedures on a regular basis.
- Develop adequate incentives for the executive bodies, departments and employees to apply internal control systems.
- Establish a Risk Management Committee of the Board of Commissioners when necessary.
- Ensure that the company complies with legislation and charter provisions.

Figure 3. Sources of Assurance



Source: The Institute of Chartered Accountants in England and Wales, Implementing Turnbull, a Boardroom Briefing, 1999.

The authority of the Board of Commissioners is stated in the Articles of Association and the CG Code

The CG Code formulated the Board of Commissioners role and function as follows:

- The Board of Commissioners is prohibited from participating in any operational decision making. In circumstances where the Board of Commissioners makes decisions regarding matters as stipulated in the articles of association or laws and regulations, such decisions shall be made within its supervisory function, so that decisions on operational activity shall remain the responsibility of the Board of Directors. The authority of the Board of Commissioners shall be carried out within their supervisory and advisory function;
- In circumstances where it is deemed necessary in the interest of the company, the Board of Commissioners may impose sanction on members of the Board of Directors in the form of a suspension, subject to further determination by GMS;
- In circumstances where a vacancy occurs in the Board of Directors or in a situation as stipulated by laws and regulations and the articles of association, the Board of Commissioners may carry out the function of the Board of Directors on a temporary basis;
- To enable the exercise of its function, the members of the Board of Commissioners, collectively and individually, are entitled to have access to, and to obtain information regarding the company on a timely and complete basis;
- The Board of Commissioners shall have rules and guidelines set out in a charter to ensure that its duties can be executed in an objective and effective manner. The charter can also be used as one of the tools for performance evaluation purposes;
- In performing its oversight function, the Board of Commissioners shall submit an accountability report for overseeing the conduct of the management by the Board of Directors in the framework of obtaining the release and discharge (*acquit et decharge*) from GMS;

AoA of a limited liability company set out the authority of the Board of Commissioners which commonly covers:

- Members of the Board of Commissioners, whether collectively or individually, at any time during office hours of the company, shall have the right to enter any building, office or premise used by the Company and shall be entitled to examine accounts, letters, and other evidence, to examine and to review cash flow and others, and also authorize to have all information on every action that has been carried out by the Board of Directors.

- The Board of Commissioners has a right to request explanation from the Board of Directors on any matters relating to the Company, and each member of the Board of Directors is obliged to provide such required information.
- If consider necessary, the Board of Commissioners have a right to request for professionals assistance, for a limited period and/or to form an audit committee in performing their duties, on the cost of the Company.

B. The Election and Dismissal of Commissioners

1. The Election and Term of Commissioners

Article 111 of the ICL stipulated that:

1. Members of Boards of Commissioners shall be appointed by GMS.
2. Initially, members of Boards of Commissioners shall be appointed by founders in the deeds of establishment.
3. Members of Boards of Commissioners shall be appointed for a definite period and may be reappointed.
4. Articles of Association shall stipulate procedures for the appointment, replacement, and dismissal of members of the Board of Commissioners and may also provide for the nomination of members of the Board of Commissioners.

CG Code Part IV stipulated that members of the Board of Commissioners are appointed and terminated by GMS through a transparent process. For publicly listed companies, State-Owned Enterprises, province and region- owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, the process of evaluating the candidates for the member of the Board of Commissioners shall be conducted prior to the GMS by the Nomination and Remuneration Committee. The appointment of an independent commissioner shall have considered the opinion of the minority shareholders which shall be obtained through the Nomination and Remuneration committee.



Companies can maintain their vitality and ability to adapt to new challenges by changing the composition of their Board of Commissioners. Commissioners may indeed lose some of their (independent) edge if they remain on a Board too long. A company may wish to impose term-limits, either for the entire Board of Commissioners or a certain percentage, to keep its members focused. Either way, reappointment should not be automatic, but a conscious decision by the shareholder(s) and the Commissioners concerned.

In accordance with French law, for example, a Commissioner's mandate may not exceed six years unless the GMS decides to renew this mandate, and Commissioners older than 70 years may not exceed one-third of Board membership. In this respect, the Hellebuyck Commission recommends that Commissioners' mandates should not exceed four years and the number of Commissioners over 65 years should not exceed one-third of the Board membership.¹² The French Corporate Governance Code (Vienot II) provides in turn that the duration of a Commissioner's term of office, set by the internal regulations, should not exceed a maximum of four years, in order to enable shareholders to rule upon their appointment with sufficient frequency.¹³

12 AFG ASFFI (Association Française de la Gestion Financière). Hellebuyck Commission Recommendations on Corporate Governance, § II.D.4 (June 29, 1998). See also: http://www.ecgi.org/codes/documents/afg_asffi_amended_2001.pdf/

13 Report of the Committee on Corporate Governance ("the Vienot II Report"), July 1999.



Shareholders should receive sufficient information to determine the abilities of Board of Commissioners nominees to fulfill their duties and, if applicable, to ascertain their independence. Some useful items of information include:

- The identity of the candidate.
- The identity of the shareholder (or the group of shareholders) that nominated the candidate.
- The age and educational background of the candidate.
- The professional qualifications and experience.
- The positions held by the candidate during the last five years.
- The positions held by the candidate at the moment of his/her nomination.
- The Evaluation Report about the candidate's up-to-date work for (with) the company as a member of the Board of Commissioners, in case of his/her reappointment.
- The nature of the relationship the candidate has with the company.
- Other Board of Commissioners memberships or official positions held by the candidate.
- Other nominations of the candidate for Board of Commissioners or official positions.
- The candidate's relationship with affiliated persons of the company.
- The candidate's relationship with major business partners of the company.
- Information related to the financial status of the candidate and other circumstances that may affect the duties and independence of the candidate as a Board member.
- The refusal of the candidate to respond to an information request of the company.

Information about Board of Commissioners nominees is one item of the AGM materials that must be made available to shareholders before the AGM (i.e. 20 days prior to the AGM). It must be made available at the premises of the company's head office and any other places specified in the AGM notification. This information (included in the AGM material) should be posted on the internet, preferably on the company's website. Electronic dissemination is a simple and cost-effective method of allowing broad public access.

2. The Removal of Commissioners

Article 119 of the ICLt regulates that the provisions with regard to the dismissal of members of Boards of Directors contemplated in Article 105 shall apply *mutatis mutandis* to the dismissal of members of Boards of Commissioners.

Article 105 stipulates the following:

- 1) Members of Boards of Directors may be dismissed at any time by virtue of GMS resolutions stating the reason therefor.
- 2) The resolutions to dismiss members of Boards of Directors shall be adopted after the directors concerned have been given the opportunity to defend themselves in the GMS.
- 3) In the event that a resolution to dismiss a member of a Board of Directors as mentioned above is adopted by a resolution outside a GMS in accordance with the provisions contemplated in Article 91¹⁴, the member of the Board of Directors concerned shall first be notified of the planned dismissal and be given the opportunity to defend himself/herself before the resolution for dismissal is adopted.
- 4) The opportunity to defend himself/herself before the resolution for dismissal is adopted shall not be deemed necessary in the event the relevant director shows no objection against such dismissal.
- 5) The dismissals of the members of the Board of Directors shall come into effect as from:
 - a. the closing of GMS contemplated in number (1);
 - b. the date of the resolution contemplated in number (3);
 - c. other date determined in the GMS resolution contemplated in number (1);
 - d. other date determined in the GMS resolution contemplated in number (3).

In line with the provisions contemplated in the ICL, the Indonesian CG Code stated that termination of members of the Board of Commissioners shall be effected by GMS for a reasonable cause and after the relevant member of the Board of Commissioners has been given an opportunity to defend himself or herself.¹⁵

¹⁴ Article 91 of the ICL regulates that Shareholders may also adopt binding resolution without convening GMS provided that all shareholders with affirmative vote give their approval in writing by signing the relevant proposal.

¹⁵ CG Code Part IV C



Best Practices

Both international practices and the ICLICL allow the AoA to provide for additional grounds for dismissing Board of Commissioners members. Grounds may include providing false information to the company as a candidate for the Board of Commissioners, willful neglect of Board of Commissioners responsibilities, or conviction of a criminal act.

C. The Composition of the Board of Commissioners

1. The Number of Commissioners

The numbers of commissioners shall be limited to the numbers set out in AoA. A Board of Commissioners must have a minimum of one Commissioner or more.¹⁶ Boards of Commissioners consisting of more than 1 (one) member shall constitute a council and no member of the Board of Commissioners may act alone but rather on the basis of a resolution of the Board of Commissioners.¹⁷

The ICL Article 108 paragraph (5) stated that Companies whose business activities are related to the collection and/or management of the public's funds, Companies who issue acknowledgements of indebtedness to the public, and Public Companies must have at least 2 (two) members of their Boards of Commissioners.



Best Practices

Companies should choose a Board of Commissioners size that will enable it to:¹⁸

- Hold productive and constructive discussions
- Make prompt and rational decisions
- Efficiently organize the work of its committees, if these are established.

The number of Commissioners should be guided by legal requirements, the specific needs of the company and its shareholders.

Having either too few or too many commissioners can be a problem for effective decision-making. A small Board of Commissioners may not allow the company to benefit from an appropriate mix-of-skills and breadth of experience. A larger Board of

16 ICL, Article 108 paragraph (3)

17 ICL, Article 108 paragraph (4)

18 CG Regulations, Article 131

Commissioners is typically more difficult to manage and can make consensus building a time-consuming and difficult task. The challenge in selecting the correct Board of Commissioners size is striking an appropriate balance.

The CG Code stated that The composition of the Board of Commissioners shall be of sufficient size that suits the complexity of the business of the company by taking into account the effectiveness in decision making.

2. Who Can Be a Commissioner?

Under the ICL. A commissioner is an individual capable of performing legal actions except for those who in the 5 (five) years before their appointment:¹⁹

- a. were declared bankrupt;
- b. were members of a Board of Directors or Board of Commissioners who were declared to be at fault causing a Company to be declared bankrupt; or
- c. sentenced for crimes which caused financial losses to the state and/or which were related to the financial sector.

Under the company's AoA. The company's AoA may also set out additional criteria and conditions which a commissioner or a prospective commissioner must satisfy, provided that such requirements do not violate basic rights of shareholders.²⁰

Other requirements. The commissioners of a company which is subject to industry-specific regulations, such as a bank, an insurance company or a securities company, may be subject to stricter requirements.²¹ It would be prudent for companies which are subject to industry-specific regulations to investigate their industry's requirements carefully while selecting commissioners.

For issuers and public companies, candidates for the Board of Commissioners must meet the requirements stipulated under Decision of the Chairman of Financial Services Authority, as follows:²²

1. Have a good character and moral;
2. Are legally competent;

19 ICL, Article 110 paragraph (1)

20 CG Regulations, Article 10.1

21 Decision 1087, Article 3.4

22 Decision of the Chairman of Capital Market Supervisory Agency Number KEP-45/PM/2004 Article 1.

3. Have never been declared bankrupt or been the Director or Commissioner who were responsible for causing a company to go bankrupt within 5 (five) previous years before appointed;
4. Have never been found guilty of criminal act within 6 (six) years before appointed.

→ *For more information on the fiduciary duties of a director, see Section F.2 of this Chapter.*



Best Practices

At the beginning of his/her term, every Board of Commissioners member must fulfill all the conditions required by the law, corporate governance regulations and internal company documents. If something changes in that respect during the term, the Board members should inform the President of the Board. All the conditions for the Board members shall be applicable to Commissioners elected after a Board of Commissioners vacancy.

Upon the Board of Commissioners' proposal, the GMS shall adopt a resolution about the necessary conditions for the election of the Board members, taking into consideration the nature of the company's activities and its purposes. These conditions can be general, if applicable to all Commissioners, and specific, if applicable to a particular Commissioner.

To avoid conflicts of interest, individuals should not be elected to the company's Board of Commissioners when they are:

- A Commissioner of a competing company
- A manager of a competing company
- An employee of a competing company.

Nominees for the Board of Commissioners should also not be related to suppliers, affiliated persons, as well as employees of the independent External Auditor.

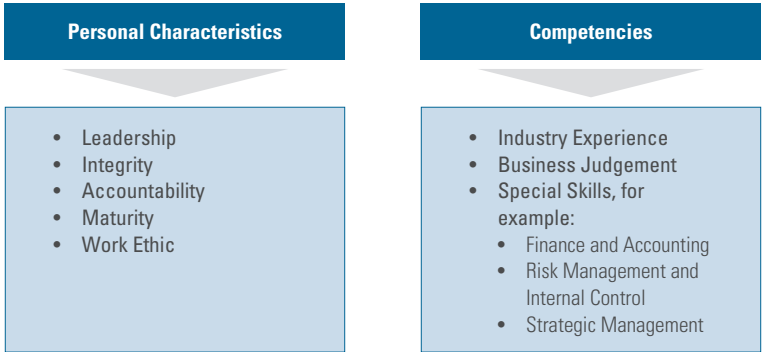
3. Qualifications of Commissioners

Commissioners should possess the necessary skills and experience to contribute to the work of the Board of Commissioners. Figure 4 illustrates the personal characteristics and competencies required for this task.

The CG Code states the following²³:

- Members of the Board of Commissioners shall have the capability and integrity required to ensure that the oversight and advisory function can be carried out properly.
- Members of the Board of Commissioners are prohibited from utilizing the company for his/her personal, family, business group and or other parties’ interests;
- Members of the Board of Commissioners shall understand and comply with the articles of association and the laws and regulations as related to their duties;
- Members of the Board of Commissioners shall understand and implement the GCG Code.

Figure 6. Recommended Characteristics and Competencies for Board of Directors Members



Source: IFC, March 2004

23 Indonesia’s CG Code Part IV C.2



Company Practices in Indonesia

Indonesian companies feel that work experience within the company and the industry as well as personal maturity are important criteria when electing commissioners. Other popular criteria include contacts and loyalty to the company as well as independence, expertise and leadership are also considered important. It can thus be inferred that the benefits of independent commissioners are already fully understood by Indonesian companies.

There are no legal requirements with regard to the qualification criteria of commissioners. As a result, such criteria need to be specified elsewhere. For example, companies may find it useful to include qualifications in their internal company documents, such as their AoA, internal regulations or other company policies.

Notwithstanding the above, there are of course requirements applicable to companies which are regulated by industry-specific laws regulations, such as banks, insurance companies, securities companies, and so on, in which case the commissioners of the Board of Commissioners may need to satisfy certain qualification requirements. For instance, in addition to the requirements set out in Section 2 (Who can be a commissioner?), in setting out the qualification of members of the Board of Commissioners, the company shall take into account provisions regarding dominant position stipulated under Article 26 of Law No.5 of 1999 regarding Prohibition of Monopoly Practice and Unfair Competition. Again, it would be prudent for companies which are subject to industry-specific regulations to examine their industry's requirements carefully while selecting their commissioners.



The article of association should set forth the qualification criteria for commissioners. Commissioners should have the following qualifications:

- The trust of shareholders (reflected in their supporting votes for such commissioners), other commissioners, directors, managers, and employees of the company
- The ability to relate to the interests of all stakeholders and make well-reasoned decisions
- The professional expertise and education needed to be effective
- International business experience, knowledge of national issues and trends, knowledge of the market, products, and competitors
- The ability to translate knowledge and experience into solutions.

It may, however, be difficult for the company to determine whether a potential commissioner possesses these qualifications. Moreover, a brief description of such qualifications in the company's article of association may lead to ambiguity and thus be of little use. Instead, companies may wish to include the above criteria in their internal regulations or other internal documents. Indeed, many companies in the U.S. use corporate governance guidelines for this purpose.

Shareholders should be informed of the commissioners' qualifications and the list of candidates for the Board of Commissioners should indicate whether, at the time of election, the candidate is or will be:

- The President Director
- An Board of Directors member
- An officer or employee of the company
- Able to meet the qualifications of an independent commissioner.

The background of Board of Commissioners candidates should be checked for a criminal record and for past administrative offences that are not de minimis in nature, and to see whether such candidates meet the requirements set out in the ICL, the CG Regulations and the AoA of the company.

In every moment during its term, the Board of Commissioners should comprise of members who in totality have the knowledge, capability and professional experience necessary for the successful direction of the company. At least one member needs to have the knowledge and experience of running finance and accounting in listed companies.

4. Categories of Commissioners

International practices distinguish between different categories of commissioners according to the degree to which such commissioners are involved (or related to) in the affairs of the company, and divides them into three categories of executive, non-executive, and independent commissioners. In Indonesia, categories of commissioners regulated in the Article 120 of the ICL, which consists of Independent Commissioner and Delegated Commissioner.



Company Practices in Indonesia

Many Indonesian public companies are controlled by a single majority shareholder or a group of shareholders who are well informed about the affairs of the company and able to closely monitor the company's management. The remaining ownership is often widely dispersed and many of these, often minority, shareholders lack the resources and information to effectively monitor management and defend themselves against the potential abuses of large shareholders. In these types of companies, independent commissioners have an especially important role:

(i) Independent Commissioners

According to the CG Regulations, approximately one-third of commissioners on the Board of Commissioners of a listed company should be independent commissioners.²⁴ The Indonesia's CG Code stipulates that the number of Independent Commissioners shall be such as to ensure that the control mechanism runs effectively and in accordance with laws and regulations. One of the Independent Commissioner shall have an accounting or finance background.

²⁴ Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, November 2002, page 60. See also: http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf.



Most international and national codes of corporate governance recommend that Boards of Commissioners be composed of a majority of Commissioners who contribute:

- An outside perspective and greater impartiality in their judgments
- Additional external experience and knowledge
- Useful contacts.

In most EU countries, Commissioner normally exercise oversight of the financial and strategic decision-making functions of the company. Apart from these, there are three areas in need of disinterested monitoring by Commissioner:

- Nomination of directors
- Remuneration of President Director and member of Board of Directors
- Internal and external audit.

In the U.K., the Higgs report groups the role of the Commissioner around four issues:²⁵

1. Strategy

Commissioners should constructively challenge and contribute to the development of the company's strategy.

2. Performance

Commissioner should scrutinize the performance of management in meeting agreed upon goals and objectives and monitor the reporting of performance.

3. Risk

Commissioner should satisfy themselves that financial information is accurate, and that financial controls and systems of risk management are robust and defensible.

4. People

Commissioners are responsible for determining appropriate levels of remuneration for Directors, have a prime role in appointing, and where necessary removing, President Director, and in succession planning.

²⁵ Derek Higgs, Review of the role and effectiveness of non-executive directors, January 2003. See also: <http://www.ecgi.org/codes/documents/higgsreport.pdf/>

Independent Commissioners

International practices distinguishes between independent commissioners and non-independent commissioners. Good corporate governance practice suggests that, an independent commissioner is an individual who has not received substantial financial or other benefits from such company in the last three years, such as:

- have not been an employee of the company or a shareholder of 10% or more of the company
- have not paid to or received from the company a substantial amount, or been a major shareholder of a company that has paid to or received from the company a substantial amount (the threshold of such amount should be determined by the GMS and set out in the AoA of the company)
- have not been an External Auditor of the company.

→ *For more information on related persons, see Chapter 4, Section C.2.*



Best Practices

Commissioners who are independent can make a substantial contribution to important decisions of the company, especially in evaluating executive performance, setting executive and commissioner remuneration, reviewing financial statements, and in resolving corporate conflicts. Independent commissioners give investors additional confidence that the Board of Commissioners' deliberations will be free of obvious bias. Companies are advised to disclose information about independent commissioners in the annual report.

IFC defines "Independent Commissioner" as a Commissioner who:

1. Has not been employed by the Company or its Related Parties in the past five years.
2. Is not, and is not affiliated with a company that is an advisor or consultant to the Company or its Related Parties.
3. Is not affiliated with a significant customer or supplier of the Company or its Related Parties.

4. Has no personal service contracts with the Company, its Related Parties, or its senior management
5. Is not affiliated with a non-profit organization that receives significant funding from the Company or its Related Parties.
6. Is not employed as an Director of another company where any of the Company's Directors serve on that company's Board of Directors.
7. Is not a member of the immediate family of an individual who is, or has been during the past five years, employed by the Company or its Related Parties as a Director.
8. Is not, nor in the past five years has been, affiliated with or employed by a present or former auditor of the Company or of a Related Party.
9. Is not a controlling person of the Company (or member of a group of individuals and/or entities that collectively exercise effective control over the Company) or such person's brother, sister, parent, grandparent, child, cousin, aunt, uncle, nephew or niece or a spouse, widow, in-law, heir, legatee and successor of any of the foregoing (or any trust or similar arrangement of which any such persons or a combination thereof are the sole beneficiaries) or the executor, administrator or personal representative of any Person described in this sub-paragraph who is deceased or legally incompetent.

(For the purposes of this definition, a person shall be deemed to be "affiliated" with a party if such person (i) has a direct or indirect ownership interest in; or (ii) is employed by such party; "Related Party" shall mean, with respect to the Company, any person or entity that controls, is controlled by or is under common control with the Company).

Commissioner should be disqualified from being independent if they answer "Yes" to one or more of the following questions in Table 3:

Table 3. Are Commissioners on Your Board of Commissioners Independent?

	Yes	No
Is the Commissioner an employee of the company? Has the Commissioner been an employee of the company over the last five years?		
Has the Commissioner been a member of the Board of Commissioners or the Board of Directors of the company, except as an independent Commissioner?		

Table 3. Are Commissioners on Your Board of Commissioners Independent? (Cont'd)

	Yes	No
Has the Commissioner paid to or received from the company a substantial amount apart from a fee received as Commissioner? ²⁶		
Has the Commissioner been, directly or indirectly, a shareholder of more than 10% of the company or an associated company (including affiliated person) of the company? Has the Commissioner been a member of the Board of Commissioners or Board of Directors of such a shareholder?		
Has the Commissioner had within the last three years a significant business relationship with the company or a related person or the company? Has the Commissioner been in the same period a shareholder, partner, External Auditor, commissioner, member of the Board of Commissioners or the board of Directors of the entity that had a significant business relationship with the company?		
Has the Commissioner been a member of the Board of Director of another company in which an director of the company is a member of the Board of Directors?		
Is the Commissioner a representative of the significant shareholder?		
Has the Commissioner served as a member of the Board of Commissioners at least six terms in a row, even if he/she was an independent member?		
Is the Commissioner in any of the above-mentioned relationships with an associated company, controlling shareholders of the associated company, Commissioner or members of the Board of Commissioners or Board of Directors of the associated company?		

If a Commissioner ceases to be independent, the Commissioner should immediately notify the Board of Commissioners with an explanation of why the criteria of independence no longer apply. The Board of Commissioners is then advised to:

- Notify shareholders that the Commissioner is no longer independent
- Disclose information about independent Commissioner in the annual report of the company, giving shareholders the opportunity to verify any changes in the status of Independent Commissioner.

In any event, Independent Commissioner should refrain from actions that may compromise their independent status.

Other international and national codes of corporate governance have similar definitions for Independent Commissioner. In the U.K. for example, a Commissioner is considered independent when the Board of Commissioners

²⁶ The threshold of such amount should be determined by the GMS and set out in the charter of the company.

determines that the Commissioner is independent in character and judgment, and there are no relationships or circumstances which could affect, or appear to affect, the Commissioner's judgment. Such relationships and circumstances would include those, in which the Commissioner:²⁷

- Is a former employee of the company or group, and his/her employment (or any other material connection) has ended less than five years ago.
- Has, or has had, within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, Commissioner, or senior employee of a body that has had such a relationship with the company.
- Has received or receives additional remuneration from the company apart from a Commissioner's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme
- Has close family ties with any of the company's advisers, Commissioner or senior employees
- Holds cross-directorships or has significant links with other Commissioners through involvement in other companies or bodies
- Represents a significant shareholder
- Has served on the Board of Commissioners for more than 10 years.

The large number of definitions with their detailed qualifications may give rise to confusion. In reality, understanding and defining independence need not be complex. The Council of Institutional Investors (CII), a grouping of some of the world's largest institutional investors, defines an Independent Commissioner plainly in the following way: "Stated most simply, an Independent Commissioner is a person whose commissionership constitutes his/her only connection to the corporation." This cuts to the heart of the matter. For those interested in learning how to apply this simple definition in practice, the CII also lists specific circumstances that compromise independence.²⁸

Finally, it should be noted that Commissioner independence is not a panacea. The New York Stock Exchange is a telling example. In 2003, the exchange was enveloped in a scandal over the excessive compensation of its Chief Executive Officer, despite the fact that compensation levels had been approved by a committee staffed and chaired by Independent Commissioner.

27 The Combined Code on Corporate Governance, July 2003, Section 1, A.3.1. See also: www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf/

28 For more information on the CII (in English), see: <http://www.cii.org/>

D. The Structure and Committees of the Board of Commissioners

1. President Commissioner

The article 108 ICL regulated that Board of Commissioners shall consist of 1 (one) or more members. In addition, the articles of association of a company usually stipulate that in the event of a Board of Commissioners composed of more than 1 (one) member, one of them should be appointed as the President Commissioner.

Further, Indonesia's CG Code stated in Part IV C that each of the members of the Board of Commissioners, including the President Commissioner, has equal position. The duty of the President Commissioner of the Board of Commissioners as *primus inter pares* is to coordinate the activities of the Board of Commissioners.



Best Practices

The ability of the President Commissioner to properly discharge his/her duties depends on his/her being vested with sufficient and appropriate powers, and on his/her personal and professional qualifications. The President Commissioners should have an outstanding professional reputation and should be of the highest integrity, be committed to the interests of the company, and enjoy the trust of shareholders and the other commissioners.

There should be a clear division of responsibilities at the head of the company between the running of the Board of Commissioners and the executive responsibility for the running of the company's day-to-day operations—both on paper, as required by law, and in actual practice. Companies should define the authority of the President Commissioner, as well as that of the President Director, in as much detail as possible in the internal regulations.



The President Commissioner's other duties, or responsibilities, should be defined in the internal regulations for the Board of Commissioners. In addition, the company may wish to draft a position description, or terms of reference, which could contain the following elements:²⁹

The President Commissioner:

- Provides leadership and ensures for the Board of Commissioners' effectiveness.
- Establishes, implements and reviews procedures that govern the Board of Commissioners' work.
- Schedules a Board of Commissioners meeting calendar and coordinates it with the Board's committee chairs.
- Organizes and presents meeting agendas and ensures that all commissioners receive appropriate information on a timely basis.
- Periodically interacts with the President Director and acts as a liaison between the Board of Commissioners and executives.
- Ensures for accurate, timely, and clear information to and from the other commissioners.
- Ensures for effective communication with shareholders
- Arranges regular evaluations of the Board of Commissioners' performance, as well as of its committees and individual commissioners.
- Facilitates the effective contribution of independent commissioners and enables constructive relations between commissioners.
- Carries out other duties as requested by the GMS and the Board of Commissioners as a whole, depending on needs and circumstances.

²⁹ These model terms of reference contain elements from the "Review of the Role and Effectiveness of Non-executive Directors," by Derek Higgs, January 2003 and the Report of the NACD Blue Ribbon Commission on Director Professionalism, Appendix B.

2. Committees Established by a Board of Commissioners

As the business environment continues to become more complex, the demands on and responsibilities of the Board of Commissioners and its members continue to grow. The Board of Commissioners' committees are widely considered a key tool for Board of Commissioners to overcome and effectively deal with such challenges.

In carrying out its duty, the Board of Commissioners may form committees. Any proposal from the committees shall be submitted to the Board of Commissioners for approval.³⁰

More specifically, committees:

- Permit the Board of Commissioners to handle a greater number of complex issues in a more efficient manner, by allowing specialists to focus on specific issues and provide detailed analysis and recommendations back to the Board.
- Allow the Board of Commissioners to develop subject-specific expertise on the company's operations, most notably on financial reporting, risk, and internal control.
- Enhance the objectivity and independence of the Board of Commissioners' judgment, insulating it from potential undue influence of managers and controlling shareholders.

It is of crucial importance that committees are understood to be part of the Board of Commissioners. It is the Board of Commissioners that establish committees, set their terms of reference through committee internal regulations, appoint their members and turn their recommendations into action.³¹

The Board of Commissioners must issue detailed regulations on the establishment and the duties and responsibilities for each Board of Commissioners committee and its members.

a. Types of Committees

A company may establish several types of committees, as discussed in more detail in Table 4 below, if it decides that it is necessary. Committees are not a must. ICL, the Article of Association and the CG Code require that a company should establish committees, although they do recommend that companies establish committees if they see that committees would facilitate the operations of the

³⁰ Indonesia's CG Code Part IV C. 3.7

³¹ ICL, Article 121

Board of Commissioners. Both the CG Code and the ICL suggest that the Board of Commissioners may form committees in order to assist it in its activities. The types of committees suggested by the CG Code include Audit Committee, Nomination and Remuneration Committee, Risk Policy Committee and Corporate Governance Committee. The CG Code also allows companies to set up other committees according to resolutions of the GMS.

For publicly listed companies, state-owned enterprises, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, an Audit Committee shall be established, whereas other committees are formed as required.³²

It should be noted that a large number of committees can be hard to manage and may lead to a fragmentation of the Board of Commissioners. It is advisable to establish committees as the need arises, starting with the most critical ones, and then establishing others as experience is gained. The Board of Commissioners may establish either permanent or ad-hoc Board committees. The most important committee from the shareholder perspective is the Audit Committee. Some of the committees that a company should consider establishing are described in Table 4.

32 CG Code Part IV 3.7

Table 4. Different Types of Committees

	Proposed Functions	Recommendations for the Committee's Composition
Nomination and remuneration Committee^{33,34}	<ul style="list-style-type: none"> • To assist the Board of Commissioners in determining the selection criteria for candidates of the member of the Board of Commissioners and the Board of Directors as well as the remuneration system; • To assist the Board of Commissioners in preparing for the candidates of the members of the Board of Commissioners and the Board of Directors and proposing the amount of their remuneration. The Board of Commissioners may propose the candidates and their remuneration for approval by GMS in accordance with the articles of association; • The existence of the Nomination and Remuneration Committee and its work system shall be reported to the GMS. 	<p>The majority of the Nomination and Remuneration Committee members should be independent commissioners. One of them should be appointed as Chairman of the Committee.</p> <p>The Nomination and Remuneration Committee members need to be knowledgeable about the basic principles of business ethics, management, ICL, Manpower Act and other applicable regulations. For publicly listed companies, state-owned enterprises, province and region owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, the Nomination and Remuneration Committee is chaired by an Independent Commissioner, whilst the other members may consist of a Commissioner and or professionals from outside of the company.</p>
Audit Committee³⁵	<ul style="list-style-type: none"> • Shall function to assist the Board of Commissioners to ensure that: (i) financial reports are presented appropriately in accordance with the generally accepted accounting principles; (ii) internal control structure is adequate and effective, (iii) internal and external audits are conducted in accordance with applicable audit standards, and (iv) audit findings are followed up by the management; • The Audit Committee shall review candidates for external auditors including their remuneration, and submits its recommendation to the Board of Commissioners.³⁶ 	<p>The composition of the Audit Committee shall be such so that it can accommodate with the complexity of the company by taking into account the effectiveness in decision making. For publicly listed companies, state-owned enterprises, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, the Audit Committee is chaired by an Independent Commissioner and the members may consist of Commissioners and or professionals from outside the company. One of the members should have an accounting and or finance background.³⁷</p>

33 CG Code Part IV 4.2

34 CG Regulations, Article 15.1

35 CG Regulations, Article 15.1

36 CG Code Part IV 4.1.a. and 4.1.b

37 CG Code Part IV 4.1.c

Table 4. Different Types of Committees (Cont'd)

	Proposed Functions	Recommendations for the Committee's Composition
Risk Policy Committee^{38,39}	<ul style="list-style-type: none"> • Shall function to assist the Board of Commissioners in reviewing the risk management system established by the Board of Directors and evaluating the company's risk tolerance. 	<p>Members of the Committee need experience in the industry in which the company is active. The Committee will likely benefit from members with other areas of expertise such as finance and operations.</p> <p>Members of the Risk Policy Committee consists of members of the Board of Commissioners, but, if necessary, professionals from outside of the company may be appointed.</p>
Corporate Governance Committee⁴⁰	<ul style="list-style-type: none"> • Shall function to assist the Board of Commissioners in reviewing the GCG policies prepared by the Board of Directors and monitoring the effectiveness of the GCG practices, including aspects related to the business ethics and social responsibility of the company. 	<p>Members of the Committee must be of the highest integrity, enjoy the trust of all shareholders, and be knowledgeable on legal and ethical standards.</p> <p>Members of the Corporate Governance Committee shall consist of the members of the Board of Commissioners, but, if necessary, professionals from outside of the company may be appointed.</p> <p>If deemed necessary, the Corporate Governance Committee may be combined with the Nomination and Remuneration Committee.</p>

b. Authority of Board of Commissioners Committees

The Board of Commissioners is a collective body in which:

- All members have equal rights and duties All members bear joint and several liability
- Members act together as a body according to specific decision-making procedures.

Although the above suggests that the ultimate decision-making responsibility rests with the entire Board of Commissioners, Board of Commissioners committees can resolve and make decisions on issues delegated to them by the Board of

38 CG Code Part IV.4.3

39 CG Regulations, Article 15.1

40 CG Code Part IV 4.4

Commissioners, provided that resolutions of a committee are only valid and enforceable if a majority of members of such committee who are present and vote at the meeting of the committee are also members of the Board of Commissioners.

c. The Composition of Board of Commissioners Committees

The number of members on a Board of Commissioners committee is determined by the Board of Commissioners. In every committee, at least one member should be a member of the Board of Commissioners and at least one member should fulfill all the conditions for an independent commissioner. The Board of Commissioners should appoint one member as Chairman of each committee. Other parties, most notably managers, who are not members of the Board of Commissioners committee, may be invited to present or elaborate on particular issues, but have observer status only, i.e., are precluded from conferring or deciding on particular issues.



Best Practices

Experienced and knowledgeable commissioners should staff Board of Commissioners committees. There needs to be a sufficient number of members to accomplish the work at hand. Since the work of Board of Commissioners committees may involve time-consuming reviews, the participation of commissioner in multiple Board of Commissioners committees should be restricted. Before allowing participation in multiple committees, Board of Commissioners should review all the activities assigned to the committee, estimate time necessary for effective realization of these activities, as well as free time potential members can dedicate to the work of the committee. Board of Commissioners committees may occasionally require the assistance of outside advisors. However, these advisors must not receive Board of Commissioners committee member status.

Many stock exchanges further recommend that Board of Commissioners committees be composed of and/or chaired by independent commissioners. The listing requirements of some stock exchanges, for example the New York Stock Exchange, go further and require a majority of independent commissioners, as well as the Audit and Human Resources Committees to be composed solely of independent commissioners.

3. The President of Supporting Committee of a Board of Commissioners

The Chairman of a committee is responsible for its effectiveness, regardless of his/her other duties.



Best Practices

The Chairman of a committee plays an important role in organizing its work. Ideally, committees should be chaired by independent commissioners. This holds particularly true for the Audit and Remuneration Committees which, according to best corporate governance practices, are to be chaired by independent commissioners.

The Chairman of the committee should keep the President of the Board of Commissioners informed about its work. In addition, the committee Chairmen should be present at the GMS to respond to shareholders' questions.

A committee Chairman should:

- At least once in three months inform the Board of Commissioners about all the questions important for the committee's work
- Without undue delay submit all data requested by the Board of Commissioners
- Take necessary administrative measures to ensure that the committee performs its tasks.

E. The Working Procedures of The Board of Commissioners

The Board of Commissioners is a governing body, which operates according to procedures defined by the ICL, the AoA, or the internal regulations of the company.

1. The President and Board of Commissioners Meetings

The authority of the President Commissioner is regulated in the Articles of Association or internal regulations of the company.



Best Practices

More specifically, the President Commissioner facilitates the work of the Board of Commissioners by:

- Facilitating decision-making on agenda items.
- Encouraging open discussions on issues in a friendly and constructive atmosphere.
- Providing Board of Commissioners members with an opportunity to express their points of view on matters being discussed.
- Steering the Board of Commissioners towards a consensus.

In doing so, the President Commissioner should act with conviction and, at all times, in the best interests of the company. Moreover, the internal regulations or other internal documents should impress upon the President Commissioner the responsibility to:

- Encourage commissioners to freely express their opinions on agenda items and other issues.
- Discuss opinions of commissioners openly.
- Initiate the drafting of the Board of Commissioners' decisions.

2. The Board of Commissioners Meetings

Board Meetings.

The Board of Commissioners must follow legal requirements in making valid decisions, or risk having them overruled by the courts upon complaints.



Best Practices

Commissioners should ensure that Board of Commissioners and committee meetings are well-organized and held on a regular basis. Commissioners should actively participate in the Board of Commissioners meetings and each director should:

- Take part in discussions and voting
- Participate in the work of Board of Commissioners committees, if he/she is a member of the committee
- Demand a Board of Commissioners meeting to discuss matters of concern
- Notify the Board of Commissioners when he/she is unable to attend meetings.

In addition, Board of Commissioners members should have sufficient time for the performance of their functions. The Board of Commissioners should develop rules to regulate the participation of its members on other companies' Boards of Commissioners. The general rule for directorship on multiple Board of Commissioners should, however, be based on time-constraints. If a commissioner does not have the time, he/she should not take on the responsibility.

Written Resolutions.

Written Resolutions. Except to the extent that the AoA or internal regulations require action by the Board of Commissioners taken at a meeting, an action required or permitted to be taken by the Board of Commissioners may be taken without a meeting. In regards with this issue, Article 116 of the ICL stipulated that the Board of Commissioners shall be obliged to prepare a minute meeting of the Board of

Commissioners which contain all proceedings and resolutions taken and keep the copy thereof. Further, a standard AoA of a limited liability company may stipulate as follows:

- Any matters that are discussed and decided in the Board of Commissioners' Meeting should be drawn-up in the Minutes of Meeting. The Minutes of Meeting shall be prepared by a person who attended the meeting and assigned by the Chairman of the Meeting, and the Minutes of Meeting shall be signed by the Chairman of the Meeting and another member of the Board of Commissioners appointed by the Meeting.
- The Board of Commissioners may also make a valid decision without convening a Board of Commissioners' Meeting, provided that all members of the Board of Commissioners have been notified in writing and all members of the Board of Commissioners have granted their approval to such written proposal and signed such resolution.
- A resolution made in such manner shall have the same force as a valid resolution made in a Board of Commissioners' Meeting.

3. The First Board of Commissioners Meeting

The first meeting of the Board of Commissioners is not regulated in the ICL nor the CG Code, and so the Board of Commissioners or the newly appointed one is encouraged to have it regulated in its article of association or manual along with other internal arrangements.



Best Practices

The first meeting of a newly elected Board of Commissioners should be held no later than one month after it is elected. As a matter of convenience, the first Board of Commissioners meeting can be organized to follow the GMS. In addition, it is recommended that the first Board of Commissioners meeting:

- Define and confirm the priorities of the Board of Commissioners.
- Establish committees if appropriate.
- Elect committee chairman.

A company may also wish to develop an induction training for new Board of Commissioners members that cover, among other topics, an overview of the company's:

- Industry and sector of operation
- Business operations
- Current financial situation
- Strategy
- Business risks
- Key employees' background and skills.

4. The Schedule of Board of Commissioners Meetings

The article of association or the internal regulations/manual can specify the procedures for convening and conducting Board of Commissioners meetings.



Best Practices

The Board of Commissioners should have a working plan in addition to a schedule for meetings that includes the topics to be addressed. The Board of Commissioners should hold regular meetings. The Board of Commissioners should meet at least four times a year. The Board of Commissioners may, however, wish to hold meetings as often as deemed necessary.

Here is some guidance on conducting productive and efficient Board of Commissioners meetings:

- **Develop an annual calendar of meetings.** This will allow commissioners to slot the meetings in their agendas. Note that this calendar should serve as a guide, i.e. the Board of Commissioners should hold additional meetings when warranted and, vice versa, cancel meetings when there are no issues to be resolved.

- **Set an agenda well in advance.** Commissioners will thus be able to properly focus on and prepare for the task at hand. The President Commissioner may wish to send a draft agenda in advance, allowing for comments and suggestions.
- **Place important issues at the beginning of the agenda.** Commissioners often have other commitments and might need to leave early. Scheduling meetings for the early, rather than latter part of the day, is thus often **more conducive to foster interactive discussions.**

In addition to regular meetings, the Board of Directors needs to organize a meeting to review and approve the annual report. This Board meeting needs to take place at most two months prior to the AGM.

A standard article of association of a limited liability company may include provisions on the Board of Commissioners meetings, such as a Board of Commissioners' meeting may be held at any time if deemed necessary.

5. Who Has the Right to Convene a Board of Commissioners Meeting?

The President Commissioner normally convenes regular Board of Commissioners meetings. However, an article of association of a company may state that a Board of Commissioners' meeting may be held by one or more member of the Board of Commissioners, or upon a written request of the Board of Directors, or upon the written request of one or more shareholders jointly holding at least 1/10 (one-tenth) of the total number of shares with valid voting rights issued by the Company.

6. Proper Notice for Board of Commissioners Meetings

The necessary information and materials should be sent to commissioners together with the notice of the Board of Commissioners meeting sufficiently in advance to enable each commissioner to thoroughly review the information.

Regulations on notice for the Board of Commissioners Meetings are usually stipulated in the article of association and further stated in more details in the charter/manual. For example a public company's article of association regulates as follows:

- Notice for a Board of Commissioners Meeting shall be made by a member of the Board of Commissioners which is authorized to represent the Board of Commissioners
- Notice for a Board of Commissioners' Meeting must be made in writing and delivered directly to each of the members of the Board of Commissioners with sufficient receipt, or by registered mail or courier services, or telex, or facsimile, or electronic mail (e-mail), no later than 3 (three) days prior to the said meeting, not including the date of the notice and the date of the meeting, or within a shorter time period for an urgent matter.
- The notice for the Board of Commissioners' Meeting must contain the agenda, the date, the time and the venue of the meeting. The Board of Commissioners' Meeting shall be held within the domicile of the Company or the place where the Company's activities are conducted.



Best Practices

Commissioners should properly prepare themselves to participate effectively in meetings. They should not vote on items on which they have not been fully informed or which they do not understand. The internal regulations or other internal documents should determine the form of the notice and the way materials are delivered that is most convenient and acceptable to all commissioners (for example by mail, telegraph, fax, or e-mail). Such delivery method must ensure that the notice reaches the commissioner's contact details which have been registered at the company.

7. The Quorum for Board of Commissioners Meetings

A quorum is the minimum number of commissioners that must participate in a meeting for decisions to be valid. Since the ICL does not specify the quorum for Board of Commissioners Meetings, the articles of association of a company may require that a quorum of the Board of Commissioners should consist of one half (1/2) of the total members of the Board of Commissioners that are present or represented in the meeting.

8. How Commissioners Can Participate in Board of Commissioners Meetings

Commissioners can participate in voting when they are:

- Physically present at the meeting.
- Participating by conference call, video call or other means of communication (provided that all commissioners can see and hear each other clearly, and each commissioner may speak at the same time as other attending members if he/she wishes to do so).
- Absent, by assert his/her opinion in writing and by signing it, then delivered to the President Commissioner or to other member of the Board of Commissioners that will chair the Board of Commissioners' Meeting, on whether he/she agree or disagree on the matters to be discussed, and his/her opinion would be considered as a valid vote in the Board of Commissioners' Meeting.

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



Best Practices

Although the law does not impose express requirement, certain items are of such importance that commissioners need to be physically present, and the company should consider making it compulsory that the commissioners adopt resolutions on such matters in a physical meeting (rather than by written resolution or in a telephone meeting). These items include:

- The approval of the strategic plan and the approval of the company's financial and business plan.
- Calling the AGM, and making decisions on items related to the organization of the AGM.
- The preliminary approval of the annual report of the company.
- Convening or refusing a request by third parties to convene an EGM.
- The election of the President Commissioner.
- The creation and early termination of the authority of executive bodies.
- The suspension of the President Director and the appointment of an interim President Director.
- The reorganization or liquidation of the company.
- Increasing the charter capital and issuing shares.



Best Practices

When participating in Board of Commissioners meetings, each commissioner should:

- Listen and understand oral presentations.
- Ask questions. This is particularly important for presentations or reports given by executives during Board of Commissioners meetings, especially when these materials are presented in a complex or ambiguous manner.
- Request supporting materials. When presented with a particular issue that does not correspond to the commissioner's area of expertise, additional information in the form of studies, independent appraisals or opinions, and other documentation on the subject should be requested prior to the meeting.

9. The Consideration of Written Opinions (Absentee Ballots)

Good corporate governance suggests that the article of association or internal regulations should specify that written opinions of commissioners can be considered in determining the existence of a quorum for Board of Commissioners meetings and the validity of the voting results.



Best Practices

The article of association, internal regulations, or other internal documents should enable Board of Commissioners members to make decisions by absentee vote. However, for resolutions required by the article of association to be adopted by voting in person, the votes of absentees expressing their opinion in written form should not be counted for the quorum. Companies should develop procedures for absentee voting, including the deadline for the delivery of voting ballots and deadline for the return of completed ballots. It should give commissioners enough time to receive the ballots and make decisions on agenda items.

10. Board of Commissioners Decisions

The company articles of association may stipulate that a resolution of the Board of Commissioners' Meeting must be adopted by deliberations to reach consensus. If no consensus is reached by deliberations, the resolutions shall be adopted by voting based on affirmative vote of more than $\frac{1}{2}$ (one-half) of the total votes duly cast at the meeting. In a tie vote, the President Commissioner of the Meeting shall cast the deciding vote.

11. The Minutes of Board of Commissioners Meetings

Boards of Commissioners shall make minutes of meetings of the Board of Commissioners and keep copies thereof.⁴¹ Articles of association of both public and non-public company regulates that any matters that are discussed and decided in the Board of Commissioners' Meeting should be drawn-up in the Minutes of Meeting.

The Minutes of Meeting shall be prepared by a person who attended the meeting and assigned by the Chairman of the Meeting, and the Minutes of Meeting shall be signed by the Chairman of the Meeting and another member of the Board of Commissioners appointed by the Meeting. If the minute of meeting is made by a Notary, no signature is required.

The Minutes of Meeting shall serve as valid evidence for the members of the Board of Commissioners and to any third parties insofar as with respect to the resolutions made at the Meeting.



Best Practices

As legal and regulatory requirements of commissioners become more onerous, minutes are important records to show that the Board of Commissioners has discharged its duty of care. Under good corporate governance practices, the minutes will include the voting of each individual commissioner.

The Board of Commissioners is often required to designate a secretary of the Board of Commissioners to take notes and help prepare the minutes. In international practices, the Corporate Secretary often serves as the secretary of the Board of Commissioners and may sign the minutes as well.

The minutes provide only a brief summary of the Board of Commissioners meeting. In addition to minutes, every meeting should be followed by making verbatim reports that contain a word-for-word account of discussions held. They should form an integral part of the minutes. Verbatim reports from the meeting are supposed to be kept in company's records as a part of the minutes.

41 ICL, Article 116 paragraph a



Regardless of whether the company chooses to keep minutes and/or verbatim reports, the following documents should be preserved together with the minutes and/or the verbatim reports:

- The voting ballots
- The written opinions of directors who were not able to attend.

Each commissioner should also be given a summary of the deliberations of the Board of Commissioners. The company should establish a procedure which ensures that all commissioners will be provided with:

- Copies of the minutes and/or verbatim reports
- Reports detailing the outcome of the voting.

12. The Corporate Secretary and Board of Commissioners Meetings

The ICL as well as CG Code is silent on the role of the Corporate Secretary and Board of Commissioners meetings. However, the CG Code sheds some light on the Corporate Secretary position more related to support the Board of Directors function and not specifically mentioned to support the Board of Commissioners.

→ *For more information on the Corporate Secretary, see Chapter 6.*



Best Practices

The Corporate Secretary should be responsible for administrative and organizational matters with respect to preparing and conducting Board of Commissioners meetings. While the decision to conduct a Board of Commissioners meeting is made by the President Commissioner, the Corporate Secretary should be responsible for handling such matters as:

- Notifying all commissioners of Board of Commissioners meetings
- Sending voting ballots
- Collecting completed ballots and absentee ballots
- Ensuring compliance with the procedures for Board of Commissioners meetings; and
- Keeping the minutes and verbatim reports.

F. The Duties and Liabilities of Commissioners

Each member of the Board of Commissioners shall perform in good faith, prudence, and full of responsibility to perform his supervisory duty and provide advices to the Board of Directors as contemplated in Article 108 paragraph (1) in the interests of the Company and in accordance with the Company’s purpose and objectives.⁴²



Best Practices

In some countries, the Board of Commissioners is legally required to solely act in the interest of the company (without specifying the interest of the company towards its shareholders and/or stakeholders). However, acting solely in the best interest of the company can encourage management to entrench themselves and shareholders (and indeed the legislator) will need to carefully consider whether to require commissioners to act in the best interests of shareholders as well.

It is important to note that when a court action is brought against a commissioner, reasonableness and good faith are presumed. However, the ICL does not define “good faith” or “reasonableness.”

Turning to other jurisdictions for guidance, for example the U.S. and U.K., the concepts of reasonableness and good faith are viewed as fundamental principles of a commissioner’s duty, notably that of care and loyalty.

1. The Duty of Care

Commissioners on the Board of Commissioners are responsible for exercising their rights and discharging their duties in good faith, with care and in a professional manner.

⁴² ICL, Article 114 paragraph (2)



A commissioner should:

- Act honestly and in good faith
- Refrain from being passive
- Use care and prudence to the maximum extent that could be expected from a good commissioner in a similar situation under similar circumstances
- Not cause the company to act unlawfully
- Regularly attend and actively participate in Board of Commissioners meetings
- Place matters on the agenda of Board of Commissioners meetings, and demand such meetings when necessary
- Ensure that an efficient and effective system of internal control is in place
- Demand that the President Director and The Board of Directors' members provide adequate information to the Board of Commissioners so that its members are properly informed on corporate matters
- Exercise a reasonable amount of supervision over management.

2. The Duty of Loyalty

In international corporate governance practice, the duty of loyalty is of central importance to the governance framework, underpinning the effective implementation of key corporate governance issues, for example, monitoring of related party transactions and establishing remuneration policies for members of the Board of Commissioners and members of the Board of Directors.

The duty of loyalty requires commissioners to exercise their powers in the interests of the company as a whole. Simply put, commissioners should not allow personal interests to prevail over the company's interests. The duty of loyalty usually prohibits commissioners from:

- Participating in a competing company
- Entering into any transaction with the company without first disclosing the transaction and obtaining Board of Commissioners or GMS approval

- Using corporate property and facilities for personal needs
- Disclosing non-public, confidential information
- Using company information or business opportunities for private advantage, i.e. personal profit or gain.



Best Practices

The duty of loyalty requires the commissioner to act in the best interest of the company regardless of:

- Who nominated and elected such member
- Pressures from other commissioners, shareholders, or other individuals to take actions or make decisions that are not in the best interest of the company.

It is of fundamental importance that, in carrying out its duties, the Board of Commissioners should not be viewed, or act, as an assembly of individual representatives for various constituencies.⁴³ While specific commissioners may indeed be nominated or elected by certain shareholders (and sometimes contested by others), it is an important feature of the Board of Commissioners' work that commissioners when they assume their responsibilities carry out their duties in an even-handed manner with respect to all shareholders. This principle is particularly important to establish in the presence of controlling shareholders that are able to select all commissioners.

Further, commissioners and affiliated persons (for example, family, friends, and business partners) should not accept gifts from persons interested in Board of Commissioners' decisions, or accept any other direct or indirect benefits. An exception can be made for symbolic gifts that are given as a common courtesy or souvenirs that are given during official events. These exceptions should be described in internal regulations or other internal documents of the company.

43 OECD Principles of Corporate Governance, Annotations to Principle V.B. on the Responsibility of the Board. See also: www.oecd.org

a. Conflicts of Interest

A commissioner should not discharge his/her duties if there is a conflict of interest between him/her and the company and its shareholders.



Best Practices

A conflict of interest may arise when a commissioner or his/her related person:

- Enters into contractual relationship with a company
- Have financial interests in that action in a way that can be reasonably expected to influence the commissioner's behavior contrary to the interests of the company.

➔ *For more information on related party transactions and the role of commissioners in such transactions, see Chapter 12, Section B.3.*

Commissioners should refrain from actions that may potentially result in a conflict between their own interests and the interests of the company. They are also advised to refrain from voting in situations where they have a personal interest in the matter in question. Commissioners should immediately inform the Board of Commissioners about any potential conflicts of interest.

A commissioner must disclose to the Board of Commissioners information about the existence of conflict of interest between him/her and the company. Such information must be disclosed at the first Board meeting after the commissioner is aware of the conflict of interest.

b. Confidentiality of Information



Best Practices

Commissioners should not disclose confidential information or use their access to company information for their personal interests or the interests of third parties. The personal use of confidential information ultimately damages shareholders. It is recommended that:

- Commissioners take steps to protect confidential information.
- Commissioners should not disclose information or use it in their own interests.
- Standards for the use of confidential information should be specified in the internal documents of the company.
- Contracts between the company and commissioners stipulate the obligation of commissioners to not disclose confidential information for a period of 10 years after they leave the company.

To create an effective mechanism to prevent the unauthorized use of confidential information, the company should require commissioners to:

- Notify the Board of Commissioners in writing of their intention to enter into transactions that involve securities of the company or its subsidiaries
- Disclose information about previous transactions with securities of the company in accordance with the procedures for disclosing material facts as specified by securities legislation.

Board of Commissioners members, before taking over their position as a member, should sign a special statement that they are aware of and that they will follow all legal requirements and duties connected with confidential information.

c. Formalization of the Duties of Commissioners



Best Practices

The company should develop and incorporate into its internal documents a list of clearly defined duties of Board of Commissioners members.

3. Commissioner Access to Information



Best Practices

Every commissioner of the Board of Commissioners has a right to request the President Director and member of Board of Directors in the company to provide the information and documents regarding the financial conditions, business performance of various units in the company and of the company itself. It is essential for commissioners to have access to the information they need to properly discharge their duties, including full and accurate responses to their inquiries from members of the executive bodies, and other company officers.

The company should create a mechanism to ensure that commissioners are provided with information about the most important financial and business developments of the company, as well as other developments that may have an impact on shareholder interests. The internal regulations or other internal documents should provide that the President Director, the Board of Directors' members, and heads of major divisions have the duty to promptly submit full and reliable information to the Board of Commissioners. In reaching this goal it is of particular importance to establish co-operation in this field between members of the Board of Commissioners on one hand, and the Corporate Secretary and the Board of Directors of the company, on the other hand.

The company's internal documents should include the right of commissioners to demand information from the executive bodies.

4. Liabilities of Commissioners

Each member of the Board of Commissioners shall share in personal liability for the Company's losses if the Commissioner concerned is at fault or negligent in performing the tasks contemplated in paragraph (2).⁴⁴

In the event that a Board of Commissioners consists of 2 (two) or more members of the Board of Commissioners, the liability contemplated in paragraph (3) shall be apply jointly and severally to each member of the Board of Commissioners.⁴⁵

It is important that customary business practices and other relevant circumstances be taken into consideration to determine the grounds and the amount of commissioners' liability.



Best Practices

The company should:

- Encourage commissioners to perform their duties in a proper way
- Take measures to terminate the authority of commissioners who are responsible for inflicting losses
- Hold commissioners responsible when they do not fulfill their obligations towards the company.

5. When are Commissioners Relieved from Liability and Responsibility in Respect of the Company Losses?

Managing the affairs of a company is a complex process with the risk that decisions made by the Board of Commissioners, acting reasonably and in good faith, will ultimately prove wrong and entails adverse consequences for the company. Commissioners cannot generally be held liable for decisions made in good faith.

⁴⁴ ICL, Article 114 paragraph (3)

⁴⁵ ICL, Article 114 paragraph (4)

Pursuant to Article 114 paragraph (5) of ICL, members of Boards of Commissioners may not be held liable for the losses if they can prove that:

- they have carried out their supervision in good faith and prudence in the interests of the Company and in accordance with the Company's purpose and objectives;
- they do not have any direct or indirect personal interest in the actions of management of the Board of Directors which caused the losses; and
- they have given the Board of Directors advice to prevent the losses arising or continuing.

Commissioners are not relieved from liability after they have resigned from the Board of Commissioners or when they are dismissed from the Board of Commissioners for actions and decisions made during their tenure as a commissioner.

6. Who Can File a Claim against Commissioners?

On behalf of the Company, shareholders representing at least 1/10 (one tenth) of the total number of shares with voting rights may sue in the district court members of the Board of Commissioners who because of their fault or negligence gave rise to losses to the Company.⁴⁶

7. The Minutes of Board of Commissioners Meetings and Commissioner Liability

Article 116 of the ICL stated that the Boards of Commissioners shall make minutes of meetings of the Board of Commissioners and keep copies thereof.



Best Practices

To effectively enforce provisions that regulate the liability of commissioners, it is recommended that the company keep detailed minutes (and possibly verbatim reports) of meetings. It is important for the Board of Commissioners to keep detailed minutes of Board of Commissioners meetings to determine who voted for a certain decision and who can be held liable (to the extent the court considers such factors).

⁴⁶ ICL, Article 114 paragraph (6)

8. Protection from Liability for Commissioners

Article 114 of the Limited Liability Company stipulated that each member of the Board of Commissioners shall be personally liable for the loss suffered by the Company if it resulted from its fault or negligent in performing its duties.⁴⁷ In the event the Board of Commissioners consist of 2 (two) members or more, the responsibility as referred to in paragraph (3) shall jointly and severally apply to each member of the Board of Commissioners.⁴⁸ However, a member of the Board of Commissioners shall not be liable for the loss if it is proven that:⁴⁹

- a. it has performed the supervisory duty with good faith and prudent principle for the interest of the Company and in accordance with its purpose and objective;
- b. it has no, either directly or indirectly, personal interest to the Board of Directors' management over the Company's which causing the Company's loss; and
- c. it has provide advice to the Board of Directors in order to prevent the occurrence or continuity of such loss.



Best Practices

Most companies should allow their commissioners to protect themselves from, or at least limit the liability for, losses incurred while they fulfilled their duties. Such mechanisms are:

- Officer and commissioner liability insurance
- Provisions in the article of association and internal regulations that indemnify commissioners against claims, litigation expenses and liabilities in certain circumstances.

47 ICL, Article 114 paragraph (3)

48 ICL, Article 114 paragraph (4)

49 ICL, Article 114 paragraph (5)

Companies may reimburse a commissioner for expenses incurred in defending a claim related to his/her role as a Board of Commissioners member, if he acted:

- Honestly
- In good faith
- In the best interests of the company
- In compliance with law, the article of association and internal regulations.

A company may wish to obtain liability insurance for commissioners to cover the risk that their actions might result in losses to the company or third parties. Liability insurance for commissioners should allow the company to use civil law remedies more productively. It is also often needed to attract competent commissioners.

G. Evaluation and Education of the Board of Commissioners

To be effective, Board of Commissioners should have the necessary resources to develop and maintain the knowledge and skills of its commissioners. Training programs, based on periodic evaluations of the Board of Commissioners and its members, are fundamental to this end.



Best Practices

The importance of Board of Commissioners evaluations is widely recognized in the international business community. It is also recommended that:

- The Board of Commissioners evaluate its performance annually.
- The annual report reflects the results of the performance evaluation.
- The performance evaluation of the Board of Commissioners and its members may be carried out by:
 - Commissioners through self-evaluation.

An alternative approach calls for confidential Board of Commissioners peer evaluations coordinated by an external party, such as legal counsel or specialized consultants.

1. Self-Evaluation by the Board of Commissioners

A self-evaluation is a useful tool for the Board of Commissioners to privately assess the quality of its work. Through critical reflection and self-evaluation, commissioners can be more responsive to shareholders, investors, and other stakeholders.

Self-evaluation methods include:

- Organizing a retreat and inviting an outside facilitator.
- Organizing a special Board of Commissioners meeting to evaluate the work of the Board of Commissioners or, alternatively, setting aside time during a regular meeting to address performance issues.
- Designing checklists that Board of Commissioners members can use to assess their work.
- Participating in specialized training programs, thereby providing commissioners the opportunity to critically reflect on their performance and develop and share new ideas.



Best Practices

The CG Regulations requires that the internal corporate governance rules of a company should include a mechanism to evaluate the effectiveness of the Board's performance, activities of every committee that it had establish, the Board of Directors and every member of the Board of Commissioners.

Another useful way to evaluate the Board of Commissioners is to invite a consultant, advisor, institute of commissioners, or rating agency to independently assess the Board of Commissioners.

2. Education and Training

In international practices, it is customary for commissioners to take vigorous executive and professional training before they are appointed to the Board.

In many multi-national corporations, it is compulsory to give commissioners (i) periodical corporate training, (ii) corporate governance training and (iii) evaluation of their performance. The training and evaluation of commissioners may be conducted internally or by a third party to ensure impartiality.

The evaluation of the Board of Commissioners and its members can result in important insights into the Board's strengths and weaknesses. This information can also be used by the Board of Commissioners to identify training needs, both collectively and individually. Corporate training events take on added importance in the context of transitional economies, as commissioners need to be kept abreast of changes to the legal and regulatory framework, as well as best practices. All this makes a company education policy for the Board of Commissioners and its commissioners a key success factor in developing and supporting a competent, knowledgeable and vigilant Board.



Best Practices

A variety of organizations contribute to the professional development and training of commissioners. These include stock exchanges, financial institutions, government and industry regulators, business associations, chambers of commerce, institutions of higher education, institutes of commissioners and associations set up to promote good corporate governance practices.

Commissioner training is delivered primarily by two broad types of organizations. One is corporate governance associations, which are devoted to improving corporate governance and provide training as one aspect of that effort. The other is organizations that are focused on commissioners and support, represent and set standards for commissioners. Both types of organizations can be membership associations, such as the National Association of Corporate Directors in the United States, the Institute of Directors in the United Kingdom, and the Brazilian Institute of Corporate Governance. They may serve commissioners without having a membership base, such as the Corporate Governance Centre in Kenya and the Corporate Governance Forum of Turkey.

Training can provide commissioners with:

- New skills
- Increased professionalism
- Greater awareness of relevant issues
- Access to current thinking on governance and other issues
- Opportunities to discuss issues with peers and mentors

H. The Remuneration of Commissioners

Members of the Board of Commissioners are given honorarium/service fees (*uang jasa*) including facility and/or other benefits, including tantieme and retirement benefit (*santunan purna jabatan*) in the amount determined by the GMS.

Details of the remuneration policy for commissioners generally and the remuneration of the individual commissioners should be disclosed in detail in the annual financial statements of the company. Details such as the annual salary and bonus of each commissioner must also be published in the annual financial statements. It should be an explicit item on the agenda of the Annual GMS in order to give shareholders the opportunity to debate over these matters.

The issue of commissioner remuneration is one of the more contentious in the field of corporate governance, and companies are advised to choose a cautious and circumspect approach to the question of Board of Commissioners remuneration. Excessive compensation plans are often perceived as an unjustified privilege of power. Therefore, it is of the utmost importance that commissioner compensation be competitive, yet stay within reasonable limits.



Best Practices

The remuneration payable to commissioners should be equal for all commissioners. Moreover, the fees that a company pays should be competitive, i.e. sufficient to attract competent individuals. They should be set so that they are neither very much below nor above commissioners fees paid at a peer group of companies. Setting a reasonable level of commissioner remuneration is particularly important in order not to jeopardize the special status of independent commissioners. Independent or not, a commissioner's judgment may be clouded if he/she receives a significant percentage of his/her total income in the form of a commissioner's fee. A commissioner who relies on Board compensation for his/her livelihood will soon become beholden to the company and may not be relied upon to fill his/her responsibilities in an unbiased manner.

The Board of Commissioners should regularly review the remuneration of commissioners. Pursuant to Article 66 of the ICL, the Board of Commissioners should review the company annual report submitted by the Board of Directors, part of which report deals with the Board of Commissioner remuneration.



Best Practices

Ideally, this should be done either by a remuneration committee, composed entirely of independent commissioners, or by the independent commissioners. The company should disclose its remuneration plan and the remuneration of each commissioner, either on an individual basis or in the aggregate, in its annual report. The former is easiest to implement when all Board members receive the same fees with a simple statement in the annual report: “All commissioners receive fees of _____ per year.”

Great care needs to be exercised in establishing performance-based remuneration, in particular, stock-based remuneration. Performance-based remuneration is generally considered a factor that impinges on commissioner independence.



While stock-based remuneration is common in the U.S., it is a good deal less common elsewhere and considerable controversy still surrounds it. Stock-based remuneration plans and, in particular, stock option plans are complex arrangements. While they are generally thought to provide incentives for commissioners and directors, they can also have a significant impact upon the company and shareholders.

- Stock options, it is argued, cause commissioners to focus on short-term performance and stock price movements
- If stock option grants are large, they may also create complicity between commissioners and directors who stand to make enormous sums from short-term price movements
- Shareholders risk share dilution when large option plans are granted
- Finally, large option grants have not prevented managers from manipulating companies and financial information to their benefit.

Consequently, option plans are coming under increasing scrutiny. Such plans require careful consideration, good planning, and special disclosure. Companies may be best served by avoiding stock options for commissioners.

If a company chooses to implement stock option plans, it should be transparent about the costs in terms of share dilution. The company should also be transparent about the accounting methods used to measure the costs of stock and option grants. Best practices would call for shareholder approval of stock, or option based compensation plans that could dilute shareholder value or affect profits.

Personal loans or credits to the company's commissioners are also a minefield and a potential source of controversy that companies would be well advised to avoid.



Company Practices in Indonesia

The low level of remuneration compared to the importance of the Board of Commissioners is striking. Whatever the explanation, it seems clear that commissioner remuneration needs to receive greater attention. Transparent systems of remuneration, capable of attracting qualified commissioners, need to be put in place.

I. Summary Checklist to Determine the Board of Commissioners' Effectiveness

Questions	Yes	No
<p>Has the Board of Commissioners recently devoted a significant amount of time and serious thought to the company's longer-term objectives and to the strategic options open to it for achieving them? If so, have these deliberations resulted in a Board consensus or decision on its future objectives and strategies, and have these been put in writing?</p>		
<p>Has the Board of Commissioners consciously thought about and reached formal conclusions on what is sometimes referred to as its basic corporate philosophy that is, its value system, its ethical and social responsibilities, its desired 'image' and so forth? If so, have these conclusions been set forth in explicit statements of policy, for example, in respect of terms of employment? Does the company have formal procedures for recording and promulgating major Board of Commissioners decisions as policy guidelines for line managers?</p>		
<p>Does the Board of Commissioners periodically review the organizational structure of the company and consider how this may have to change in future? Does it review and approve all senior appointments as a matter of course? Are adequate human resource development programs in place?</p>		
<p>Does the Board of Commissioners routinely receive all the information it needs to ensure that it is in effective control of the company and its management? Have there been any unpleasant surprises, for example, unfavorable results or unforeseen crises that could be attributed to a lack of timely or accurate information?</p>		
<p>Does the Board of Commissioners routinely require the President Director to present his/her annual plans and budgets for their review and approval? Does the Board regularly monitor the performance of the President Director and his/her immediate subordinate managers in terms of actual results achieved against agreed plans and budgets?</p>		
<p>When the Board of Commissioners is required to take major decisions on questions of future objectives, strategies, policies, major investments, senior appointments, does it have adequate time and knowledge to make these decisions soundly, rather than finding itself overtaken by events and, in effect, obliged to rubber-stamp decisions already taken or commitments already made?</p>		

If the answers to all of these questions are yes, it is safe to say that the company's Board of Commissioners can be considered effective. On the other hand, if the answers are negative, or perhaps not clear, then the company needs to reevaluate the composition and role of its Board of Commissioners and undertake other activities on improving its work.

Chapter **5**

**THE BOARD OF
DIRECTORS**

Table of Contents

A. THE BOARD OF DIRECTORS AND THEIR AUTHORITIES	185
1. The Authority of the Board of Directors	187
B. THE COMPOSITION OF THE BOARD OF DIRECTORS	191
1. Who Can Be a President Director or a Board of Directors' Member?	191
2. Qualifications of the President Director and Board of Directors' Members	192
3. The Composition of the Board of Directors	194
C. THE FORMATION AND TERMINATION OF THE BOARD OF DIRECTORS	195
1. The Election and Term of the Board of Directors' Members	195
2. The Termination of the Authority of the Board of Directors	199
D. THE WORKING PROCEDURES OF THE BOARD OF DIRECTORS	200
1. The President of the Board of Directors	200
2. The Board of Directors' Meetings	201
3. The Right to Call a Board of Directors' Meeting	201
4. Meeting Notification	202
5. The Quorum of the Board of Directors' Meetings	202
6. Voting During the Board of Directors' Meetings	203
7. The Minutes of the Board of Directors' Meetings	203

Table of Contents

E. THE DUTIES AND LIABILITIES OF THE MEMBERS OF THE BOARD OF DIRECTORS	205
F. PERFORMANCE EVALUATIONS	206
G. THE REMUNERATION AND REIMBURSEMENT OF THE BOARD OF DIRECTORS	207
1. Remuneration Policy	208
2. Employment Contracts for Directors	210
3. Severance Payments to the President Director and Board of Directors' Members	212



The Chairman's Checklist

- ✓ Does the company have a clear delineation and separation of authorities between shareholders, commissioners and directors? Has the company properly established a Board of Directors? Does the AoA or some other general act of the company clearly distinguish the powers of the President Director from those of the Board of Directors' members?
- ✓ Do the President Director and all Board of Directors' members possess the knowledge and skills necessary to manage the company? Do they perform their functions on a full-time basis? Is there a transparent division of tasks among the Board of Directors' members, such as finance, legal, marketing and operations?
- ✓ Who elects members of the Board of Directors? Is the President Director sufficiently involved in the nomination process of other Board of Directors' members?
- ✓ Do the Board of Directors meet regularly to discuss the affairs of the company? Are these meetings well prepared, with an agenda and reference materials distributed in advance (in writing and/or electronically)?
- ✓ Do the President Director and the Board of Directors' members regularly and adequately inform the Board of Commissioners about all operations of the company? Do the Board of Directors provide all relevant information to the Board of Commissioners, the Committees of the Board and the External Auditor in a timely manner?

- ✓ Do all members of the Board of Directors clearly understand their duties to act reasonably and in good faith in the best interests of the company? Does the Board of Commissioners take measures to ensure that Directors who fail to act in accordance with these duties are held liable under civil, administrative, and/or criminal law?
- ✓ Are thorough performance reviews of the Board of Directors based on periodically conducted analysis of key performance indicators? Does the Board of Commissioners rigorously evaluate directors at least annually, if not more frequently? Does the Board of Commissioners clearly link performance and remuneration when deciding on directors' remuneration?
- ✓ Do all commissioners fully understand how stock options function? Are all commissioners and shareholders aware of the different methods of recording and reporting the cost of stock options? Has the Board of Commissioners critically examined the use of options as an incentive tool, ensured that option grants are not merely a management giveaway and communicated this fully and effectively to shareholders? Is the shareholders meeting properly informed before the shareholders decide to issue stock options or to delegate that authority to the Board of Commissioners?

This chapter describes the composition of “executive bodies” as they are often structured in practice, and the authorities, formation and working procedures of such executive bodies, as well as their interaction with the Board of Commissioners, their duties evaluation, liabilities and remuneration.

The executive body of a limited liability company in Indonesia is called the Board of Directors (BoD) and it is one of the three organs of a company.¹ The ICL provides definition of the Board of Directors as the Company Organ with full authority and responsibility for the management of the Company in the interests of the Company in accordance with the Company’s purposes and objectives and to represent the Company in and out of court in accordance with the provisions of the AoA.²

As it is the central organ of a company, provisions on the Board of Directors, its structure, roles and responsibilities, authority, meetings, members’ nomination, appointment, and remuneration are stipulated in the ICL, CG Code as well as companies’ AoA.

1 ICL, Article 1 paragraph (2)

2 ICL, Article 1 paragraph (5)

A. The Board of Directors and Their Authorities

Board of Directors is the Company Organ with full authority and responsibility for the management of the Company in the interests of the Company in accordance with the Company's purposes and objectives and to represent the Company in and out of court in accordance with the provisions of the AoA.³

Furthermore, Article 92 paragraph (3) to (6) of the ICL stipulates that companies' Boards of Directors shall consist of 1 (one) or more members of the Board of Directors. Companies whose business is related to the collection of and/or management of the public's funds, Companies which issue acknowledgements of indebtedness to the public, or Public Companies must have at least 2 (two) members of the Board of Directors. In the event that the Board of Directors consists of 2 (two) or more members of the Board of Directors, the division of management tasks and authority between the members of the Board of Directors shall be determined by a GMS resolution and in the event that the GMS does not make any determination, the division of the tasks and authority of the members of the Board of Directors shall be determined by a resolution of the Board of Directors.

While the CG Code regulated, each member of the Board of Directors can carry out its duty and take decisions in accordance with their respective assignments and authorities. However, the execution of tasks by each member of the Board of Directors remains to be a collective responsibility. The position of each respective member of the Board of Directors including President Director is equal. The duty of the President Director as *primus inter pares* is to coordinate the activities of the Board of Directors.⁴

³ ICL, Article 1 paragraph (5)

⁴ Indonesia's CG Code Part IV.D



Best Practices

In Indonesia, the establishment of a Board of Directors is mandatory for limited liability companies. Regardless of the fact that the establishment of the Board of Directors is not mandatory for all companies, it is always recommended. However, companies could consider setting out a mechanism in their charters for the Board of Directors to make decisions on a collective rather than an individual approach, at least for important company decisions. When such issues are brought before the Board of Directors, it can facilitate discussion and coordination among key managers and help them to arrive at a decision which is most beneficial to the company.

The Board of Directors assembles the key resources at the President Director's disposal to help achieve the company's goals. Larger companies may need a Board of Directors to deal with more complex business models and organizational structures. Smaller companies typically have simpler business models and fewer resources to establish formal structures.



Best Practices

The work of the Board of Directors should be guided by an annual work plan that is delivered annually to the Board of Commissioners or the GMS as stated in the AoA. The annual work plan should contain basic guidelines for the daily operations of the company. Good corporate governance principles further recommend that:

- The President Director and the Board of Directors seek the approval of the Board of Commissioners for transactions that fall outside the scope of the financial and business plan (non-standard operations)
- The company develop internal regulations or other internal documents detailing procedures for the President Director and the Board of Directors to obtain such approval from the Board of Commissioners
- The Board of Commissioners has the right to veto decisions made by the President Director and the Board of Directors to implement non-standard operations.

1. The Authority of the Board of Directors

ICL sets out that the Board of Directors, as an executive unit, shall undertake its duty to manage the company for the interest of the company in the pursuit of its purposes and objectives.⁵ The Board of Directors shall have the authority to manage the company in accordance with the policy which is considered accurate, and shall be in accordance with the provision as regulated under the ICL and/or the AoA.⁶ Further, the CG Code stated that the Board of Directors as a company organ shall function and be responsible collegially for the management of the company. Each member of the Board of Directors can carry out its duty and take decisions in accordance with their respective assignments and authorities. However, the execution of tasks by each member of the Board of Directors remains to be a collective responsibility. The position of each respective member of the Board of Directors including President Director is equal.⁷ Furthermore, any such mechanism must be provided for in detail in the AoA of the company.

ICL specifies several of the Board of Director's duties and obligations, which include:

- undertake the management of Companies in the interest of the Companies and in accordance with the Companies' purpose and objectives⁸
- represent Companies in and out of the courts⁹
- make a register of shareholders, special register, GMS minutes, and minutes of meetings of the Board of Directors; make annual reports and the Company's financial documents as contemplated in the Company Documents Act; and maintain all registers, minutes and the Company's financial documents and others of the Company's documents.¹⁰

Regarding the day to day management of the company, the Board of Directors' duties and responsibilities are stipulated in the company's AoA. The Indonesia's CG Code provides general guidelines which stipulate that the duties of the Board of Directors shall cover 5 (five) main tasks, namely in the areas of management, risk management, internal control, public relation, and social responsibility.

5 ICL, Article 92 paragraph 1

6 ICL, Article 92 paragraph 2

7 The Indonesia's CG Code Part IV.D

8 ICL, Article 92 paragraph (1)

9 ICL, Article 98 paragraph (1)

10 ICL, Article 100 paragraph (1)

Management¹¹

1. The Board of Directors shall formulate the vision, mission, and values of the company as well as the short and long term program of the company to be discussed and approved by the Board of Commissioners or GMS in accordance with the AoA;
2. The Board of Directors shall be able to manage resources of the company effectively and efficiently;
3. The Board of Directors shall consider the interest of the stakeholders properly;
4. The Board of Directors may delegate certain authority to the committee established in support of the execution of its duty or to an employee of the company to carry out a certain duty, but the ultimate responsibility shall remain with the Board of Directors;
5. The Board of Directors shall have work rules and guidelines set out in a charter to ensure that its duties can be executed in an objective and effective manner. The charter can also be used as one of the tools for appraising performance.

Risk Management¹²

1. The Board of Directors shall establish and implement a sound risk management within the company covering all aspects of the company's activities;
2. Each strategic decision taken, including the creation of new products or services, shall carefully consider its risk exposures, ensuring appropriate balance between the benefit and risk.
3. To ensure proper implementation of the risk management, the company shall have a work unit or a person in charge for such function.

Internal Control¹³

1. The Board of Directors shall establish and maintain a sound internal control system to safeguard company's assets and performance and its compliance with laws and regulations;

11 Indonesia's CG Code Part IV.D.3.1

12 Indonesia's CG Code Part IV.D.3.2

13 Indonesia's CG Code Part IV.D.3.3

2. Publicly listed companies, state-owned enterprises, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, shall have an internal control function or unit;
3. The internal control function or unit shall to assist the Board of Directors in ensuring the attainment of objectives and business sustainability by: (i) evaluating the implementation of the company's program; (ii) providing recommendations to improve the effectiveness of the risk management process; (iii) evaluating the company's compliance with company's regulations, implementation of GCG and the laws and regulations; and (iv) facilitating sound coordination with external auditor;
4. The internal control unit or the head of an internal control function shall be responsible to the President Director or to the Director in charge for the internal control function. The internal control unit has a functional relation with the Board of Commissioners through the Audit Committee.

Public Relations¹⁴

1. The Board of Directors shall ensure the existence of a sound communication between the company and its stakeholders by empowering the function of a Corporate Secretary;
2. Function of the Corporate Secretary is to ensure: (i) a sound communication between the company and its stakeholders; and (ii) the availability of information that is accessible to stakeholders in accordance with the proper need of stakeholders;
3. Publicly listed companies, state-owned enterprises, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, shall have a Corporate Secretary whose function may also include investor relations;
4. In the event that the company does not have a separate compliance work unit to ensure the compliance with laws and regulations, such function shall be carried out by the Corporate Secretary;

14 Indonesia's CG Code Part IVD.3.4

5. The Corporate Secretary or the person who executes the Corporate Secretary's function shall be responsible to the Board of Directors. Report on the implementation of the Corporate Secretary's duty shall also be submitted to the Board of Commissioners.

Social Responsibility¹⁵

1. In preserving the company's sustainability, the Board of Directors shall be able to ensure the fulfillment of the company's social responsibility;
2. The Board of Directors shall have a clear and focused written planning in meeting the company's social responsibility.

15 Indonesia's CG Code Part IVD.3.5

B. The Composition of the Board of Directors

1. Who Can Be a President Director or a Board of Directors' Member?

Those who may be appointed as members of the Board of Directors are individuals capable of performing legal actions, except those who in the 5 (five) years previous to their appointment had:¹⁶

- a. been declared bankrupt;
- b. been members of a Board of Directors or a Board of Commissioners declared to be at fault in causing a Company to be declared bankrupt;
- c. been sentenced for crimes which caused losses to the state and/or were related to the finance sector.

The ICL regulates that members of the Board of Directors are appointed by the GMS.¹⁷ AoA shall regulate the procedures to appoint, replace, and dismiss members of the Board of Directors, and may also regulate the procedures to nominate the members of the Board of Directors.¹⁸ The CG Code recognizes the position and role of the President Director as a coordinator of the activities of the Board of Directors (as *primus inter pares*).

➔ *For more information on concepts of (i) persons who are prohibited from management of enterprises and (ii) related persons, see Chapter 4, Section C.2.*

16 ICL, Article 93

17 ICL, Article 94 paragraph (1)

18 ICL, Article 94 paragraph (4)



Best Practices

Best practices dictate that individuals should not be appointed to the Board of Directors when they are:

- Directors of a competing company;
- Managers of a competing company; or
- Employees of a competing company.

The President Director of the Board of Directors should not be engaged in any business activities other than those related to the management of the company and the governance of its subsidiaries.

2. Qualifications of the President Director and Board of Directors' Members

The Board of Directors can only be effective when they have adequate financial and human resources, as well as members with the necessary experience, knowledge, skills and time to exercise their duties.



Best Practices

AoA or the internal regulations should specify the qualifications of members of the Board of Directors as well as heads of major divisions. Members of the Board of Directors should generally satisfy the following requirements:

- To enjoy the trust of shareholders, Board of Commissioners, other directors and employees of the company
- To own the ability to relate to the interests of all stakeholders and to make well-reasoned decisions
- To possess the professional expertise, education and appropriate organizational skills

- To possess (international) business experience, knowledge of national economic, political, legal and social issues, as well as trends and knowledge of the market, products and competitors (national as well as international)
- To have the ability to translate knowledge and experience into practical solutions that can be applied to the company.

Moreover, a background check on candidates should be conducted for a possible record of criminal or administrative offenses. Evidence of such offenses would likely result in the rejection of a candidate.

ICL does not have any provisions regarding the specific qualifications for the Board of Directors' member. They are highly varied depending on the business, size and company's need. However, again, The CG Code provides general guidelines for company's reference where members of the Board of Directors must be professionals that possess the integrity, experience and capability required for carrying out their respective duties.

In more detail, The CG Code provides guidelines in the aspects of capability and integrity, as follows:¹⁹

1. Members of the Board of Directors shall have the capability and integrity required to ensure the proper execution of management function;
2. Members of the Board of Directors are prohibited from utilizing the company for his/her personal, family, business group and or other parties' interests;
3. Members of the Board of Directors shall understand and comply with the AoA and the laws and regulations as related to their duties;
4. Members of the Board of Directors shall understand and implement the GCG Code.

19 Indonesia's CG Code Part IVD.3.2

3. The Composition of the Board of Directors

The number of the Board of Directors' members should be set forth in the company's AoA, the internal regulations or a specific resolution from the Board of Commissioners.

The ICL Article 92 regulates that the Board of Directors of a company shall consist of 1 (one) or more members. In the event that the Board of Directors consists of 2 (two) or more members, the division of management tasks and authority between the members of the Board of Directors shall be determined by a GMS resolution. In the event that the GMS does not determine the division of management tasks and authority, then such management task and authority shall be determined by the Board of Directors Meeting. Further, for companies engaging in collection of and/or management of the public's funds, companies which issue acknowledgements of indebtedness to the public, or public companies must have at least 2 (two) members of the Board of Directors.

The provision of the CG Code stated that the composition of the Board of Directors shall enable it to make effective, right and timely decisions and to act independently, and shall be of sufficient size that suits the complexity of the business of the company by taking into account the effectiveness in decision making.



Company Practices in Indonesia

The size of the Board of Directors will need to be adapted to the specific circumstances of the company and, consequently, will vary in composition. It will dominantly depend on the activities of the company, size (number of employees), level of development and other characteristics of the company. All this is important for determining the optimal number of directors, their qualifications and professional skills. The Board of Directors might include the following persons:

- The President Director
- The Chief Operating Officer/Operation Director
- The Chief Financial Officer/Finance Director
- Marketing and Sales Director
- General Affairs Director
- The Human Resources Director.

C. The Formation and Termination of the Board of Directors

1. The Election and Term of the Board of Directors' Members

President Director

Article 94 of the ICL provides regulations regarding the appointment, replacement and dismissal of members of the Board of Directors, which covers:

- (1) Members of Boards of Directors shall be appointed by the GMS
- (2) Members of Boards of Directors shall be appointed for a certain period and may be re-appointed
- (3) AoA shall provide procedures for the appointment, replacement and dismissal of members of the Board of Directors and may also provide procedures for nominating members of the Board of Directors
- (4) Resolutions of GMS with regard to the appointment, replacement, and dismissal of members of the Board of Directors shall also determine when the appointment, replacement or dismissal comes into effect.

The CG Code reinforced the provision above and stated that members of the Board of Directors are appointed and terminated by the GMS through a transparent process. For publicly listed companies, SOEs, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, the process of evaluating the candidates for the member of the Board of Directors is carried out by the Nomination and Remuneration Committee prior to the GMS.



High-level personnel decisions, in general, and the selection of Board of Directors members, more specifically, are best accomplished by the President Director, in tandem with the Board of Commissioners. Personnel decisions should not be political decisions. The assessment of the skills and qualifications of potential Board of Directors members is best done by someone who works day in, day out with potential candidates. Shareholders or Board of Commissioners that insist on close control over this process may be better served by developing policies that specify outcomes rather than getting involved in the details of selection. Drafting precise and effective terms of reference for key executive positions is but one example. At the very least, proposals for membership on the Board of Directors should be closely coordinated with the President Director, by having him/her nominate and the Board of Commissioners approve candidates.

Almost every corporate governance system has the Board of Commissioners elect the President Director and other Board of Directors members. In Indonesia, although the ICL only expressly requires that the Board of Directors elect the President Director and is silent on other Executive Board members, it is common for joint venture companies to require that the Board of Directors approve certain executive positions, such as Deputy President Director, Chief Operating Officer, or Chief Accountant. The Board of Commissioners is in a better position compared to shareholders to set the key criteria for what kind of President Director the company needs, organize proper succession planning and search for such a person. For this purpose, the Board of Commissioners may set up an independent Human Resource Committee, which will be in charge of making a recommendation as to potential candidates for the position of President Director. Shareholder interests are not adversely affected, as Board of Commissioners members are bound by their duties of loyalty and care to act in the best interests of the company and its shareholders. It is especially advisable to delegate this power to the Board of Commissioners in countries in transition such as Indonesia, where Board of Commissioners are nascent in their development vis-à-vis controlling shareholders, and need to be strengthened. Finally, because management oversight is one of the Board of Commissioners main

authorities, the Board's authority to dismiss the President Director and other members of the Board of Directors should coincide with its authority to elect these important individuals.

A public company may consider delegating the Human Resource Committee (if any) with the following duties in connection with the appointment of Board of Directors' members:

- Submit the proposal for a Board of Directors' member
- Give an opinion on proposals for the appointment of Executive Board members originating from shareholders or the Board of Commissioners
- Draft or evaluate the draft of appointment procedures for Executive Board members
- Periodically (at least twice a year) assess the size and composition of the Executive Board, conditions for the appointment and make recommendations with regard to any changes, which will be presented to the shareholders at the next GMS.

Shareholders should have the opportunity to receive sufficient information (in writing and/or electronic form) about candidates for the position of President Director and Board of Directors before the GMS. Up-to-date information should also be made available to all shareholders during the GMS. The information about candidates for the executive bodies should include the:

- Identity of the candidate
- Age and educational background of the candidate
- Position(s) held by the candidate during the last five years
- Position(s) held by the candidate at the moment of his/her nomination
- Relationship(s) that the candidate has with the company
- Membership(s) of the candidate in the Board of Directors of other legal entities, or any other positions held in such entities
- Information on the nomination(s) of the candidate for a position in executive bodies and other positions of other legal persons
- Relationship(s) of the candidate with affiliated persons
- Relationship(s) that the candidate has with major business partners of the company
- Information related to the financial status of the candidate and other circumstances that may affect the duties of the candidate as a member of executive bodies
- Refusal of the candidate, if any, to provide information to the company.

It is recommended that candidates present a written statement to the Board of Directors that indicates their willingness to accept the position of President Director or Board of Directors member, should they be elected for that position. In the absence of such a statement, candidates should verbally confirm that they are willing to accept the position.

ICL does not set the maximum term, neither limit the re-election of the board of Directors' member for a certain number of terms. The company's AoA would specify the period. However, the common practice in Indonesia is that the terms usually 5 years and can be re-elected for maximum 2 times. Please note that members of the Board of Directors may be dismissed at any time by virtue of a GMS resolutions stating the reason therefor.²⁰

For public listed company, Regulation Number IX.J.1 in Article 13(b) provides that term for the member of the Board of Director and Board of Commissioner must not exceeds 5 (five) years for 1 period or until the end of the annual GMS at the end of 1 period of tenure.



Best Practices

It is recommended that the Board of Directors' members be elected for a period that will enable them to become acquainted with the company's business and not to be constrained by short-term goals.

²⁰ ICL, Article 105 paragraph (1)

2. The Termination of the Authority of the Board of Directors

AoA of the Company shall provide procedures for the appointment, replacement and dismissal of members of the Board of Directors. Resolution of GMS regarding this matter shall also determine when the appointment, replacement and dismissal come into effect. The Board of Directors shall notify the change of members of the Board of Directors to the MOLHR to be registered in the Company Registry, within the latest period of 30 (thirty) days as of the resolution date of the GMS.²¹

21 ICL, Article 94 paragraph (4), (5) and (6)

D. The Working Procedures of the Board of Directors

1. The President of the Board of Directors

The Board of Directors is a governing body, which operates according to procedures defined by the ICL, the AoA, or the internal regulations of the company. The Board of Directors of a Company shall consist of 1 (one) member of the Board of Directors or more. For Companies engaging in mobilizing public funds, issuing debt instrument or an Issuer shall have a minimum of 2 (two) members of Board of Directors. In the event the Board of Directors consists of 2 (two) members of the Board of Directors or more, the distribution of duty and authority among the members of the Board of Directors shall be determined based on the GMS resolution.²²

President Director for Board of Directors meetings, the President Director should have the authority to:

- Convene, organize and preside over Board of Directors' meetings;
- Sign all documents, decisions and minutes of the Board of Director;
- Perform any other duties as specified in the AoA, internal regulations or a resolution of the Board of Commissioners.



Best Practices

In addition, the Chairman of the Board of Directors (President Director) can:

- Facilitate discussions and decision-making and create a constructive atmosphere
- Take steps to ensure that all members are sufficiently prepared to contribute to the work of the Board of Directors.

²² ICL, Article 92 paragraph (3), (4) and (5)

2. The Board of Directors' Meetings

The AoA, or a specific resolution by the Board of Directors should establish:

- The frequency of Board of Directors meetings
- The procedures for organizing and conducting Board of Directors meetings
- The procedures for making decisions during Board of Directors meetings.



Best Practices

The precise frequency of meetings should, however, ultimately depend on the unique circumstances of each company.

3. The Right to Call a Board of Directors' Meeting

The AoA or a specific resolution by the Board of Directors should establish who has the power to convene a meeting of the Board of Directors. It usually stipulated in the AoA that the President Director have this power.



Best Practices

The Board of Directors is a hands-on, problem-solving mechanism. Other Board of Directors members should also have a voice in calling Board of Directors meetings and setting the meeting agenda.

The AoA or a specific resolution by the Board of Directors must specify the procedures for convening and conducting Board of Directors meetings.

4. Meeting Notification

Since the Board of Directors is a management tool, it will likely need to respond to the changing demands of the company and its external environment, and be prepared to act quickly. While rapid response is necessary, it may make careful and extensive preparation for meetings difficult and, in some cases, impossible. Obviously, Board of Directors' members should be as well-prepared as practical. They should be notified in advance to give them time to prepare and effectively participate in meetings.



Best Practices

Directors should not vote on agenda items unless they are well informed. Whenever possible, materials should be sent to Board of Directors' members in advance, together with the notice and the meeting agenda, to give them sufficient time to explore all the questions that will be raised at the meeting and to decide how they will vote. This may, however, not always be the case and, under some circumstances, sound decision-making may not be possible. Decision-making may be postponed when members:

- Cannot be notified in a timely manner
- Have not received the required information on time
- Have not been provided with sufficient time to prepare for the meeting.

The internal regulations or other internal documents should determine the form in which notice and materials are to be delivered to Board of Directors' members in the most convenient and appropriate way.

5. The Quorum of the Board of Directors' Meetings

The quorum of Board of Directors meetings refers to the number of members that must participate in the meeting before it can make a valid decision. The AoA or a specific resolution by the Board of Directors should specify the required quorum for Board of Directors meetings. The quorum should not be less than one half of the total number of Board of Directors members. A Board of Directors' meeting that lacks a quorum cannot make valid decisions. However, usually under the AoA, in the event that

the quorum for meeting of Board of Directors is not fulfilled, then the second meeting can be held in the next day, and the President Director can decide solely if in the second meeting, the quorum was not fulfilled again.

6. Voting During the Board of Directors' Meetings

A simple majority of Board of Directors members who participate in the meeting should be sufficient to approve Board of Directors decisions, unless the AoA or a specific resolution by the Board of Directors require a supermajority vote. Each Board of Directors' member should have one vote. The AoA, internal regulations or a resolution by the Board of Directors can specify that the President Director can cast a deciding vote in the case of a tie.

7. The Minutes of the Board of Directors' Meeting

Boards of Directors shall make a register of shareholders, special register, GMS minutes and minutes of meetings of the Board of Directors. All registers and minutes, and the Company's financial documents and others of the Company's documents as contemplated above shall be kept in the Company's domicile.²³



Best Practices

The minutes of Board of Directors meetings should include the following information:

- The location and time of the meeting
- The names of the persons present at the meeting
- The agenda of the meeting
- The issues on the agenda, as well as the voting results on an individual basis
- The decisions made by the Board of Directors
- The rationale for the decisions.

²³ ICL, Article 100 paragraph (1) and (2)

The President Director (or the Chairman of the Board of Directors,) should sign the minutes.



Best Practices

Although it is not legally compulsory, in order to practice good corporate governance and improve transparency, the minutes of the Board of Directors meeting should be made available upon the request of:

- Board of Commissioners or Audit Committee members
- The External Auditor
- A shareholder (or a group of shareholders) possessing voting shares.

E. The Duties and Liabilities of the Members of the Board of Directors

The members of the Board of Directors have the same duties of care and loyalty as Board of Commissioners members, and are subject to the same liability standards as Board of Commissioners members, unless either the AoA, internal regulations, other general internal documents, or employment contract provide for stricter standards.

→ *For more information about the duties and liabilities of directors, see Chapter 4, Section E.*

F. Performance Evaluations

Periodic performance evaluations of the Board of Directors are an important oversight tool. They can help create a system of constant performance management. The results of periodic evaluations can be a solid ground for defining measures for the work improvement of this corporate body.



Best Practices

The AoA or internal regulations of the company can stipulate that the performance of the Board of Directors be evaluated by the Board of Commissioners at least annually, if not more frequently. The Board of Commissioners may also find it useful to receive evaluations on the performance of the Board of Directors that are carried out by the President Director and Board of Directors members themselves, through self-evaluation within the framework of the company's human resources performance evaluation and planning process.

→ *For an example of a self-evaluation framework, see Chapter 4, Section G.*

G. The Remuneration and Reimbursement of the Board of Directors

The provision regarding the amount of remuneration of the members of the Board of Directors shall be determined based on the resolution of GMS and may be conferred to the Board of Commissioners.²⁴



Best Practices

Executive remuneration is an important aspect in attracting managerial talent. Excessive executive remuneration packages, on the other hand, are often perceived as an unjustified privilege of power. Consequently, it is of the utmost importance that executive compensation be competitive, yet stay within reasonable limits, ideally in relation to a peer group of companies.

The remuneration of executives should not be left to the sole discretion of the executive bodies themselves. This should fall under the Board of Directors' authority. Companies should state in their charters that the approval of executive remuneration is a prerogative of the Board of Directors. It is important that the Board of Directors take into consideration performance-related factors that are based on the company's key performance indicators when determining the remuneration of executives. Some of the issues that have a bearing on remuneration are:

- Scope of responsibilities
- Required type and level of qualifications
- Experience of the candidates
- Personal and business qualities of the candidates
- Typical level of remuneration in the company and in the industry in general
- The financial performance of the company.

²⁴ ICL, Article 96 paragraph (1) and (2)

Comparative corporate governance practice usually divides an executive director's remuneration into two parts, base salary and variable part (performance-related remuneration). An executive's base salary is usually a function of his/her background and experience, whereas variable compensation is generally based upon the executive's performance.

1. Remuneration Policy

As a matter of good corporate governance, the remuneration policy for the individual directors should be disclosed in detail in the annual financial statements of the company. It should be an explicit item on the agenda of the annual GMS to give shareholders the opportunity to debate these matters.

The Remuneration Committee (if it is established) should draft a proposal to the Board of Commissioners for the remuneration policy or give an opinion on the remuneration policy proposal made by the Board of Commissioners.

The remuneration of directors can consist of a fixed and a variable component.

The fixed component typically consists of a base salary. The most important factor in determining an executive's base salary is compensation practice among a peer group of similar companies.

The most important factor in determining an executive's variable remuneration is his/her contribution towards the short and long-term financial performance of the company. The variable component often consists of an annual bonus and is based on key performance indicators. Variable compensation has come to represent a large part of an executive's remuneration package in many countries, to better motivate performance.



The variable component of the remuneration should align the interests of the executive directors with the long-term interests of the company and its shareholders. There are many ways to link executive pay to individual and company performance. Some common financial indicators utilized in variable compensation plans are:

- Earnings before interest, taxes, depreciation and amortization (EBITDA)
- Operating profit
- Return on Assets (ROA)
- Return on Investment (ROI) or Equity (ROE)
- Return on Capital Employed (ROCE)
- Economic Value Added (EVA) and
- Achievement of specific individual objectives.

There are many other financial indicators. Non-financial indicators are equally important and valuable in managing executive performance, and can be organized around:

- **Customers:** For example, customer satisfaction levels, retention rates, customer loyalty and acquisitions
- **Operational Processes and Efficiency:** For example, quality, cycle time and cost measures, and after sales service
- **Internal Growth/ Knowledge Management:** For example, training programs, employee satisfaction rates, absenteeism and turnover.

The Board of Directors will want to carefully develop key performance indicators and link executive remuneration to these indicators.

The practice of offering executives long-term incentives such as shares options has now been exercised widely in Indonesian companies. Currently, it is very common to offer a competitive compensation package, of which shares options or performance-related bonuses comprise a major part, to executives of public companies.



While remuneration is generally considered a responsibility of the Board of Directors, stock-and option-based compensation is increasingly an issue for which shareholder approval is required. The reason is that equity compensation contains considerable hidden costs for shareholders. These costs are hidden since accounting practices do not generally reveal the true price-tag of option-based compensation plans. For this reason, more and more companies are attempting to disclose the true cost of option compensation. In addition, some exchanges such as the New York Stock Exchange and the NASDAQ now require shareholder approval of all equity-based compensation plans.²⁵

While remuneration plans may serve to attract top executive talent and motivate better performance, the field of executive remuneration is both complex and a lightning rod for shareholder and public criticism. Companies that introduce such plans, in particular stock-option plans, should do so with a good deal of circumspection and a maximum level of transparency.

2. Employment Contracts for Directors

The ICL is silent on the contract for Board of Directors, and a director is not considered as employee under the Indonesian Manpower Law. From a legal point of view, such contract can be considered as a commercial contract rather than an employment contract. The Board of Director is a company organ appointed by the GMS, and such appointment being reflected in the Deed of Minutes of GMS meeting made before the Public Notary. GMS will decide the policy and amount of the remuneration that will be given to the members of Board of Director, and the Deed will be the legal evidence or underlying document from which the appointment of a director is made, including terms and condition of his/her engagement. For the GMS of public companies, terms and conditions (such as tenure, remuneration and position)

25 New York Stock Exchange Corporate Accountability and Listing Standards Committee, June 6, 2002.

of the appointment or engagement of a director shall be decided by the shareholders in the GMS, and the Deed of GMS's resolution will serve as legal document for the company to disclose or address the issue. For certain non-public companies, the terms and conditions of the engagement are usually incorporated in a letter of appointment made by the (majority) shareholders.



Best Practices

In addition to the general data of contracting parties (the name of the President Director, or members of the Board of Directors and the name of the company), these employment contracts must include:

- The starting date of the contract
- The rights and duties of the President Director, or member of the Board of Directors
- The rights and duties of the company
- Remuneration
- The term of the contract.

The company may consider including the following additional terms and conditions in the employment contracts with the President Director and members of the Board of Directors:

- Sanctions to be applied for failing to carry out one's responsibilities
- Benefits and other privileges (e.g., discounts on purchases of company shares, health insurance, reimbursement for housing costs)
- Indemnification
- Confidentiality clauses during the term of the contract and after the executive leaves the company regardless of the reason for leaving
- Non-competition clauses during the service period and after the executive leaves the company for whatever reason
- A commitment to protect the interests of the company and its shareholders
- Grounds for early termination.

If a Remuneration Committee is established, the company (through the company's AoA by the Board of Commissioners) should require the Remuneration Committee to draft a proposal for the remuneration of each individual member of the Board of Directors, or give an opinion about the Board of Commissioners proposal.



Best Practices

The Board of Directors should negotiate the employment contracts with the President Director and members of the Board of Directors. Good corporate governance practice would suggest that the Board of Directors should never determine their own remuneration. The Board of Directors and, ideally, an independent Remuneration Committee should do so. To avoid potential conflicts of interest, executive directors who are also Board of Directors members should not vote on their own employment contracts. In summary, it is recommended that Board meetings deal with these issues:

- Board of Directors be counted for the quorum of the Board of Directors
- The votes of Board of Directors not be counted when approving the terms and conditions of their own employment contracts.

3. Severance Payments to the President Director and Board of Directors' Members

In many other countries, executives may, under certain circumstances, be dismissed without cause and yet receive severance payments. This may occur when a company has been acquired and the acquirer wishes to install new management. These severance plans are sometimes referred to as golden parachutes. Golden parachutes can be defined as a clause in an executive's employment contract specifying that he/she will receive large benefits in the event that the company is acquired and the executive's employment is terminated. These benefits can take the form of severance pay, a bonus, stock options or a combination thereof. Like other forms of compensation, golden parachutes are often the object of criticism.



Best Practices

It is recommended that the employment contracts of the President Director and members of the Board of Directors include a provision for severance payments when their employment contracts are terminated prematurely without justifiable reasons.

Chapter **6**

**THE ROLE OF THE
CORPORATE
SECRETARY**

Table of Contents

A. THE ROLE OF THE CORPORATE SECRETARY	218
1. The Need for and Importance of the Corporate Secretary	218
2. The Qualifications of a Corporate Secretary	220
3. The Independence of the Corporate Secretary	222
4. The Appointment of the Corporate Secretary	223
B. THE AUTHORITY OF THE CORPORATE SECRETARY	226
1. General Provisions	226
2. Developing Corporate Governance Policies and Practices	228
3. Legal and Organizational Support of the Board of Directors	228
4. Protecting Shareholder Rights	232
5. Providing for Information Disclosure and Transparency	233
C. PROFESSIONAL ASSOCIATIONS OF CORPORATE SECRETARIES	236



The Chairman's Checklist

- ✓ Does the company have a Corporate Secretary? Does the company need a Corporate Secretary? What contributions can a Corporate Secretary make to the company's governing bodies?
- ✓ Is the position of Corporate Secretary filled on a full-time basis, or does the Corporate Secretary combine his/her functions with other duties?
- ✓ Does the Corporate Secretary have an adequate mix of professional and personal skills and competencies?
- ✓ How does the company regulate the activities of the Corporate Secretary? Has the company mentioned the position of Corporate Secretary in its articles of association or internal regulations, or even adopted internal regulations for the Corporate Secretary?
- ✓ Has the company determined the obligation of the Board of Commissioners and the Board of Directors to ensure that the Corporate Secretary has access to all information necessary to perform his/her duties? Are commissioners and directors obliged to provide the Corporate Secretary with all information requested or needed by the Secretary to properly fulfil his/her duties? Does the Corporate Secretary serve as an effective link between the Board of Commissioners and the Board of Directors of the company?

- ✓ What is the Corporate Secretary's role in ensuring timely and material disclosure to investors and the public? Does the Corporate Secretary work together with the company's legal and investor relations departments?
- ✓ What role does the Corporate Secretary play in planning and organizing the GMS?
- ✓ How does the Corporate Secretary assist the Board of Directors in preparing for and conducting Board meetings? Does the Corporate Secretary play a meaningful role in Board of Commissioners' training and evaluation?

From an international perspective, the work of the Corporate Secretary is essential to the governance and administration of a company. The Corporate Secretary helps the governing bodies perform their duties and execute their responsibilities. This chapter focuses on the functions, qualifications and authorities of the Corporate Secretary, and the role that the Corporate Secretary plays in implementing good corporate governance practices.

In Indonesia's regulatory framework, the Corporate Secretary is a concept introduced and recognized by the CG Code as obligatory for listed company, state owned company, province and region-owned company, companies that raise and manage public funds, company of which products or services are widely used by public, and companies with extensive influence on environment.¹ Moreover, based on the Regulation No. IX.1.4, the Corporate Secretary is an obligation for public companies.

1 Indonesia's CG Code Part IV D

A. The Role of the Corporate Secretary

1. The Need for and Importance of the Corporate Secretary

In the beginning of 2004, The National Committee on Corporate Governance had launched The Indonesian Banking Sector Code for Corporate Governance, which its provisions include guidance for corporate secretary for all banks in Indonesia. While OJK as a regulatory body for public and listed companies had issued CG regulation regarding corporate secretary in its regulation No. IX.I.4. regarding Corporate Secretary.

The Corporate Secretary ensures that the governing bodies follow existing internal corporate rules and policies, changes them or institutes new ones, when appropriate. The Corporate Secretary can also assist in establishing and maintaining clear communication between the various governing bodies of the company in compliance with the company's article of association, CG code and other internal regulations. In addition, the Corporate Secretary helps to ensure that the governing bodies adhere to all relevant regulatory requirements, both domestic and possibly foreign. Accordingly, the Corporate Secretary often acts as an advisor to Board of Commissioners and Board of Directors on regulatory requirements, listing rules and legislation related to corporate governance. The Corporate Secretary may also identify gaps in corporate governance matters and propose ways to address such weaknesses.

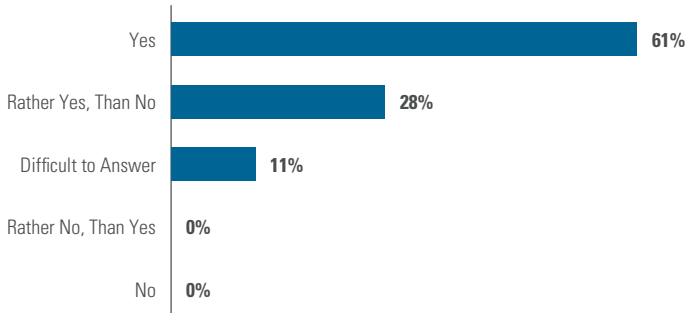
Figures 1 and 2 below demonstrate the increasingly prevalent view that the Corporate Secretary can play an important role in companies and also indicate the types of companies that might benefit the most from the creation of such a position.



Comparative Practices

An increasing number of companies are introducing the position of Corporate Secretary. A number (47%) of surveyed companies in Russia state that they have a Corporate Secretary whose main function is to provide legal support to the Board of Commissioners. An increasing number of companies also understand that Corporate Secretaries contribute to improved corporate governance.

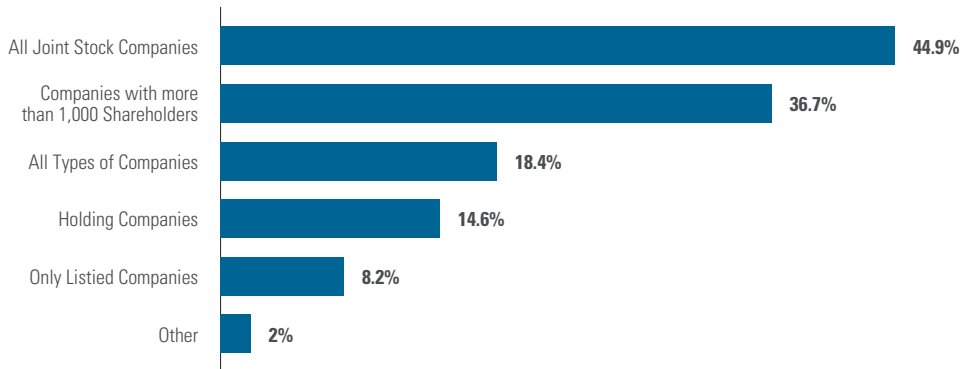
Figure 1. Does the Corporate Secretary's Work Improve Corporate Governance?



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

Most companies consider the position of Corporate Secretary of great importance for joint stock companies, especially for companies with more than 1,000 shareholders.

Figure 2. Type of Companies that Require a Corporate Secretary



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

In Indonesia, the appointment of the Corporate Secretary is not mandatory for all companies. However, it is mandatory if the relevant company has submitted a registration application with OJK or for public listed company and bank. However, other companies can have a Corporate Secretary, if they consider the establishment of this corporate body to be in their best interest. Best international practices indicate that the bigger companies, both public and private, appoint the Corporate Secretary as a part of good corporate practice.

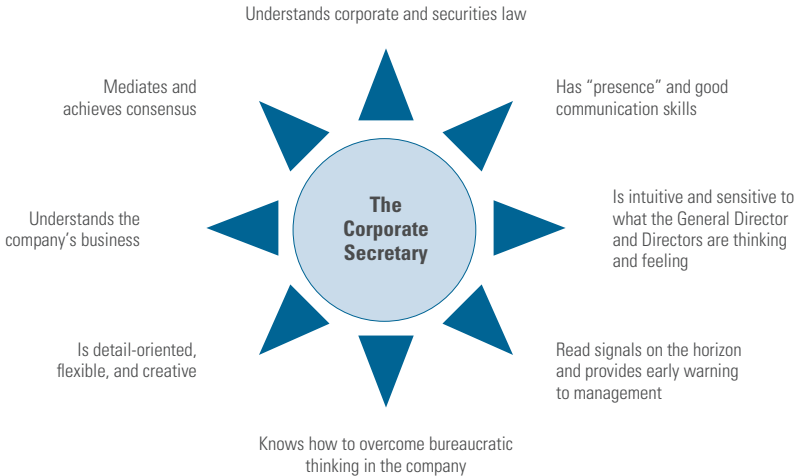
2. The Qualifications of a Corporate Secretary

A full-time staff member, exclusively dedicated to this task, can best fulfil the functions of the Corporate Secretary.

When selecting a Corporate Secretary, the Board of Directors should look for an individual with the highest qualifications and skills. The Board of Directors will need to assess the candidate’s education, work experience, professional qualities and skills. The general outline as well as the detail and specific criteria and requirement for evaluating the candidates will be determined by the general documents adopted by the Board of Directors (for example, the CG Code or the internal regulations for the Corporate Secretary). A detailed Corporate Secretary job description, including rights and duties that are not determined by the law, is the responsibility of the Board of Directors and needs to be developed in conjunction with the contract signed between the Corporate Secretary and the Board of Directors. At the same time it is important to note that the term of office of the Corporate Secretary has to be stipulated by the company regulation.


The core qualifications for Corporate Secretaries are illustrated in Figure 3.

Figure 3. Qualifications and Skills of Corporate Secretaries



Source: IFC, March 2004

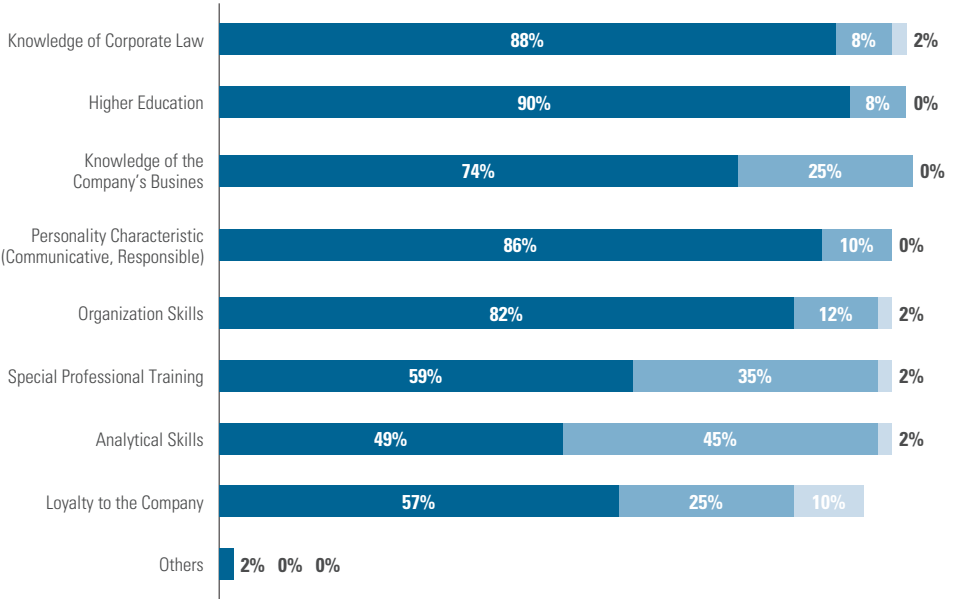
The Corporate Secretary needs to be a person with an impeccable reputation. A company should avoid appointing individuals with criminal record or significant administrative offences.



Comparative Practices

Many companies that have Corporate Secretaries appear to understand the required qualifications and mix-of-skills, as illustrated in Figure 4.²

Figure 4. Type of Companies that Require a Corporate Secretary




Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

2 IFC-RID Survey on the Work of Corporate Secretaries in Russian Companies, April 2003

More than 93% of surveyed companies felt that the Corporate Secretary would benefit from specialized training to more effectively meet the requirements of the position. More than 79% of companies were confident that it was necessary to develop a professional set of standards for Corporate Secretaries to ensure the highest degree of professionalism.

3. The Independence of the Corporate Secretary

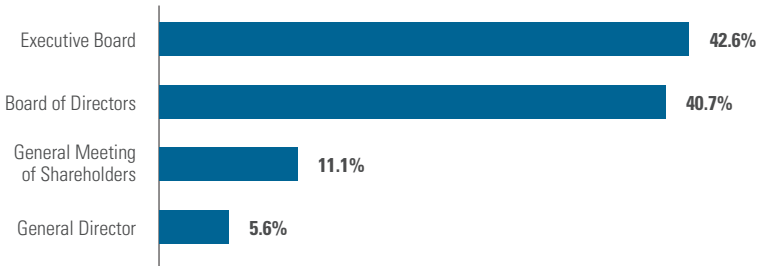
To act in the interests of the company and its shareholders at all times, the Corporate Secretary must be shielded from undue influence from management and other parties. The Corporate Secretary should, thus, be accountable to and controlled by the Board of Directors.



Comparative Practices

Figure 5 shows that, in practice, most Corporate Secretaries surveyed have been subject to some degree of influence by executives that could compromise their independence. Approximately 43% reported directly to either the President Director or the Executive Board.³

Figure 5. The Corporate Secretary Is Accountable to the:



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

3 IFC-Russian Institute of Directors Survey on the Work of Corporate Secretaries in Russian Companies, April 2003

The Corporate Secretary should devote sufficient time to his/her responsibilities and duties. Therefore, all companies in Indonesia established a fulltime Corporate Secretary unit in their organization structure headed by an executive officer. In smaller companies, the Legal Counsel or person holding a similar position, may carry out the duties of the Corporate Secretary, if there are no adverse effects on efficiency and quality of performing Corporate Secretary duties.

4. The Appointment of the Corporate Secretary

The procedure for selecting the Corporate Secretary should be set forth in the company's internal regulations as well as other detail information such as general and specific criteria. The Corporate Secretary is designated by appointment. The Corporate Secretary is appointed by the Board of Directors. The Board of Directors should define the terms and conditions of the employment contract and specifically address the issues of remuneration and termination.

a. Information about Candidates for the Corporate Secretary

Before deciding who will be the Corporate Secretary, the Board of Directors should possess all necessary information about potential candidates, in order to adequately assess their qualifications, experience, personal capabilities and qualities for that job. Therefore, a nominee for the position of Corporate Secretary should provide the Board of Directors with sufficient information to evaluate his/her candidacy. Candidates should, at a minimum, be required to provide information on:

- Educational background
- Employment in other companies
- Any relationship they may have with affiliated persons and/or major business partners of the company
- The number and type of company shares they own, if any
- Declaration of non-conviction for criminal or significant administrative offences
- Any other aspects and circumstances that may influence their performance as Corporate Secretary, in accordance with general company documents and Board of Directors' requests.

This information may be supplemented by personal references and interviews with directors and, in particular, with the Chairman (President Director), since a good

personal rapport between the Chairman and other directors and the Corporate Secretary will be important in maintaining effective working relationships. The Corporate Secretary should notify the Board of Directors immediately of any changes in circumstances that may influence his/her ability to effectively serve as the company's Corporate Secretary.

b. The Contract with the Corporate Secretary

Remuneration and other rights and duties of the Corporate Secretary are precisely defined by the contract concluded between the Board of Directors and the Corporate Secretary, in a form of an employment contract. As mentioned above, large companies are well advised to employ the Corporate Secretary on a full-time basis to allow them to properly execute their duties.

The Chairman of the Board of Directors is authorized to make a draft of the contract that will be concluded with a Corporate Secretary.

c. The Office of the Corporate Secretary

Large companies may even find it necessary to establish an Office of the Corporate Secretary, staffed by several assistants. Additional staffing may be useful for companies with a large number of shareholders, a large number of Board of Commissioners and Board of Directors and/or numerous Board of Commissioners committees.



Basic Practices

Many foreign companies, particularly publicly listed companies, have an Office of the Corporate Secretary with several staff members. Figure 6 shows the situation in U.K. companies.

Figure 6. Correlation Between the Company's Size and the Number of Staff in the Corporate Secretary's Office

	Company Turnover (in £m)						
	All	Under 10	10-49	50 - 99	100 - 499	500 - 1,000	Over 1,000
	%	%	%	%	%	%	%
Number of Staff in the Corporate Secretary's Office							
1 Employee	25	58	50	10	20	5	5
2 Employees	23	23	21	43	27	18	8
3 Employees	23	16	26	24	22	32	19
4 Employees	11	3		13	19	14	14
5 - 10 Employees	16		3	10	11	27	49
Over 10 Employees	2				1	4	5

Source: Company Secretaries Responsibility and Salary Survey 2000/2001, Institute of Chartered Secretaries and Administrators

Should a company want to establish an Office of the Corporate Secretary, it may wish to specify its responsibilities in the internal regulations or other internal documents.

B. The Authority of the Corporate Secretary

1. General Provisions

Based on CG Code, main authorities of the Corporate Secretary is to ensure a sound communication between the company and the governed bodies as well as to provide any available information that is accessible to the governed bodies in accordance with the proper need of the governed bodies. The authorities of the Corporate Secretary is also including: (i) organizing the meetings of GMS, Board of Commissioners and Board of Directors, (ii) advising meeting procedures, (iii) preparing the meeting minutes, (iv) ensuring the conformity of the Board of Directors' resolutions with prevailing laws and regulations in Indonesia and (v) providing financial information and a copy of meeting minutes of the Board of Directors and other information to the members of the Board of Directors. Moreover, according to the CG Regulation, main authorities of the Corporate Secretary is to (i) conduct society services on every information needed by the investor in accordance with listed and public companies condition, (ii) provide advisory service to the listed and public companies' Board of Directors to comply with the Capital Market Law and its implementing regulation, and (iii) act as a contact person between listed or public companies with Bapepam and society.

Best practices suggest that the Articles of Association or other internal documents should define in detail the Corporate Secretary's authority and the duty of all governing bodies to assist the Corporate Secretary in discharging his/her duties.

Figure 7 provides an overview of the Corporate Secretary's authorities, taking into consideration international best practices.

Figure 7. The Authorities of the Corporate Secretary



Source: IFC, March 2004

In Indonesia, CG Code has stipulates the authorization of the Corporate Secretary under the function of Board of Directors which related to the Public Relations sections as follows:

- a. The Board of Directors shall ensure the existence of a sound communication between the company and its stakeholders by empowering the function of a Corporate Secretary;
- b. Function of the Corporate Secretary is to ensure: (i) a sound communication between the company and its governed bodies; and (ii) the availability of information that is accessible to the governed bodies in accordance with the proper need of the governed bodies;
- c. Publicly listed companies, state-owned enterprises, province and region- owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, shall have a Corporate Secretary whose function may also include investor relations;
- d. In the event that the company does not have a separate compliance work unit to ensure the compliance with laws and regulations, such function shall be carried out by the Corporate Secretary;

- e. The Corporate Secretary or the person who executes the Corporate Secretary's function shall be responsible to the Board of Directors. Report on the implementation of the Corporate Secretary's duty shall also be submitted to the Board of Commissioners.

2. Developing Corporate Governance Policies and Practices

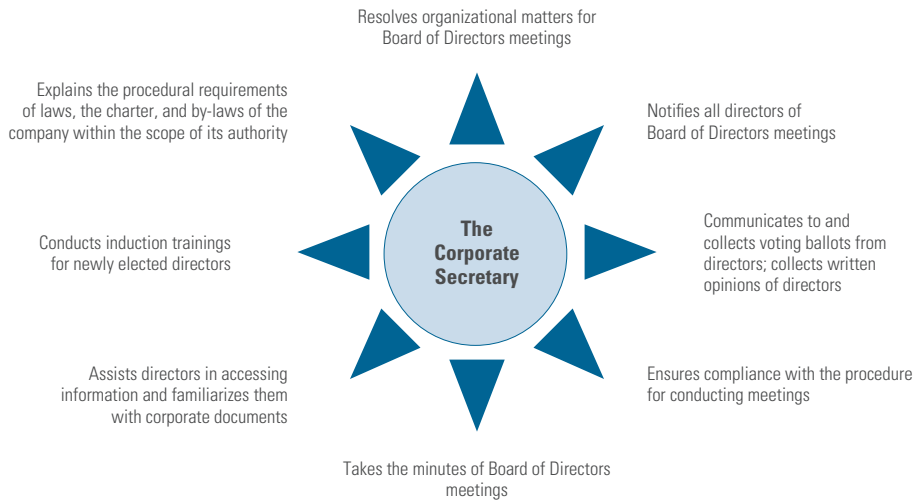
Taking into consideration the authority of the Corporate Secretary, as well as practical experiences in implementing corporate policies and practices, this corporate body is ideally suited to help the company and its Board of Directors develop a system of corporate governance. More specifically, the Corporate Secretary can play an important role in the development of, compliance with and periodic review of the company's governance policies and practices.

In developing an explicit and clearly stated plan to improve the company's corporate governance policies and practices, the Corporate Secretary lays the groundwork for reforms in this area. Perhaps more importantly, he/she can demonstrate the company's commitment to corporate governance by monitoring compliance with these policies and informing the Board of Directors of any breaches. Finally, by reviewing the company's policies on a regular basis (by keeping abreast of the latest developments in corporate governance, changes in the legal and regulatory framework, and international best practices), the Corporate Secretary ensures that the company's governance standards remain high and up-to-date.

3. Legal and Organizational Support of the Board of Directors

Most of the Corporate Secretary's time will be spent supporting the Board of Directors as depicted in Figure 8.

Figure 8. The Functions of the Corporate Secretary in Relation to the Board of Directors



Source: IFC, March 2004

a. Organizing Board of Directors Meetings

Although the CG Code or other Indonesian Law does not stipulate the function of the Corporate Secretary specifically, the company internal regulation may stipulates that The Corporate Secretary is responsible for organizing Board of Directors meetings. Although Board of Directors meetings are ultimately the responsibility of the Chairman, the Corporate Secretary handles all administrative and organizational matters such as:

- Helping the Chairman prepare the agenda
- Developing presentations on substantive and procedural issues under discussion
- Preparing model briefs for boardroom discussions.

This is the reason why it is recommended that the Chairman organizes Board of Directors meetings together with the Corporate Secretary.

It is also advisable that the Corporate Secretary is responsible for communicating with other members of the Board of Directors connected with organizing and conducting Board meetings. These activities include:

- Giving notice of Board of Directors meetings to all directors
- Distributing voting ballots to directors
- Collecting completed ballots and the written opinions of directors who are not physically present at the meeting
- Forwarding the ballots and written opinions to the Chairman
- Conducting other activities in order to organize mutual communication between members of the Board of Directors and the Chairman in the period between Board meetings.

In addition, the Corporate Secretary should help ensure that procedures for Board of Directors meetings are followed.

Along with the Chairman, the Corporate Secretary is responsible for drafting the minutes of Board of Directors meetings, as well as keeping them in the company's archives.

The Corporate Secretary should brief newly elected directors on:

- The corporate procedures that regulate the operations of the Board of Directors and other governing bodies
- The organizational structure and officers of the company
- The company's internal documents
- The decisions of the GMS and the Board of Directors that are in effect
- The availability of information required by directors for the proper discharge of their duties.

b. Providing the Board of Directors with Access to Information

According to the CG Code, the Corporate Secretary plays a key role in assisting directors in obtaining the information they need for sound decision-making. The Corporate Secretary provides directors with timely and full access to:

- The minutes of the Board of Commissioners meetings
- Decisions and documents approved by the President Director and the Board of Commissioners

- The minutes of meetings and reports prepared by the Audit Committee, the Internal Auditor, the External Auditor, or any other Committees established by the Board of Commissioners and Board of Directors
- Financial documents.

It would be useful for a company to describe the role of the Corporate Secretary in the internal regulations or other internal documents of the company.

c. Providing Legal Assistance to Directors on Governance Issues

While there are no laws and regulations stipulated the authority of the Corporate Secretary for companies in Indonesia, best practices recommend that the Corporate Secretary should assist directors with interpreting legal and regulatory acts related to corporate governance, including listing rules, corporate governance codes, and international regulations and developments. This also holds true for procedural issues regulated in the article of association, internal regulations and/or other internal documents relating to preparing and conducting the GMS and Board of Directors meetings, and on information disclosure. The Corporate Secretary should not, however, render legal advice that falls outside the scope of his/her duties. The duties of the Corporate Secretary should be clearly defined in relation to those of the company's Legal Counsel.

The Corporate Secretary should directly notify the Chairman of any possible violations of corporate procedures, if and when he/she becomes aware of such violations. Such violations may include, among others:

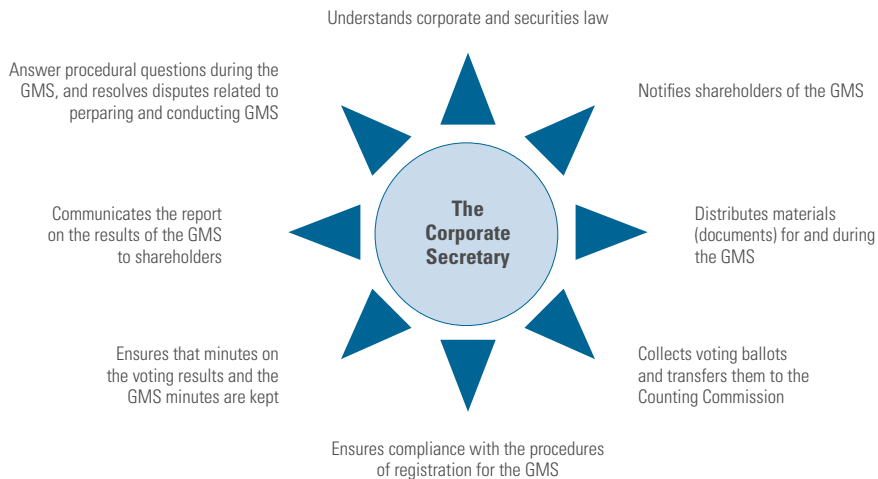
- Alleged illegal acts or omissions of corporate officers or other corporate employees in fulfilling their legal duties and obligations
- Violations of procedures regulating the organization of the GMS, Board of Directors meetings, the disclosure of information and protection of shareholder rights.

4. Protecting Shareholder Rights

a. Organizing the General Meeting of Shareholders

The Corporate Secretary plays an important role in organizing the GMS. Figure 9, shows the functions of the Corporate Secretary according to best practices in this regard:

Figure 9. The Functions of the Corporate Secretary in Relation to the GMS



Source: IFC, March 2004

a. Liaising between Shareholders during Control Transactions

The Indonesian regulations do not cover the role of the Corporate Secretary during control transactions. However, according to best practices, the Corporate Secretary acts as a liaison between the controlling shareholder(s) in a buyout of common shares (and securities convertible into common shares) and the other shareholders of the company during a control transaction. The Corporate Secretary does this by ensuring that the mandatory offer is distributed to all shareholders. The Corporate Secretary should follow the procedures for the distribution of the mandatory offer to non-controlling shareholders. The same can be applied to squeeze-out and sell-out procedures. This role of the Corporate Secretary also includes active co-operation with external persons (like brokers, dealers and banks), specialized and authorized for the realization of those

activities. The Corporate Secretary should also communicate with minority shareholders to inform them about their rights in the context of takeovers.

b. Assisting in Enforcing Shareholder Rights

Best practices suggest that the Corporate Secretary:

- Ensures that the company takes proper notice of all duly submitted shareholder petitions
- Channels all duly submitted shareholder inquiries to the appropriate governing bodies and departments of the company.

The Corporate Secretary should try to resolve any conflicts, especially those concerning the maintenance of the book of shareholders, promptly and fairly.

c. Assisting in Resolving Corporate Conflicts

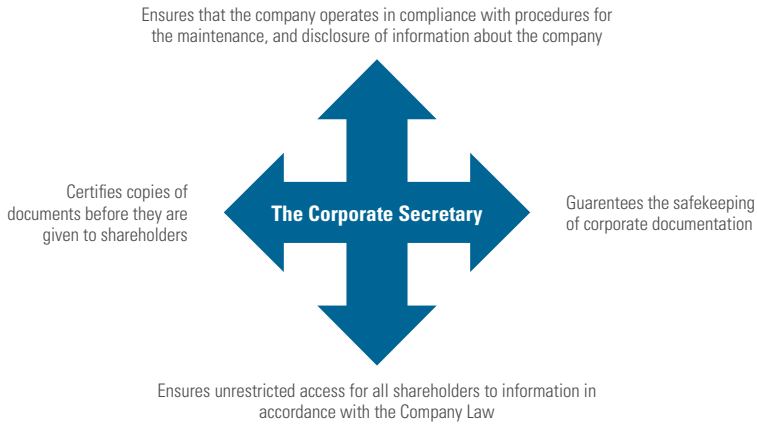
It is recommended from best practices that the Corporate Secretary should be responsible for recording corporate conflicts. The Corporate Secretary registers inquiries, letters, or demands filed by shareholders, reviews these and duly transmits them to the governing bodies that have the authority to resolve the conflict. The effectiveness of the company in preventing and resolving conflicts depends on its responsiveness to all legitimate complaints. The Corporate Secretary also needs to periodically follow up on the status of complaints in order to make sure that they have been properly and fully addressed, and either resolved or rejected.

Conflicts can arise among Board of Commissioners, Board of Directors members, and shareholders. The Corporate Secretary should notify the Chairman of any potential or existing conflicts so that they can be dealt with appropriately. Best practices suggest that the Corporate Secretary acts as a liaison in case of conflicts among them.

5. Providing for Information Disclosure and Transparency

The Corporate Secretary can play an important role in helping the Board of Directors and President Director in particular; fulfil their respective obligations to disclose material information on a timely basis to external institutions and company's shareholders, in accordance with the financial market regulations. According to best practices, the Corporate Secretary's authority related to information disclosure is shown in Figure 10.

Figure 10. The Authorities of the Corporate Secretary Related to Information Disclosure



Source: IFC, March 2004

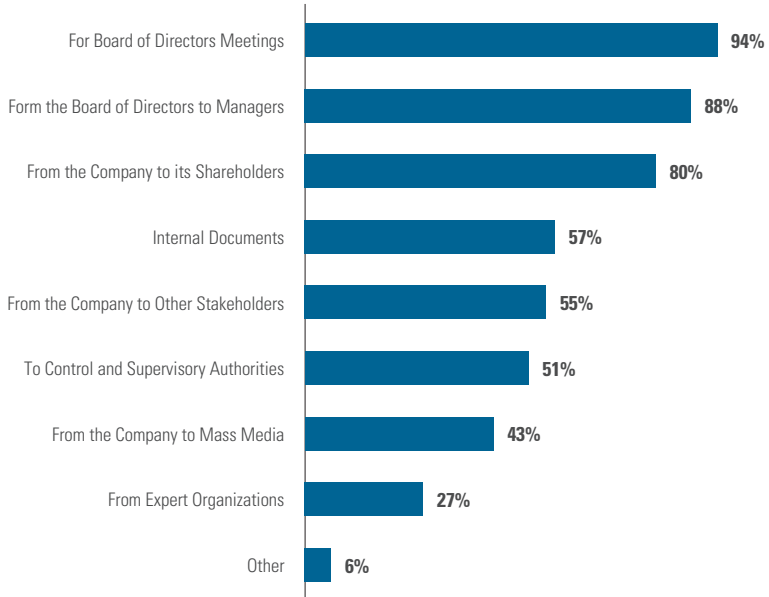
The Corporate Secretary also helps to ensure the transparent control procedures. More specifically, he/she acts as a liaison between the Board of Commissioners and the Board of Directors.



Comparative Practices

Figure 11 illustrates the views of some Russian companies on the role that the Corporate Secretary plays in providing information about the company. Most companies agree that the Corporate Secretary should provide information in support of Board of Commissioners meetings, and to management and shareholders. There is, however, considerably less agreement with respect to the Corporate Secretary's role in providing other types of information to outsiders, for example, control and supervisory authorities.

Figure 11. Percentage of Companies Where the Corporate Secretary Coordinates Information Flows



C. Professional Associations of Corporate Secretaries

The position of Corporate Secretary requires a unique skills-set, as shown in Figure 3 above. The Indonesian Corporate Secretary Association (ICSA) is currently promoting the benefits of having a Corporate Secretary; training efforts are also being organized to train the nascent profession. In foreign markets, professional associations or Corporate Secretaries institutes often perform this role. Typically, such association is a group of corporate secretaries and have several functions, such as to:

- Promote good governance, management, and efficient administration of companies
- Support and protect the character, status, and interests of member Corporate Secretaries
- Promote the efficiency and usefulness of the service and standard of professional conduct provided by Corporate Secretaries
- Train Corporate Secretaries
- Comment on proposed and existing laws, rules and regulations in areas of particular interest to members
- Promote and assist in the voluntary exchange of information and experience relating to the duties, problems and practices of Corporate Secretaries and their companies.

On February 28, 2008, Indonesian Corporate Secretary Association (ICSA) was established to provide assistances for public as well as private companies in trainings and knowledge sharing on corporate secretary.

Chapter **7**

AN INTRODUCTION TO SHAREHOLDER RIGHTS

Table of Contents

A. GENERAL PROVISIONS ON SHAREHOLDER RIGHTS	242
1. Reasons for Being a Shareholder	242
2. Classification of Shares	243
3. Types of Shareholder Rights	245
B. SPECIFIC SHAREHOLDER RIGHTS	249
1. The Right to Vote	249
2. The Right to Appeal Decisions of the General Meeting of Shareholders	254
3. The Right to Receive Information about the Company	255
4. The Right to Freely Transfer Shares	256
5. Pre-Emptive Rights	257
6. The Right to Demand the Redemption of Shares	260
7. Shareholder Rights during the Liquidation of the Company	261
8. The Right to Review the Shareholder List	262
9. The Right to File a Claim on Behalf of the Company	263
10. The Right to Receive Dividends	264
11. The Right to Summon a General Meeting of Shareholders	264
12. The Right to Nominate Candidates to be Elected as Member of the Board of Commissioners and the Board of Directors	265
13. Restriction on Founding Shareholders	265

Table of Contents

C. THE STATE AS A SHAREHOLDER	266
1. The State as an Ordinary Shareholder	266
2. The State as the Holder of Privileged Rights	266
3. Exercising the Rights of the State as a Shareholder	267
D. THE SHAREHOLDER REGISTER	268
1. The Company Share Register - Register Book of Shareholders	268
2. Registration for Obtaining the Effective Statement	269
3. Registration with Business Registrar	270
E. THE PROTECTION OF SHAREHOLDER RIGHTS	271
1. Guarantees in the Indonesian Company Law	271
2. Judicial Protection	271
3. Non-Governmental Organizations for the Protection of Shareholder Rights	272
4. Company Articles of Association	272
5. Shareholder Activism and Collective Action	273
6. Shareholder Agreements	275
F. RESPONSIBILITIES OF SHAREHOLDERS	277
1. Obligation to Make Full Payment for their Subscribed Shares	277
2. Obligation to be Liable to Debt and other Liabilities of the Company	277
3. Other Obligations	278



The Chairman's Checklist

- ✓ Does the company's AoA protect shareholder rights as stipulated by the ICL, Capital Market Law, OJK Regulation and the CG Code and other relevant regulations? Do all directors take appropriate measures to ensure that these rights are respected?
- ✓ Do all directors take measures to encourage shareholders to exercise their rights, in particular, the right to vote? Do shareholders exercise their rights collectively?
- ✓ Are shareholders provided with free access to company information beyond the requirements of the ICL, Capital Market Law and OJK Regulation? Are shareholder requests processed properly and on time?
- ✓ Does the Board of Directors provide competent registers and institutions with timely, full and accurate information about the company, especially in relation to shareholders' rights?
- ✓ Does the Board of Directors encourage shareholders to protect their rights by using all the mechanisms provided by legislation and the CG Code?
- ✓ Does the Board of Directors ensure that the AoA, internal regulations and other internal documents do not stipulate additional obligations of shareholders other than the ones that are clearly defined by law?

By investing in shares, investors become shareholders and receive a number of rights attached to these securities. Shareholders rely on the rights they receive in return for their investment. For most shareholders, this includes the right to participate in the profits of the company. Other rights are also important, especially from the perspective of the maintenance and increase of investment. These rights include, among others, the right to vote on the Board of Commissioners and the Board of Directors composition, any amendment to the AoA including the capital changes, approve the annual report and financial statements, and the right to access information about the company and its activities. Through these rights, shareholders ensure that the Board of Directors of the company do not misappropriate their investment.

The quality of investor protection has several corporate governance implications, such as the depth of capital markets, ownership patterns, dividend policy, and the efficiency of allocating resources.¹ Where laws are protective of shareholders and well enforced, shareholders are willing to invest their capital, financial markets are broader and more valuable. In contrast, where laws do not adequately protect shareholders, the development of financial markets is stunted. When shareholder rights are protected by the law, and indeed by the company itself, outside investors are willing to pay more for financial assets such as equity. They pay more because they recognize that, with better legal protection, more of the firm's profit will return to them as dividends and/or capital gains as opposed to being expropriated by Board of Directors or controlling shareholders.

According to the Indonesia's CG Code, Shareholders as owners of share capital shall have certain rights and responsibilities within the company in accordance with the laws and regulations and the AoA of the company. In exercising their rights and responsibilities, the shareholders shall observe the following principles:²

1. The shareholders must be aware that in exercising their rights and responsibilities, they shall also consider the sustainability of the company.
2. The company shall facilitate the exercise of the ownership rights and responsibilities of the shareholders based on the principle of fairness and in accordance with laws and regulations and the articles of association.

This chapter provides an overview of shareholder rights and the rules a public company must follow to protect these rights. Some specific rights, such as the participation in the GMS, are discussed in detail in other chapters of this Manual.

1 Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, Investor Protection and Corporate Valuation, National Bureau of Economic Research, Working Paper 7403, October 1999

2 CG Code Part V

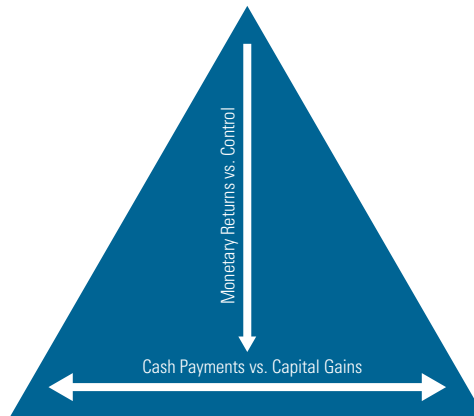
A. General Provisions on Shareholder Rights

1. Reasons for Being a Shareholder

Investors purchase company shares for a variety of reasons. The most common reasons are shown in Figure 1.

Figure 1. Common Reasons for Becoming a Shareholder

Control: Shares provide investors with the opportunity to legally control the company and influence decision-making by nominating directors and, possibly, management. The greater the number of voting shares a shareholder holds, the greater the influence he wields.



Dividends: Dividends play an important role in the decision to invest. Regular dividend payments, especially if an investor holds a portfolio of shares, can generate predictable cash flows.

Capital Gains: Investors purchase shares to benefit from capital growth. Unlike dividends, shares need to be sold to realize the gains represented by rising share prices.

Source: IFC, March 2004

Shares bestow on their owners the right to attend and cast votes in GMS, receive payment of dividends and the remainder of assets from liquidation, and exercise other rights under the ICL. However, these rights will apply after the shares are recorded in the register of shareholders under the name of the shareholders and do not apply to certain classification of shares as determined in the ICL. Each share provides its owner indivisible rights.³

2. Classification of Shares

The AoA shall determine 1 (one) or more classifications of shares. In the event that there are more than one share classifications, the AoA shall determine one of them as common shares.⁴ The various types of classification of shares do not always show that the classifications are each independent and separate from one another, but may constitute a merger of 2 (two) or more classifications.⁵ Shareholders shall be provided with the proof of shares ownership.⁶

→ *For more information on authorized capital and shares, see Chapters 9 and 11.*

a. Common Shares

Owners of common shares have the right to participate in the decision-making process of the company, most commonly exercised by voting during the GMS. They also have the right to share in the profits of the company either through dividends or through capital gains.

In Indonesia, common shares have the following characteristics:⁷

1. The right to vote to adopt resolutions in GMS regarding all matters related to the management of the Company;
2. The right to receive dividends allocated; and
3. The right to receive the remainder of assets in liquidation.

Each share will have the same nominal value or accountable par, which is a portion of the capital of the company. The AoA of a company define the number, nominal value or accountable par, and rights attached to common shares. Every common share carries

3 ICL, Article 52 paragraph (1), (2), (3) and (4)

4 ICL, Article 53 paragraph (1) and (3)

5 ICL, Elucidation of Article 53 paragraph (4)

6 ICL, Article 51

7 ICL, Elucidation of Article 53 paragraph (3)

the same rights, interests and obligations to their owners in accordance with the ICL and the AoA.

b. Preferred Shares

A company has the right to issue various classes of preferred shares. It is stipulated under the Article 53 of ICL that in the event the company issued more than 1 (one) share classes, then the AoA shall determine one amongst them as common shares. All preferred shares of the same class must have the same rights to their owners. In the case of listed companies that have various preferred stocks, the rights and obligations attached to those preferred stocks must be fully disclosed to shareholders and approved by the GMS.

Although there is no specific regulation, it is a good practice that the company AoA specifies the amount of dividends and/or the liquidation value of preferred shares or, alternatively, the procedure for determining the amount of dividends and the liquidation value of preferred shares.

The ICL distinguishes preferred shares according to the specific rights they grant. Preferred shares include shares of types as described hereunder:

- Share with voting rights or without voting rights;
- Share with special rights to nominate members of the Board of Directors and/or members of the Board of Commissioners;
- Shares which after a certain period of time will be withdrawn or exchanged for some other classification of shares;
- Shares which bestow on their holder the right to priority over holders of shares with other classifications in receiving dividends in the allocation of dividends cumulatively or non-cumulatively;
- Shares which bestow on their holders the right to priority over holders of shares with other classification in receiving allocations of the remainder of the Company's assets in liquidation

Under the ICL, the principal comparisons between common and preferred shares of shareholding companies are summarized in Figure 2.

Figure 2. Comparison of Common and Preferred Shares

	Common Shares	Preferred Shares
Mandatory	Yes, must always be issued	No, are optional
Can Different Classes of shares be issued?	No, only one class of common shares may be issued	Yes, different classes of shares can be issued
Can this type of share be converted into other securities?	Yes, common shares may converted into other securities	Yes, preferred shares may converted into other securities
Do shareholders have the right to vote, to attend the GMS or to nominate candidates to the Board of Commissioners and the Board of Directors?	Yes, with certain statutory exceptions	Yes, except for non-voting preferred shares See Section B.1 of this Chapter
Do shareholders have the right to freely transfer their shares?	Yes	Yes
Can the AoA grant additional rights to shareholders?	Yes	Yes

3. Types of Shareholder Rights

The ICL distinguishes between the rights of individual shareholders and the rights held collectively by a group of shareholders. It is also possible to distinguish shareholder rights according to their nature. Some rights relate to the decision-making process and the organization of the company. Others relate to the capital and the return on shareholder investment.

Figure 3 below illustrates the two-sided nature of the shareholder rights.

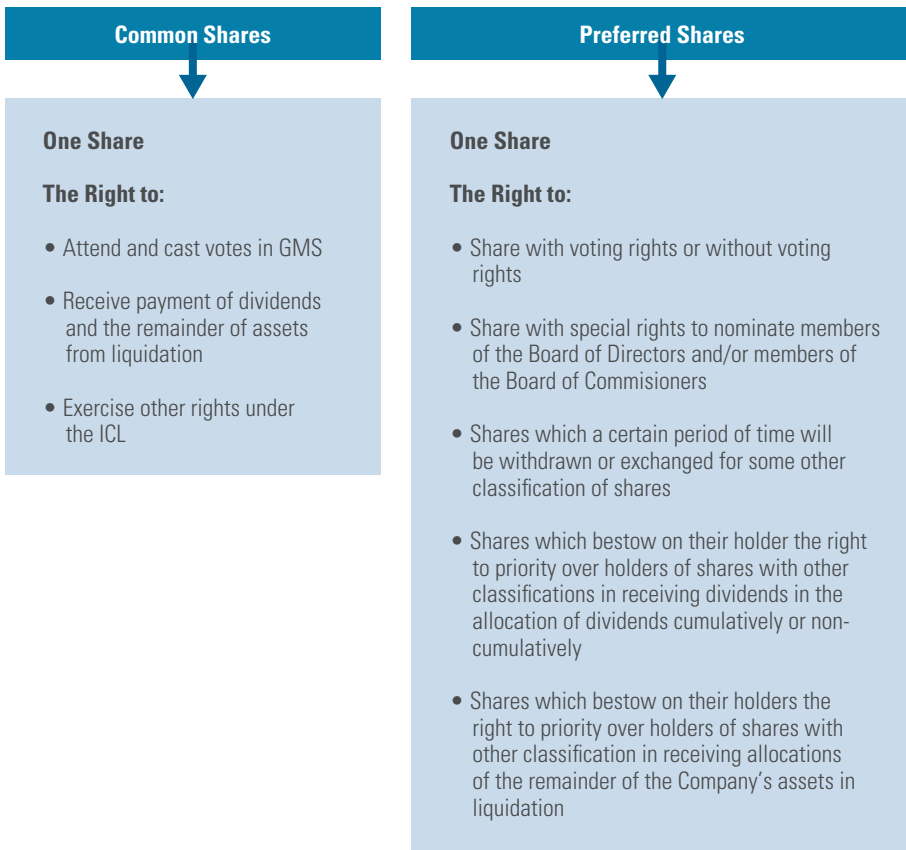
Figure 3. The Two-Sided Nature of Shareholder Rights



Source: IFC, March 2004

Figure 4 summarizes the rights of shareholders by types of shares and by the percentage of shares held. Neither the company nor its shareholders can change these rights. The company AoA can however provide additional rights to shareholders as long as they are not prohibited by legislation.

Figure 4. Comparison of Common and Preferred Shares



The Indonesia's CG Code has code provisions on Rights of Shareholders and Key Ownership Function.⁸

1. The rights of shareholders shall be protected and exercised in accordance with laws and regulations and the articles of association of the company. The rights of the shareholders shall essentially include:
 - a. The right to attend, express an opinion, and vote in the General Meeting of Shareholders based on the provision that one share entitles the right of the holder to issue one vote;
 - b. The right to obtain information regarding the company on a timely, proper and regular basis, except with respect to confidential matters, so that the shareholders can make a decision in relation to their investment in the company based on accurate information;
 - c. The right to receive shares of profit appropriated for shareholders in the form of dividends and other profit sharing, in proportion to the shares owned;
 - d. The right to obtain full explanation and accurate information with regard to the procedures to be met in relation to the convening of the General Meeting of Shareholders in order for the shareholders to participate in decisions, including those affecting the existence of the company and the rights of the shareholders;
 - e. In the event that there is more than one type and classification of shares in the company, then: (i) each shareholder is entitled to cast a vote in accordance with the type, classification and number of shares owned; and (ii) each shareholder is entitled to obtain a fair treatment based on the type and classification of the share owned.
2. The shareholders as owner of share capital shall be responsible for observing the laws regulations and the articles of association of the company. The responsibility of a shareholder shall include:
 - a. The controlling shareholder shall: (i) consider the interest of the minority shareholders and other stakeholders in accordance with laws and regulations; and (ii) disclose information regarding the company's ultimate shareholders to the law enforcement agencies, in the event that there is suspected that a violation is committed against laws and regulations, or when requested by the relevant authority;
 - b. The minority shareholder shall be responsible for exercising its right properly in accordance with laws and regulations and the articles of association;

8 CG Code Part V

- c. As shareholders shall: (i) segregate the company's asset from his/her personal asset; and (ii) segregate his/her function as a shareholder from that as a member of the Board of Commissioners or the Board of Directors, it that shareholder holds position in one of the two organs;
- d. In the case where a shareholder becomes the controlling shareholder in several companies, it is necessary that the accountability and inter-company relations are carried out clearly.

In addition to that, here in Indonesia, each shareholder is entitled to file suit against the company in the district court if the shareholder has been harmed by any action of the company considered unfair and unreasonable as a result of a resolution of the GMS, Board of Directors and/or Board of Commissioners.⁹



Best Practices

A shareholder should have the right to file suit against directors including derivative and class action law suits. The country's legal system should provide and enforce mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated (see *OECD Principles of Corporate Governance, pages 40 & 42*).

⁹ ICL, Article 61 paragraph (1)

B. Specific Shareholder Rights

1. The Right to Vote

Shareholders can participate in the decision-making of the company through their right to vote during the GMS. Important matters that fall within the authority of voting at GMS include: i) amendments to company AoA; ii) development strategy of the company; iii) authorization of additional shares; election or dismissal of the Board of Commissioners and the Board of Directors ; iv) extraordinary transactions such as investment or sales of assets in equivalent to 50% or more of the company's total assets; vi) approval of dividend and annual financial statements; and vi) reorganization or resolution of the company.

Each share issued shall carry one vote, unless the AoA determine otherwise. However, the vote shall not apply to:¹⁰

- a. Shares in the company controlled by the company itself;
- b. Shares in a parent company directly or indirectly controlled by its subsidiary; or
- c. Shares in the company controlled by another company whose shares are directly or indirectly owned by the company.

Holders of a fraction of the nominal value of a share shall not be granted individual voting rights unless the holder of a fraction of the nominal value of a share individually or together with another holder of a fraction of the nominal values of a share with the same classification of share has a nominal value equal to 1 (one) nominal value of that classification.¹¹ It is because each share bestows on its owner indivisible rights and in the event that 1 (one) share is owned by more than 1 (one) person, the rights arising out of the shares shall be exercised by means of appointing 1 (one) person as their joint representative.¹²

¹⁰ ICL Article 84

¹¹ ICL, Article 54 paragraph (2)

¹² ICL, Article 52 paragraph (4) and (5)



Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval (see OECD Principles of Corporate Governance, page 18).

The right to vote can be conducted either severally or through a representative by virtue of a power of attorney.¹³ A proxy holder is authorized to act on behalf of the shareholder and to make any decision the shareholder could have made during the GMS. However, shareholders are not permitted to give a power of attorney to more than one proxy for part of the shares they own with different votes.¹⁴ A listed company is not allowed to restrict the participation by its shareholders in the GMS and should facilitate its shareholders' authorization of their representatives to participate in the GMS when shareholders so request. A standard form of letter of proxy must be attached to GMS' invitation and sent to shareholders prior to the GMS. Except for limitations provided by legislation, any individual can serve as a proxy so long as this person is given an appropriate written proxy. Letters of proxy shall be in writing in the form as prescribed by the company and need not be notarized. However in voting, members of the Board of Directors, members of the Board of Commissioners, and employees of the company concerned are prohibited from acting as proxies for shareholders.¹⁵

13 ICL Article 85 paragraph (1)

14 ICL Article 85 paragraph (3)

15 ICL Article 85 paragraph (4)



The corporate governance framework should ensure that proxies are voted in accordance with the direction of the proxy holder and that disclosure is provided in relation to how undirected proxies will be voted. It is important to disclose how the Chairperson of the meeting (as the usual recipient of shareholder proxies obtained by the company) will exercise the voting rights attached to undirected proxies. The objective of facilitating shareholder participation suggests that companies favorably consider the enlarged use of information technology in voting, including secure electronic voting in absentia (see OECD Principles of Corporate Governance, page 35). A common electronic voting system that helps shareholders to vote in absentia is the public network DRE (direct recording electronic) voting system which uses electronic ballots and transmits vote data from the polling place to another location over a public network. Voting data may be transmitted as individual ballots as they are casted, periodically as batches of ballots throughout the election day, or as one batch at the close of voting. This includes Internet voting as well as telephone voting. Some countries that use this system for voting include the Estonia, Ireland, Switzerland, the UK and the US.

→ *For more information on the GMS, see Chapter 8.*

a) The Right to Vote Common Shares

Common shares grant voting rights to their holders. However, there are some circumstances when common shares become non-voting. These circumstances are as follows:¹⁶

- a. Shares owned by the Company itself;
- b. Main shares of the Company that are owned by its subsidiaries, either directly or indirectly; or
- c. Shares of the Company which are owned by other Company which shares, either directly or indirectly, owned by the Company.

16 ICL Article 84 paragraph (2)

Legal Consequences

GMS can request withdrawal of such shares and shareholders shall be required to waive their shareholdership status with respect to such shares.

Precludes voting on all issues during the GMS.

Precludes voting on the approval of the related party transaction in which the shareholder is an interested party.



Best Practices

Current laws and regulations in Indonesia have not stipulated cases where voting rights are precluded. The following cases are considered good practices:

Preconditions	Legal Consequences
<p>Violation of Rules on Acquisition of shares in control transactions: When a person (or a group of affiliated persons) has not followed the procedures specified by the law on securities when acquiring these shares</p>	<p>Precludes voting on all issues during the GMS</p>
<p>Violation of Rules concerning a mandatory bid offer:</p> <p>When a person (or a group of affiliated persons):</p> <ul style="list-style-type: none"> • Acquires common shares of the target company that exceed 25% of common shares (i.e. 25% of votes in the GMS of that company) or • Holding 25% or more of the shares with voting rights intends to buy more shares that leads to ownership of 51%, 65%, or 75% of the total shares with voting rights of that company 	<p>Common shares cannot be voted at the GMS</p>

Preconditions	Legal Consequences
<p>That person (or group of affiliated persons) will have to submit their public bid registration to the OJK/Authority. The public bid is conducted only after it is approved by the OJK/Authority and announced in advance by bid-making organizations or individuals on the mass media.</p>	
<p>The Right of squeeze-out: When the offer or following the tender offer holds at least 80% of shares of a target company, he/she can require all the holders of the remaining shares to sell him/her those shares under the conditions from the bid</p>	<p>Precludes voting on the waiver of the controlling shareholder's obligation to squeeze-out the minority shareholders</p>
<p>Shares held by the subsidiary: When a subsidiary directly or indirectly acquires shares in a parent company</p>	<p>The shares carry no voting rights at the GMS</p>
<p>Preclusion of voting rights: When the GMS is deciding the following issues:</p> <ul style="list-style-type: none"> • Shareholders' relief from duties to the company or diminution of such duties • Whether to initiate or abandon legal proceedings against the shareholder 	<p>The shareholder may not vote at a GMS when deciding these issues</p>

b) The Right to Vote Preferred Shares

ICL specifically regulates three types of preferred shares, namely voting preferred shares, dividend preferred shares and redeemable preferred shares.¹⁷

17 ICL Article 53



All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected. Their rights should not be changed unless those holding voting shares have had the opportunity to participate in the decision. Proposals to change the voting rights of different series and classes of shares should be submitted for approval at the GMS by a specified majority of voting shares in the affected categories (see *OECD Principles of Corporate Governance*, page 41).

2. The Right to Appeal Decisions of the General Meeting of Shareholders

Each shareholder is entitled to file a suit against the Company to the District Court if they suffer losses due the action of the Company which is considered to be unfair and unreasonable as a result of a resolution of the GMS, the Board of Directors, and/or the Board of Commissioners.¹⁸

Furthermore, the ICL stipulates that each shareholder is entitled to request the company that the shareholder's share be bought at a fair price if the shareholder concerned does not approve actions by the company which harm that shareholder or the company, in the form of:

- Amendments of the AoA;
- Assignment or securing of assets of the company which have a value of more than 50% (fifty per cent) of the company's net assets; or
- Merger, Consolidation, Acquisition, or spin-off.¹⁹

➔ *For more information on appealing decisions of the GMS, see Chapter 8, Section E.4.*

¹⁸ ICL, Article 61 paragraph (1)

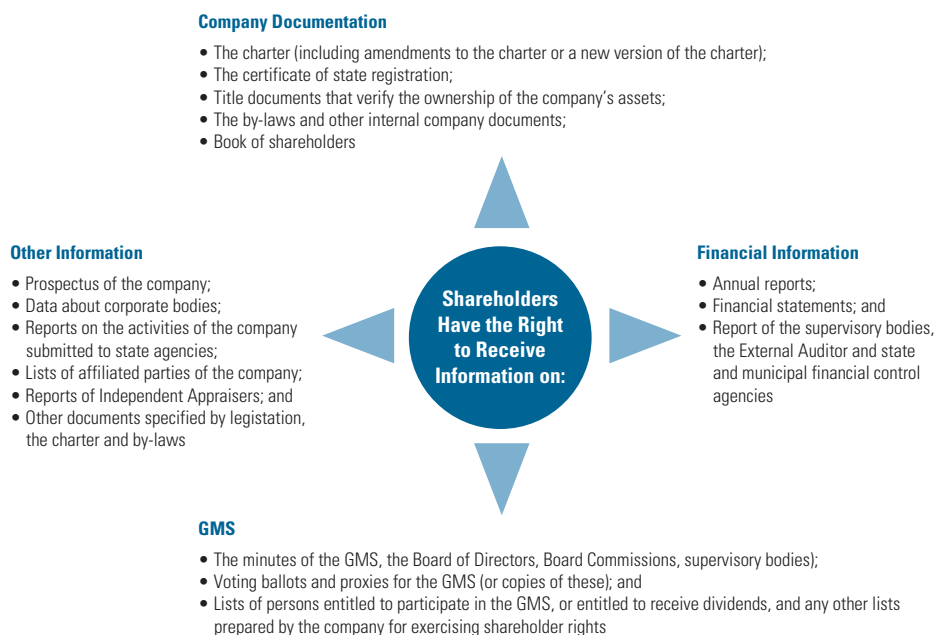
¹⁹ ICL, Article 62 paragraph (1)

3. The Right to Receive Information about the Company

Every shareholder shall have the right to examine the register of shareholders, the special register, the minutes of GMS.²⁰ In the forum of a GMS, shareholders are entitled to obtain information related to the company from the Board of Directors and/or Board of Commissioners in so far as it is connected to the agenda items and does not conflict with the company's interest.²¹ The shareholders may also request the copy of materials to the company in a GMS.²²

The AoA and internal regulations should specify the procedures that the company and shareholders must follow for the distribution of information and documents. The information rights of common and preferred shareholders under best practices are depicted in Figure 5.

Figure 5. Shareholder Information Rights



Source: IFC, March 2004

20 ICL, Article 100 paragraph (3)

21 ICL, Article 75 paragraph (2)

22 ICL, Article 82 paragraph (4)

With such a large number and variety of documents and information, it is preferable for companies with large numbers of shareholders to define in the AoA or the internal regulations the procedures for realization of shareholders' rights to receive all information. These procedures should ensure that shareholders are provided with all information within a reasonable timeframe and without disturbing the company's day-to-day activities.



Best Practices

It is good practice to provide the requested documents to the shareholders for their examination at the company's premises within five days after the request is received. The company should not charge shareholders more than the actual cost of copying the requested documents.

→ *For more information on information disclosure, see also Chapter 13.*

4. The Right to Freely Transfer Shares

Shares constitute moveable property²³ and shareholders are free to transfer their shares as stipulated in the company's AoA.

Except for voting preferred shares and shares subscribed by founding shareholders at the establishment of the company, the owners of common and preferred shares of a company have the right to freely transfer their shares to other shareholders and other persons who are not shareholders of the company. They can sell their shares at any time and at any price, without the consent of, or any pre-emptive right on the part of, the company and other shareholders.

Voting preferred shares are held by only government-authorized organizations and founding shareholders. The voting preference of founding shareholders shall be effective for three years from being granted a business registration license. After that, voting preferred shares of founding shareholders shall be converted into common shares when they can be freely transferred by the owners.

23 ICL, Article 60 paragraph (1)

There are some restrictions on the transfer of common shares subscribed by founding shareholders at the establishment of the company. Within three years from the date of being granted the business registration certificate, founding shareholders may freely transfer their common shares which are subscribed at the establishment of the company to other founding shareholders and only may transfer those shares to other non-founding shareholders upon the agreement of the GMS. After this three-year period, all restrictions imposed upon founding shareholders shall be abolished.

→ *For more information on the transfer of shares, see also Chapter 11.*

5. Pre-Emptive Rights

Pre-emptive rights for shareholders may be mandated by the article of association of company. In the event the article of association mandate that selling shareholders first offer their shares to shareholders with a particular classification or other shareholders, and within the period of 30 (thirty) days from when the date the offer is made it transpires that such shareholders have not made the purchase, the selling shareholder may offer and sell the shares to third parties. So that after the lapse of the 30 (thirty) day period, any selling shareholders compelled to offer shares is entitled to withdraw the offer. This obligation to offer to shareholders with a particular classification or to other shareholders shall only apply once.²⁴

In certain circumstances, shareholders have pre-emptive rights that allow them to purchase shares or convertible securities on a priority basis before they are offered to third parties. Thus, a shareholder has the right to subscribe newly issued shares in proportion to the par value of the shares or the book value of no par value shares he/she owns at the time the company decides to issue new shares. For listed companies, it is regulated that existing shareholders shall be given priority to be offered ordinary shares for sale at the ratio corresponding to their ownership percentage of ordinary shares in the company, except where otherwise stipulated by the GMS.²⁵

a) The Purpose of Pre-Emptive Rights

Pre-emptive rights ensure that all shareholders of the same class are treated equally. They provide the opportunity to purchase new shares when the company wants to increase its capital. Pre-emptive rights help protect shareholders from dilution, which can result in losing some of their rights due to the decrease of the percentage of shares they hold.

²⁴ ICL, Article 58

²⁵ Head of OJK Decree No. KEP-26/PM/2003

b) When Pre-Emptive Rights Exist

Whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares.

c) Pre-Emptive Rights and Fractional Shares

When shareholders exercise pre-emptive rights, fractions of shares (fractional shares) can result.²⁶ However, market practice is that the number of additional shares issued will be rounded down to the unit of share. The Board of Directors can distribute the remaining shares due to rounding to shareholders of the company or to others in an appropriate way provided that the offering conditions of such remaining shares are not better than that offered to existing shareholders.

d) The Procedure for Exercising Pre-Emptive Rights

For a listed company that intends to increase its capital stock through pre-emptive rights, the company shall conduct the following:²⁷

1. Convene a GMS to consider and approve the proposed offering;
2. Disclose the following information:
 - a) The full name of the listed company, the address of the head office, telephone, telex, facsimile, email and post office box numbers;
 - b) A description of the Securities that resulted from the exercise of the pre-emptive rights;
 - c) The date of the GMS;
 - d) The record date that determines the shareholders recorded on the Share register books have pre-emptive rights, or the coupon numbers for determining the pre-emptive rights;
 - e) The last date for exercising the pre-emptive rights with a notification that rights not exercised will expire on that date, and the last date for payment;
 - f) The trading period of the pre-emptive rights;
 - g) The price of Securities subscriptions;
 - h) The ratio of pre-emptive rights to existing shares;

²⁶ ICL Article 54

²⁷ Head of OJK Decree No Kep-26/PM/2003

- i) The procedures for subscribing for Securities;
 - j) A description of the treatment of securities that are not purchase by entitled part and pre-emptive rights in a form of fraction;
 - k) A statement regarding the procedure to transfer the pre-emptive rights;
 - l) Procedures for issuing and delivering proof of the pre-emptive rights as well as the Securities certificates;
 - m) The name of the Securities Exchange where the pre-emptive rights and the underlying shares are listed (if any);
 - n) The plan of the listed company to issue or not to issue shares or other Securities that may be converted into shares within 12 (twelve) months after the effective date;
 - o) The full name of the Party that is prepared to buy remaining shares (if any);
 - p) Dilution effect of the issuance of the shares;
 - q) The use of the funds received from the Pre-emptive Rights Offering;
 - r) A summary analysis and discussion by management; and
 - s) Information regarding where to obtain a Prospectus
3. make the Prospectus available to shareholders no later than 28 (twenty eight) days before the GMS is held.



Best Practices

A shareholder that has pre-emptive rights can exercise these rights fully or in part by submitting to the company:

- A written statement requesting the purchase of additionally issued shares or other convertible securities, must include:
 - The name of the shareholder
 - The place of residence (location) of the shareholder
 - The number of shares to be purchased by the shareholder
- A document verifying the payment for shares.

6. The Right to Demand the Redemption of Shares

Each shareholder is entitled to request the company that the shareholder's shares be bought at a fair price if the shareholder concerned does not approve of actions by the company which harm that shareholder or the company, in the form of:

- 1) Amendments of the AoA;
- 2) Assignment or securing of assets of the company which have a value of more than 50% (fifty per cent) of the company's net assets; or
- 3) Mergers, Consolidations, Acquisitions or Demergers.²⁸

In the event that the shares requested to be purchased exceed the limit of the buyback requirements that, the amount of nominal value of all shares redeemed by the company and the pledge of shares or the fiduciary security on shares held by the company itself, and/or other company which shares are directly or indirectly owned by the company does not exceed 10% (ten percent) from the amount of issued capital in the company, except otherwise regulated in the legislation in the field of capital markets, the company shall make efforts so that the remainder of the shares is purchased by the third party.²⁹

The company may redeem the shares which have issued under the following conditions:³⁰

- a. The redemption of shares shall not result in the net assets of the company becomes less than the issued capital plus the statutory reserve that has been set aside; and
- b. The amount of nominal value of all shares bought back by the company and the pledge of shares or the fiduciary security on shares held by the company itself, and/or other company which shares are directly or indirectly owned by the company does not exceed 10% (ten percent) from the amount of issued capital in the company, except otherwise regulated in the legislation in the field of capital markets.

The ICL requires that the redemption of shares shall first be agreed in the forum of GMS under the following conditions:

1. Unless otherwise stipulated under the Law of Capital Market;
2. The resolution of the GMS in order to conduct redemption of shares shall be valid if adopted in accordance with the provisions regarding notice of meeting, quorum, and approval on the number of votes to amend the articles of association as regulated in the ICL and/or the AoA.

28 ICL, Article 62 paragraph (1)

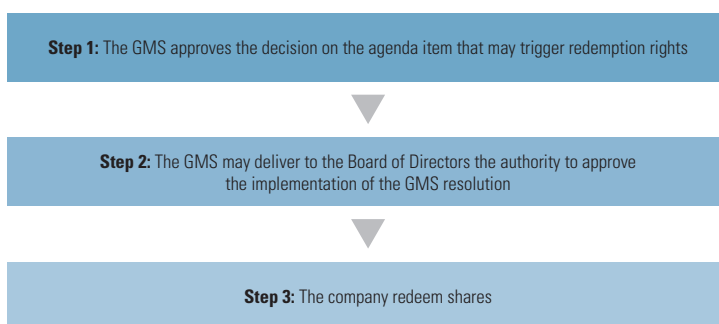
29 ICL Article 62 paragraph (2)

30 ICL Article 37 paragraph (1)

3. The GMS may deliver to the Board of Directors the authority to approve the implementation of the GMS resolution

The steps required to redeem shares are summarized in Figure 6.

Figure 6. Procedures for Redemption



7. Shareholder Rights during the Liquidation of the Company

Shareholders are residual claimants when a company is being liquidated, i.e. they will receive a portion of the assets remaining after creditor claims are satisfied. Owners of common shares have a right to receive a portion of the company's property in proportion to their holdings in the company after the company has paid out its creditors and shareholders of other classes in accordance with law.

During liquidation, a company must first satisfy its priority claimants (usually liquidation and administrative expenses, salaries, wages, employee benefits and taxes), and then obligations to creditors. Finally, the liquidator divides the remaining assets among the shareholders following a specific order of priority:

- 1) Redeemable preferred shares
- 2) Dividend preferred shares
- 3) Voting preferred shares and common shares.

The company's assets must be distributed to each group in order of priority. For example, the company cannot pay the liquidation value of preferred shares until it has paid the full liquidation value of higher priority shares. If the company does not have sufficient assets to pay all shareholders of the same priority class, then the assets must be distributed in proportion to the number of shares in the class.

Article 149 (1) of the ICL stipulated that a liquidator's obligations in settling a company's assets in the liquidation process shall cover implementation of payment of the remainder of assets resulting from the liquidation to shareholders. In the event that remaining assets have been divided among shareholders and there are creditors' bills, the District Court shall order the liquidator to retrieve the remaining assets resulting from the liquidation already divided among shareholders.³¹

8. The Right to Review the Shareholder List

The list of shareholders shall be made on the basis of the date of establishing the shareholders using an extract from the Register Book of Shareholders.

Every shareholder shall have the right to check, search, extract and copy the list of shareholders, to request amendment of incorrect information or addition of necessary information.

This right gives shareholders the opportunity to contact other shareholders and coordinate voting for collective action purposes. It is also important for verifying the information in the shareholder list, as well as exercising rights attached to shares.

Companies' Board of Directors shall make and keep a register of shareholders, containing at least:

- Shareholders' names and addresses;
- The number, serial number, and date of acquisition of shares held by shareholders and their classification in the event that more than one classification of shares has been issued;
- The amount paid up on every share;
- The name and address of an individual or legal entity who has a pledge over the shares or is the recipient of fiduciary security over shares and the date of acquisition of the pledge or registration of the fiduciary security;
- Information on the shares having been paid up in other forms.

31 ICL, Article 150 paragraph (4)

Apart from the register of shareholders, companies' Board of Directors must make and keep a special register which contains information regarding shares in the Company or in other Companies of members of the Board of Directors and Board of Commissioners together with their families and the date such shares were obtained.³²

The register of shareholders and special register must be made available in the Company's domicile so that they can be seen by the shareholders.³³ And at a shareholder's written request, the Board of Directors shall give the shareholder permission to examine the register of shareholders, special register, and GMS minutes contemplated in paragraph (1) and the annual report and to obtain copies of GMS minutes and copies of the annual report.³⁴

9. The Right to File a Claim on Behalf of the Company

The ICL introduced, in principle, the right of shareholders to request the court to overturn GMS decisions.

Each shareholder is entitled to file suit against the Company in the district court if the shareholder has been harmed by any action of the Company considered unfair and unreasonable as a result of a resolution of the GMS, Board of Directors and/or Board of Commissioners.³⁵



Best Practices

A shareholder should have the right to file suit against directors including derivative and class action law suits. The country's legal system should provide and enforce mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated (see *OECD Principles of Corporate Governance*, pages 40 & 42).

32 ICL, Article 50 paragraph (1) and (2)

33 ICL, Article 50 paragraph (4)

34 ICL, Article 100 paragraph (3)

35 ICL, Article 61 paragraph (1)

Furthermore, on behalf of the Company, shareholders representing at least 1/10 (one tenth) of the total number of shares with voting rights may file suit through the district court against the members of the Board of Directors and/or the members of the Board of Commissioners who by their fault or negligence gave rise to the losses for the Company.³⁶

→ *For more information on the liability of directors and managers, see Chapter 4, Section F, and Chapter 5, Section E, respectively.*

10. The Right to Receive Dividends

Dividends play an important role in the decision to invest in a company. One important right of shareholders is to receive dividends. The Board of Directors shall make a proposal on the pay-out ratio for each class of shares and submit it to the GMS for approval. For listed companies, the final decision is exclusively vested with the GMS which shall not be higher than the rate proposed by the Board. Dividends can be made in cash or in the form of common shares.

All net profits after the deduction to be set aside as reserves shall be allocated to the shareholder as dividends unless determined otherwise in the GMS.³⁷ The Board of Directors may decide a mid-term payment of dividends when such payment is considered to conform with the profitability of the company. Provisions regarding mid-term payment or interim dividends are stipulated in the ICL Article 72.

→ *For more information on the Right to Receive Dividends, see Chapter 10.*

11. The Right to Summon a General Meeting of Shareholders

This right is very important to shareholders to protect their rights. The ICL Article 79 stipulated that GMS may be convened at the request of 1 (one) or more shareholders who jointly represent 1/10 (one tenth) or more of the total number of shares with voting rights, unless the AoA determine a smaller number and the request shall be submitted to the Board of Directors by Registered Letter accompanied by the reasons therefor.

→ *For more information on the Right to Summon a GMS, see Chapter 8.*

³⁶ ICL, Article 97 paragraph (6) and Article 114 paragraph (6)

³⁷ ICL, Article 71 paragraph (2)

12. The Right to Nominate Candidates to be Elected as Members of the Board of Commissioners and the Board of Directors

Members of Boards of Directors and Boards of Commissioners shall be appointed by the GMS.³⁸ In practice, the majority shareholders often control the election and removal of board members.

13. Restrictions on Founding Shareholders

The regulatory framework in Indonesia does not provide any provision regarding this item.

38 ICL Article 94 paragraph (1) and 111 paragraph (1).

C. The State as a Shareholder

The State can become a shareholder in shareholding companies through buying shares or through the conversion of State companies into shareholding companies (i.e. this process is normally called as “nationalization”).

In Indonesia, the government owned shares in the State Owned Enterprises (SOEs), wholly owned or a fraction of the shares in the case of SOEs under privatization programs.

Further detail of the practices regarding this issues will be explained in Chapter 15 on SOCs.

1. The State as an Ordinary Shareholder

In this case, the influence of the State in a company is determined by the percentage of owned shares.

2. The State as the Holder of Privileged Rights

The regulatory framework in Indonesia does not provide any provision regarding this item.



Best Practices

(Foreign) investors are usually cautious about investing in companies where shares are issued having privileged rights. Despite the fact that privileged rights arrangements can play a useful role in protecting the interests of the State and the public, it is recommended that State agencies carefully weigh all the pros and cons of implementing privileged rights arrangements for each company.

3. Exercising the Rights of the State as a Shareholder

In the event that all of the State-Owned Limited Liability Company (Persero)'s shares owned by the state, then the MOLHR shall acts in his/her capacity as a shareholder, while in the event that not all of the Persero's shares owned by the state, then the MOLHR acts as a shareholder.³⁹ The MOLHR may authorize an individual or a legal entity with the right of substitution to represent him/her in the GMS, the authorized party must first obtain approval of the MOLHR with respect to:

- a. A change in the amount of capital;
- b. Amendments to the AoA;
- c. Planned utilization of profits;
- d. A merger, consolidation, acquisition, dissolution of the Persero;
- e. Long-term investment and financing;
- f. Cooperation of the Persero;
- g. Formation of subsidiaries or participation;
- h. Transfer of assets.

Further detail of the practices regarding this issues will be explained in Chapter 15 on SOCs.

39 Law on State Owned Enterprise, Article 14 paragraph (1)

D. The Shareholder Register

The shareholder register is an important document that identifies the shareholders and the owners of other registered securities of the company. It can be used to verify the number, nominal value, type, and class of shares and other registered securities held. The shareholder register is also maintained to secure shareholder rights and to monitor the circulation of shares and other registered securities.

1. The Company Share Register - Register Book of Shareholders

A company shall make and maintain a register book of shareholders from the date of being granted the certificate of business registration. Such a book may be in writing, in electronic files, or both.

The register book of shareholder shall contain at least:⁴⁰

- a) Shareholders' names and addresses;
- b) The number, serial number, and date of acquisition of shares held by shareholders and their classification in the event that more than one classification of shares has been issued;
- c) The amount paid up on every share;
- d) The name and address of an individual or legal entity who has a pledge over the shares or is the recipient of fiduciary security over shares and the date of acquisition of the pledge or registration of the fiduciary security;
- e) Information on the shares having been paid up in other forms.

A register book of shareholders shall be kept in the head office of the company.⁴¹ All shareholders shall have the right to check, refer to, extract and copy the content of the register book of shareholders at any time during the working hours of the company.⁴²

40 ICL Article 50 (1)

41 ICL, Article 100 paragraph (2)

42 ICL, Article 100 paragraph (3)

2. Registration for Obtaining the Effective Statement

Under the regulatory framework in Indonesia, a company who intends to conduct a public offering shall first submit a prospectus to the OJK. The prospectus must contain details and material facts regarding a public offering, which may influence an investor's decision. This is including a description of the capital structure, prior to and after the public offering which include a description of ownership by shareholders that own 5% or more, and directors and commissioners (number of shares, nominal value and the percentage).⁴³

In addition to this, for public companies whose registration statement has become effective must submit annual report to OJK no later than 4 (four) months after the annual report date. Information regarding shareholders with equal to or more than 5% (five percent) ownership of issuers' or public companies' shares, director and commissioners that own the issuers' or public companies' shares and group of public shareholders that own less than 5% (five percent) of issuers' or public companies' shares must be included in the annual report.⁴⁴

Other than the above, the company is also required to submit the following reporting obligation:

a. Obligation To Report Any Events, Information, or Material Facts

Regulation no X.K.1 regarding Information Disclosure that Must be Made Available to Public provides that every public company or issuer whose the registration statement has become effective, must report to OJK and announce it to public, no later than 2 (two) working days after the event occurs, which may affect the price of securities or investor's decision.

b. Obligation to Submit Periodic Financial Statement

Regulation no. X.K.2 regarding the Obligation to Submit Periodic Financial Statement requires every issuer and public company whose registration statement has become effective to submit the periodic financial statement to OJK no later than at the end of the first month after the semi-annual report date, if they are unaudited, or at the end of the second month after the semi-annual report date, if they are accompanied by an auditor's limited audit report, or at the latest at the end of the third month after the semi-annual report date, if the financial statements are audited and accompanied by the auditor's fairness opinion on the financial statement.

43 Regulation No. IX.C.2

44 Regulation No. X.K.6

c. Obligation to Report the Use of Funds Realization Received From a Public Offering

Regulation no.X.K.4 regarding Report the Use of Funds Realization Received From a Public Offering obliges the issuer whose registration statement has become effective to submit a report on the use of funds received from a public offering to OJK and Trust agent periodically every 3 (three) months (March, June, September, and December), no later than the 15th day of the following month.

3. Registration with the Business Registrar

Moreover, under the Law No. 8 year 1982 concerning Mandatory Company Registry, Company Register is a list of official record containing matters to be registered by each company. The aim of Company Register is to record any material information of the company and is the official source of information for all interested parties regarding the identity, data, and other information about the company in order to ensure business certainty.⁴⁵ This list shall include data on the company's shareholding structure (i.e authorized capital, number and nominal value of each shares and amount of subscribed and paid-up capital).⁴⁶ The competent authority who is responsible to conduct the Company Register is the Ministry of Trade.⁴⁷ For companies that have been registered in the Company Register will be given a Company Registration Certificate for a period of 5 (five) years from the date of issuance and shall be updated at least 3 (three) months before the expiry date.⁴⁸

45 Law No. 8 year 1982, Article 2

46 Law No. 8 year 1982, Article 11 paragraph (1)

47 Law No. 8 year 1982, Article 18

48 Law No. 8 year 1982, Article 22

E. The Protection of Shareholder Rights

The protection of shareholder rights lies at the center of corporate governance and is of particular importance for companies operating in emerging markets or transition economies. This protection is realized both internally (i.e. through internal corporate procedures and other guarantees envisaged by the ICL and other legislation), and externally (i.e. through outside parties).

1. Guarantees in the Indonesian Company Law

The ICL provides many guarantees to realize and protect shareholder rights. Some of these guarantees are procedural in nature and relate to the organization of the GMS. Others are reflected in the respective obligations of the governing bodies and officers of the company, i.e. members of the Board of Commissioners, the Board of Directors, the President Director.



Best Practices

It is important for the AoA to ensure that shareholder rights, and the mechanisms designed to ensure and protect these rights, are clearly defined.

2. Judicial Protection

Failing to convene an irregular meeting of the GMS as requested in accordance with the ICL within a specific period of time, the Chairman of the Board of Directors and/or Board of Commissioner shall be responsible to the law and compensate any damages and losses caused to the company. Shareholders can file a petition requesting the Court or an arbitrator to consider and/or cancel resolutions of the GMS in certain specific cases.⁴⁹

49 ICL, Article 80 paragraph (2)

Shareholders representing at least 1/10 (one tenth) of the total number shares with voting rights may file suit through the district court in certain specific circumstances.⁵⁰

3. Non-Governmental Organizations for the Protection of Shareholder Rights

The regulatory framework in Indonesia does not provide any provision regarding this item.



Comparative Practices

In some countries, NGOs play an important role in exerting pressure on companies, particularly those companies that wantonly disregard shareholder interests. NGOs may do this in a number of different ways. They may become shareholders themselves and participate in the GMS. They may also conduct letter or media campaigns to exert pressure on companies and draw public attention to the issue of shareholder rights protection. NGOs have the right to assist shareholders with:

- Providing legal help for filing a claim in court to protect shareholder rights.
- Establishing special funds for the protection of shareholders' interests.

4. Company Article of Association

A listed company shall build a rational corporate governance apparatus and an effective system of communication with shareholders in order to ensure that:

- Shareholders can fully exercise the rights provided for by law and the company's AoA.
- Shareholders are fairly treated.

⁵⁰ ICL, Article 97 paragraph (6)

A listed company shall elaborate its AoA according to the model AoA promulgated by the OJK. Pursuant to a Regulation No. IX.J.1, the main content of a listed company's AoA includes what follows:

- Name and domicile of the company
- The company's period of incorporation
- The purposes and objectives and business activities of the company
- Capitalization
- Issuance of equity securities
- Increase in the company's authorized capital
- Shares
- Proof of share ownership
- Share certificates and collective share certificates for damaged or lost shares
- Collective custody
- Transfer of rights to shares
- Members of the board of directors and commissioners
- Works plans, annual reports, annual financial reports and use of profits
- The GMS

5. Shareholder Activism and Collective Action

The protection of shareholder rights begins with good corporate behaviour, an appropriate legal and regulatory framework and appropriate enforcement procedures. Shareholders themselves must also play a role in this process. Shareholders are often the only parties aware of violations to their rights and are in the best position to either file a complaint with the company or, ultimately, with the regulatory and judicial bodies.

ICL adopts a one share one vote system. Unless the AoA stipulates otherwise, each shareholder has the right to one vote.⁵¹ The arrangement of legal protection of minority shareholders in the ICL is as follow:

51 ICL, Article 84 paragraph (1)

Articles	Minority Shareholder Rights
61 (1) of the ICL	Each shareholder is entitled to file suit against the Company in the district court if the shareholder has been harmed by any action of the Company considered unfair and unreasonable as a result of a resolution of the GMS, Board of Directors and/or Board of Commissioners.
62 (1) of the ICL	Each shareholder is entitled to request the Company that the shareholder's shares be bought at a fair price if the shareholder concerned does not approve of actions by the Company which harm that shareholder or the Company, in the form of: <ul style="list-style-type: none"> a. Amendments of the AoA; b. Assignment or securing of assets of the Company which have a value of more than 50% (fifty per cent) of the Company's net assets; or c. Mergers, Consolidations, Acquisitions, or Spin-off.
97 (6) of the ICL	On behalf of the Company, shareholders representing at least 1/10 (one tenth) of the total number of shares with voting rights may file suit through the district court against the members of the Board of Directors who by their fault or negligence gave rise to the losses for the Company.
114 (6) of the ICL	On behalf of the Company, shareholders representing at least 1/10 (one tenth) of the total number of shares with voting rights may sue in the district court members of the Board of Commissioners who because of their fault or negligence gave rise to losses to the Company.
138 (3) of the ICL	1 (one) or more shareholders who represent at least 1/10 (one tenth) of the total number of shares with voting rights may submit a petition requesting the company to be inspected.
144 (1) of the ICL	The Board of Directors, Board of Commissioners, or 1 (one) or more shareholders representing at least 1/10 (one tenth) of the total number of shares with voting rights may submit a proposal to the GMS for the Company to be wound up.



Company Practices in Indonesia

The protection of minority shareholder rights remains a key concern for many (international) investors considering investing in Indonesian companies. Powerful owners/Board of Directors often pay little or no heed to minority shareholders. On the other hand, shareholders themselves are often passive, reflecting the lack of a shareholder culture among Indonesian investors. In fact, minority shareholders seldom participate in shareholder meetings unless they are employees. This makes the role of regulatory and supervisory bodies even more important in ensuring that proper attention is paid to the protection of shareholder rights.

6. Shareholder Agreements

Shareholder agreements can be an important device for exercising collective action among shareholders. In fact, such agreements can enable minority shareholders to make use of minority rights (e.g. acquiring the 10% necessary to elect a fiduciary to examine the financial statements). The situation is more complex if agreements are concluded between shareholders and the company (or one of its governing bodies). In those circumstances, shareholders may be “locked in” in a variety of ways, e.g. by obliging themselves to always vote in favor of proposals by directors or to always follow the instructions of management in matters relating to essential shareholder rights (the right to sell their shares, the right to receive dividends and other rights).



Shareholder agreements can often be used to abuse shareholder rights and force (minority) shareholders to act in a way that is suitable for directors, managers and/or controlling shareholders. Therefore, such agreements must be carefully regulated. For example, in the U.K., shareholder agreements cannot require a shareholder to vote in one of the following ways:

- Always to follow the instructions of the company or one of its bodies
- Always approve the proposals of the company or one of its bodies
- To vote in a specified manner or abstain in consideration of special advantages.

Shareholder agreements are, in principle, a form of private, civil law contract. Yet, because of their corporate governance implications, it is necessary to make certain provisions.

First, shareholder agreements cannot substitute (or contradict) the founding documents (AoA) of the company.

Second, it is necessary to prevent the above-mentioned forms of abuse to the ability to control the voting power of minority shareholders by prohibiting the inclusion of certain terms in such agreements.

Lastly, it is necessary (particularly for publicly traded companies) to provide for greater transparency of voting control by requiring the disclosure of such arrangements. Accordingly, shareholders are required to inform GMS about the concluded contract on the next meeting of shareholders.

Under prevailing laws, there is no specific regulation on the terms of shareholder agreements or on the disclosure of shareholder agreements.

F. Responsibilities of Shareholders

1. Obligation to Make Full Payment for their Subscribed Shares

In addition to rights, shareholders also have responsibilities. The main legal responsibility of shareholders is to make full payment for shares for their subscribed shares. At least 25% (twenty five per cent) of the authorized capital must be issued and paid up in full.⁵²

2. Obligation to be Liable to Debt and other Liabilities of the Company

Companies' shareholders are not personally liable for legal relationships entered into on behalf of the Company and are not liable for the Company's losses in excess of the shares they own. However, this provisions above do not apply if:⁵³

- a) The requirements for the Company to be a legal entity have not been or are not fulfilled;
- b) The shareholder concerned directly or indirectly exploits the Company in bad faith in his/her personal interest;
- c) The shareholder concerned is involved in illegal acts committed by the Company;
or
- d) The shareholder concerned directly or indirectly illegally uses the Company's assets with the result that the Company's assets become insufficient to pay off the Company's debts.

52 ICL, Article 33 paragraph (1)

53 ICL, Article 3

3. Other Obligations

Other responsibilities may exist. Shareholders are responsible to comply with the AOA and the other prevailing laws and regulations, to observe resolutions of the GMS and the Board of Director, to provide the correct address when he/she registers subscription for shares and to perform other obligations in accordance with current law.

Other obligations may include disclosure obligations when certain thresholds of ownership are passed, or disclosure of the intent to acquire further shares or gain control of a company. These additional responsibilities generally apply to larger shareholders and are described throughout the Manual.

→ *For a discussion on the disclosure of beneficial ownership, see Chapter 13, Section B.3.*

Under certain conditions, shareholders may be held liable despite their limited liability. In particular, this refers to controlling shareholders who have the opportunity to determine the actions of or give mandatory instructions to the company.

Finally, in some countries, shareholders (especially institutional investors) may be required to vote their shares. In other countries, there is no legal requirement but it may be considered a moral imperative. Good corporate governance depends heavily on the active participation of shareholders in the governance of the company.



Best Practices

Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. They should also disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments (see *OECD Principles of Corporate Governance*, page 19).

Chapter **8**

**THE GENERAL
MEETING OF
SHAREHOLDERS**

Table of Contents

A. GENERAL PROVISIONS	285
1. Types of General Meetings of Shareholders	285
2. The Authority of the General Meeting of Shareholders	286
B. PREPARING FOR THE ANNUAL GENERAL MEETING OF SHAREHOLDERS	290
1. Drafting the Agenda	291
2. Making Preliminary Decisions	293
3. Preparing the Shareholder List	294
4. Providing Proper Notice	298
5. Approving the Agenda - Shareholders' Rights to Amend the Agenda	304
6. Preparing Draft Resolutions on Each of the Items on the Agenda	309
C. CONDUCTING THE GENERAL MEETING OF SHAREHOLDERS	310
1. Shareholder Participation Options	312
2. Shareholder Registration	312
3. Verifying and Announcing the Quorum	314
4. Opening the General Meeting of Shareholders	315
5. Electing the Voting Committee	316
6. Inviting Outside Guests as Observers	316
7. Presenting the Agenda and the Rules of Order	317
8. Discussing Agenda Items	317
9. Voting	318

Table of Contents

10. Counting and Documenting Votes	320
11. Announcing the Voting Results and Decisions	321
12. Closing the General Meeting of Shareholders	321
13. Archiving Voting Ballots	321
14. Preparing the General Meeting of Shareholders Minutes	321
15. Documents of the General Meeting of Shareholders	322
D. AN OVERVIEW OF THE EXTRAORDINARY GENERAL MEETING OF SHAREHOLDERS	324
1. When to Conduct an Extraordinary General Meeting of Shareholders	324
2. Preparatory Procedures	324
3. Circular Resolution of the Shareholders	326
E. DECISIONS OF THE GENERAL MEETING OF SHAREHOLDERS	328
1. Decisions Requiring a Simple Majority Vote	328
2. Decisions Requiring a Supermajority Vote	328
3. Decisions Requiring a Unanimous Vote	329
4. Filing Lawsuit Against GMS Decision	329



The Chairman's Checklist

The Authority of the General Meeting of Shareholders:

- ✓ Are the powers of the General Meeting of Shareholders ("GMS") clearly set forth in the AoA?
- ✓ Are there any powers of the GMS that the AoA explicitly delegates to the Board of Commissioners?

The Preparation for the General Meeting of Shareholders:

- ✓ Does the Board of Directors provide workable and timely mechanisms to include all legitimate shareholder proposals on the agenda?
- ✓ Does the Board of Directors have a clear duty to ensure that the agenda is not changed after it has been sent to all shareholders?
- ✓ Are all shareholders properly notified of the GMS?
- ✓ Is sufficient information available for all shareholders to take well-informed decisions on agenda items?
- ✓ Does the AoA require the company to provide additional information to shareholders (or others having recognized interests) on specific agenda items?
- ✓ Does the company properly inform all shareholders of the GMS on its website?

Conducting the General Meeting of Shareholders:

- ✓ Is the venue of the GMS convenient and easily accessible for all company shareholders?
- ✓ Does the company ensure that the quorum of the GMS is properly verified and properly recorded?
- ✓ Are members of the Board of Directors, Board of Commissioners, as well as the External Auditor, present during the GMS? Do shareholders have the right and opportunity to ask questions to executives and other presenters?
- ✓ Does the Board of Directors or other authorized corporate bodies or persons in accordance with company's general documents ensure that effective and independent vote counting mechanisms are in place during the GMS and that the voting results are properly recorded? Does the Board of Directors ensure that all decisions are valid and that all applicable legal requirements are met?
- ✓ Are the voting results and decisions properly communicated to shareholders?

The Extraordinary General Meeting of Shareholders:

- ✓ Does the Board of Directors convene an EGMS when circumstances require in conformity with the law?
- ✓ Does the Board of Directors convene an EGMS when the shareholder (or a group of shareholders) owning at least 10% or less of voting shares as stipulated in the company's AoA requests an EGMS?

Shareholders are the main contributors of equity capital. However, shareholders do not always wish to participate in the day-to-day management of the company's affairs. Most shareholders lack the necessary time or skills to run a company. Thus, shareholders entrust professional individuals in the Board of Directors to run the company's day-to-day operations, and elect Board of Commissioners to supervise and guide the work of the Board of Directors. However, this does not mean that shareholders completely give up their governance rights. Shareholders most commonly exercise their governance rights through the GMS.

GMS and other company organs are aligned in the same level with the separation of power to differentiate them. GMS are given the authorities which are not given to the Board of Directors and Board of Commissioners. However, GMS authorities' are limited by the provisions in the ICL and/or stipulated in the company's AoA. It is through the GMS that shareholders express their will with respect to such important company matters as the amendment of company's AoA, approval of annual reports and financial statements, the election and dismissal of Board of Directors and the Board of Commissioners, the payment of dividends and distribution of company profits, reorganization, major corporate transactions and more as stipulated in the ICL and company's AoA. The GMS also provides shareholders with the opportunity to, at least once a year, discuss these and other important matters, meet in person with their directors and commissioners, ask questions and determine the future of the company. Hence, shareholders exercise their rights to participate in the decision-making of the company through the GMS.

Preparing for and conducting the GMS is subject to detailed procedural requirements as determined by law, corporate policies and procedures. This chapter describes the authorities of the GMS, its organization and legal requirements for adopting valid decisions.

A. General Provisions

1. Types of General Meetings of Shareholders

There are two types of GMS, the Annual General Meeting of Shareholders (“AGMS”) and the Extraordinary General Meeting of Shareholders (“EGMS”).

a. The Annual General Meeting of Shareholders

ICL requires companies to hold a GMS at least once a year where the Board of Directors present all documents of the company annual report stated in Article 66 paragraph (2) of the ICL. The AGMS must be held within six months as of the end of the fiscal year. The Board of Directors shall convene the AGMS in the company’s domicile or in the place where the Company conducted its main business activity.

For public companies, the AGMS shall be held in the domicile of the stock exchange where the company’s shares are listed. However, if all the shareholders are present and/or represented in the AGMS and all the shareholders agree to the holding of an AGMS with a particular agenda, the AGMS may be held at any place located in the territory of the Republic of Indonesia. In this case, the AGMS may adopt resolutions if the resolutions are unanimously agreed.¹

b. The Extraordinary General Meeting of Shareholders

Besides the AGMS, the company can hold more meetings of this corporate body. All GMS other than the AGMS are called the EGMS. They are convened in response to specific needs and interests of the company, such as giving approval for consolidation, merger, acquisition, or spinoff, to elect and dismiss the Board of Directors and the Board of Commissioners, or to approve the capital increase or reduction.

There are no limitations on the number of EGMS that a company can conduct during the year.

¹ ICL, Article 76

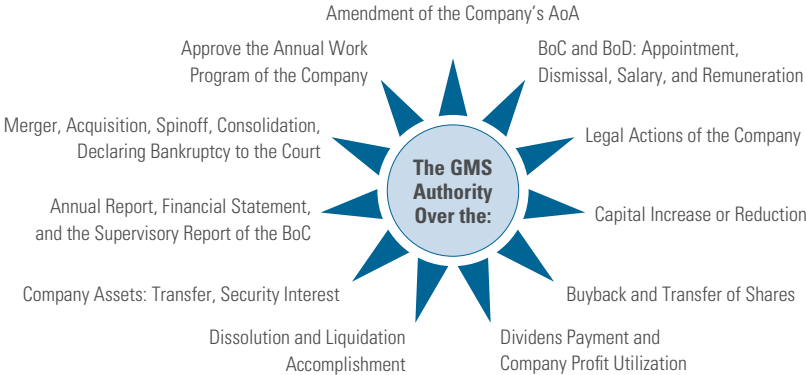
2. The Authority of the General Meeting of Shareholders

The authorities of the GMS are set forth in Chapter VI of the ICL. The AoA may, however, provide additional authorities to the GMS, unless otherwise determined by the law.

➔ *For more information on the separation of authorities between the GMS, Board of Directors, and Board of Commissioners see Chapter 4, Section A.4.a.*

The authority of the GMS is summarized in Figure 1:

Figure 1. The Authority of the General Meeting of Shareholders



More specifically, the GMS has the authority related to:

a) Decisions on Matters Relating to Governing Bodies:

- Appointment, dismissal and replacement of members of the Board of Commissioners and the Board of Directors
- Inspection of and dealing with breaches by the Board of Commissioners or Board of Directors which cause losses to the company and shareholders.

Mostly, The AoA stipulates that the GMS has the authority to decide on the number and compositions of the Board of Commissioners and the Board of Directors, as well as their salary and remuneration package. It is also stated in ICL Article 96 that a GMS may set the salary and remuneration of the Board of Directors and the Board of Commissioners.

b) Control over the Operations of the Company:

- Approve annual reports and annual financial statements
- Discuss and approve the supervisory report of the Board of Commissioners
- Discuss and approve the Board of Directors report
- Business lines, short-term and long-term developmental plans of the company.

For public companies, the Regulation No. X.K.6 stipulates the minimum contents that must be included in the Board of Commissioners and the Board of Directors reports to be presented at the GMS.

The Board of Directors report to the GMS must contain at least the following:²

- the performance of the company, including the strategic policy, measurement of achievement and the expected target, and the obstacles on the company operation
- projection of the business prospect of the company
- implementation of the corporate governance manual
- changes of the Board of Directors composition and the underlying reason of such changes (if any)

The Board of Commissioners report to the GMS must contain at least the following:³

- assessment towards the Board of Directors performance on the company management
- view on the company business prospect composed by the Board of Directors
- changes of the Board of Commissioners composition and the underlying reason of such changes (if any)

For non-public companies, there is no specific regulation on the format and contents of these reports to be presented in the GMS.

Under the ICL, there is no regulation on the authority to appoint and dismiss an external auditor. However, Article 68 of ICL stipulates that the Board of Directors must submit the company financial statement to a public accountant in certain conditions as follows:

- the company activities is to collect and manage funds of the public
- the company issue letter of debt acknowledgement to the public
- the company is a public company

2 Regulation No. X.K.6, Paragraph 2.d

3 Regulation No. X.K.6, Paragraph 2.c

- the company is a Persero
- the company own more than IDR 50.000.000.000 of assets and/or total value of the business circulation
- in the event requires by the applicable laws and regulations

➔ *For more information on internal and external control structures, see Chapter 14.*

c) Decisions on the Internal Procedures for Governing Bodies:

- Approve the amendment of AoA

The principal formalities and procedures for public and private companies in order to conduct the GMS and voting have been provided in the ICL. In addition, for listed Companies, they have to also comply with the regulation Number IX.J.1 and IX.I.1.

d) Decisions on the Capitalization:

According to Article 41 and 44 of the ICL, the companies' capital may be increased with the consent of the GMS. However, a resolution of the GMS to increase or to decrease the company capital shall be valid if adopted with due attention to the requirements for a quorum and number of votes in favor for amendments to the AoA in accordance with the provisions of ICL and/or the AoA.

➔ *For more information on capitalization, see Chapter 9.*

e) Decisions on Reorganization and Liquidation of a Company:

- Approve the mergers, acquisition, spinoff, and consolidation of the company
- Approve the liquidation the company (decision to terminate the company).

Chapter X of the ICL regulates the dissolution, liquidation and the expiry of companies as legal entities, whereby the GMS has the authority to decide through by means of GMS resolutions.

f) Decisions on Matters relating to Securities:

Article 102 paragraph (1) of ICL stipulate that a company may encumber security of more than 50% of company's assets in one or more transactions or inter-related transaction. Such Securities must be approved by the GMS unless stipulated otherwise by the AoA.

➔ *For more information on securities, see Chapter 11.*

g) Decisions on Dividends:

The GMS has the right to decide the use of net profits including the determination of the amount to be set aside for reserves. All net profits after the deduction to be set aside as reserves shall be allocated to the shareholders as dividends unless determined otherwise in the GMS. The dividends contemplated above may only be allocated if the Company has a positive balance of profits.⁴ The Board of Directors, subject to prior approval by the Board of Commissioners, may decide on the timing of dividend payment and how dividends shall be paid to shareholders.

→ *For more information on dividends, see Chapter 10.*

h) GMS Approval upon Major Corporate Transactions:

Article 102 of ICL stipulated that the Boards of Directors must obtain the GMS approval for several major corporate transactions as follows:

1. transfer of Companies' assets; or
2. assign any liabilities securities of Companies' assets,

The GMS must approved in which the transaction constitute more than 50% (fifty per cent) of Companies' net assets in 1 (one) or more, separate or inter-related transactions which occur in a period of 1(one) financial year or a longer period provided for in the AoA of the Companies.

Regarding transactions with value less than stipulated in ICL, the common practice is that the Board of Commissioners is authorized to approve such transactions. The Board of Directors should submit the transaction proposal to the board of Commissioners for approval or at least consult the board of Commissioners before undertaking the transaction. Some companies provide provisions in its AoA regarding a certain amount of the transaction where the Board of Directors should look for approval from Board of Commissioners.

→ *For more information on these transactions, see Chapter 12, Section B.*

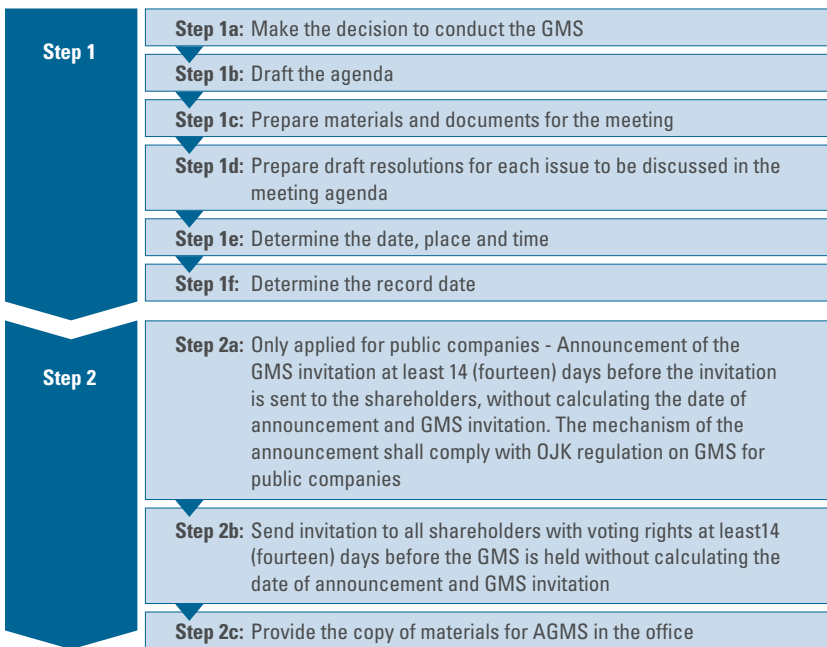
⁴ ICL, Article 71

B. Preparing for the Annual General Meeting of Shareholders

Preparing for the AGMS requires careful planning and adherence to procedural requirements. The procedures are set out in ICL and in the AoA.

The steps that must be followed are summarized in Figure 2.

Figure 2. Preparation for the GMS



1. Drafting the Agenda

The first step in preparing for an GMS is to draft the agenda. The agenda structures the GMS, and lists issues that must be addressed. Only the items properly included in the agenda in conformity with the ICL may be decided on at general meetings. Other issues, not included in the agenda may only be discussed. However, in the case where all shareholders representing 100% of the voting shares attend the GMS directly or via an authorized representative, the resolutions which are unanimously approved by the GMS shall be deemed to be effective even if the items voted on were not included on the agenda.⁵

For a public or non-public company, the GMS shall have the right to alter the meeting agenda being enclosed with the invitations sent to all shareholders. Subsequently, for these public and non-public company, it is stipulated that all resolutions and issues included in the agenda must be discussed and voted at the GMS.



Best Practices

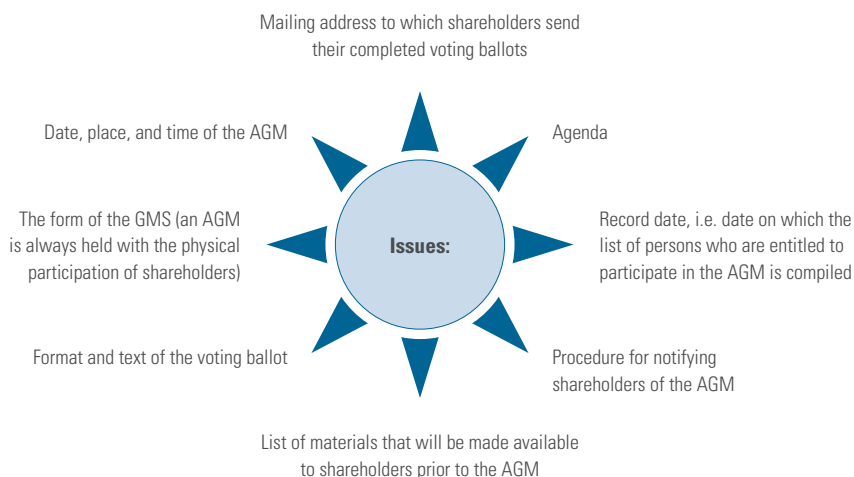
In the period preceding the decision to conduct the AGMS, the Board of Commissioners should review all the proposals, formal and informal, made by shareholders to include specific items on the agenda. Mutual understanding and cooperation between the Board of Commissioners and shareholders is very important in the corporate governance framework. In that respect, good practice would be to notify shareholders about rejected agenda items. This by no means precludes the shareholders' legal right to include items on the agenda after the decision to conduct the GMS.

⁵ ICL, Article 75 paragraph (3)

2. Making Preliminary Decisions

As depicted in Figure 3, the Board of Directors must make a number of key decisions in preparing for the GMS.

Figure 3. Issues that the Board of Directors Must Decide



Source: IFC, March 2004

a) **The Decision to Conduct the GMS**

The Board of Directors must decide to conduct the GMS before its preparation may start. As part of this decision, the Board of Directors decides the final agenda, date, place and time, notification procedures, list of materials, sample of power of attorney (if represented by proxy) and record date.

b) **The Date of the GMS**

A distinction has to be made between the AGMS and the EGMS. ICL regulates that the AGMS shall be conducted within not more than six months from the end of the financial year. The Board of Directors then determines the exact date for each AGMS, within the period stipulated by the AoA.

On the other hand, the date of the EGMS may be decided at anytime deemed as required for the Companies' interest.⁶

⁶ ICL, Article 78 paragraph (4)

c) **The Place of the GMS**

According to ICL Article 76, GMS shall be held in the Company's domicile or in the place where the Company does its main business as specified in the AoA. While the GMS of Public Companies shall be held in the domicile of the stock exchange where the Company's shares are listed. The location of the GMS as contemplated above must be located in the territory of the Republic of Indonesia. However, if all the shareholders are present and/or represented in the GMS and all the shareholders agree to the holding of a GMS with a particular agenda, the GMS may be held at any place with due attention to the condition contemplated above.



Comparative Practices

Comparative corporate governance practices recommend that:

- The GMS should be held at a location and time that allows shareholders to participate and does not impose undue expenses upon them
- The GMS should be held where the company is located or at a location defined by the AoA
- Companies that are located where access is difficult should choose a venue that is easy to access, for example by public transport. This location should be specified in the AoA
- The premises should be able to accommodate all shareholders who want to participate
- Companies should estimate how many participants are likely to attend the GMS and plan accordingly.

3. Preparing the Shareholder List

Shares bestow on their owners the right to attend and cast votes in GMS.⁷ However, these rights will apply after the shares are recorded in the register of shareholders under the name of the shareholder.⁸

⁷ ICL, Article 52 paragraph (1).a

⁸ ICL, Article 52 paragraph (2)

The next step in preparing for the GMS is to compile the list of shareholders who are entitled to participate in the GMS. Pursuant to Article 50 paragraph (1) of ICL, the Board of Directors shall keep and maintain the list of shareholders of the Company.⁹ For listed companies, administration on the shareholders is conducted by Securities Administration Agency.

a) Who Should be Included on the Shareholder List

Only persons included on the shareholder list are entitled to participate in the GMS. The distinction has to be made between right to participate in the meeting and the right to vote. Although shares bestow on their owners the right to attend and cast votes in GMS, this right do not apply to certain classification of shares as determined under the ICL.¹⁰



Best Practices

The right to participate in the GMS is a fundamental shareholder right. Processes and procedures for GMSs should allow for equitable treatment of all shareholders. (See OECD Principles, page 44). This is in accordance with the OECD principles II C, which stated that shareholders should have the opportunity to participate effectively and vote at the GMA and to be given information about the rules, including voting procedures that govern the delivery of the GMA . Therefore, the shareholder list should encompass all registered shareholders on the record date.

b) Nominal Shareholders and the Shareholder List

The regulatory framework in Indonesia prohibits the practice of nominee shareholder for company.

9 ICL, Article 50 paragraph (1)

10 ICL, Article 52 paragraph (3)



Best Practices

To ensure that all shareholders are included in the shareholder list, nominal shareholders are required to provide the company with information on the ultimate or beneficial owners they represent.

→ See Chapter 13, Section B.3 for more information on the disclosure of beneficial ownership.

c) **Information in the Shareholder List**

Article 50 paragraph (1) of the ICL, the company's Board of Director shall make and keep a register of shareholders, containing at least:

- a. name and address of the shareholders;
- b. amount, number, date of shares acquisition held by the shareholders; and the classification in the event that more than one classification of shares has been issued;
- c. amount paid-up for each share;
- d. name and address of individual or legal entity having a pledge over the shares or as the fiduciary guarantee of the fiduciary over shares, and the acquisition date of pledge on share or registration date of the fiduciary security;
- e. description on the payment of shares in other form.



Best Practices

It would be considered a good corporate practice to include the email addresses of each shareholder in the shareholder list.

d) Disclosure of Information in the Shareholder List

The register of shareholders and special register must be made available in the company's domicile so that they can be seen by the shareholders.¹¹ In some countries, information regarding physical persons, including their mailing address, may only be disclosed with their permission.

Shareholders are entitled to verify the accuracy of the information in the register about themselves and their holdings. They are entitled to make objections to any irregularity on the list and request the amendment of incorrect information or addition of necessary information. It would be a good corporate practice for a company to issue a statement within a couple of days highlighting any objection.

e) Shareholder Obligations when Selling Shares after the Record Date but Prior to the Annual General Meeting of Shareholders

Shareholders lose voting rights when they sell their shares, as voting rights are transferred automatically to the new owner. Article 55 of ICL stipulates the transfer of rights upon shares in such way regulated in the AoA and is not against the applicable laws and regulations. The transfer of rights of shares may be exercised through deed of rights transfer and then the copy of the deed is submitted in writing to the company. After the copy of the deed of transfer of shares is received, the Board of Directors must update the Shareholders List.

In practice, if the shareholder list is not updated after the record date, the selling shareholder still has the right to attend the meeting and vote. This shareholder must ensure that the new shareholder may vote at the GMS. There are two ways for the selling shareholder to fulfil this obligation:

- Grant a power of attorney to the new owner; or
- Participate in the GMS and vote in accordance with the instructions of the new owner.

¹¹ ICL, Article 50 paragraph (4)

In practice, these two options only work when the shareholder knows:

- **The identity of the buyer:** for public companies, shares are generally sold anonymously through intermediaries, thus making it impossible for the seller to identify and contact the buyer. It gets more complicated when shares are sold to multiple shareholders or during multiple and sequential transactions.
- **The record date:** In practice, shareholders are not notified about the record date before they are notified of the GMS. This makes it difficult for the seller to know if he/she is obliged to act in order to allow the new shareholder to participate in the GMS.



Best Practices

There are some ways to ensure the rights of the new shareholders as follows:

- If the instructions of the new owners coincide, their votes must be combined
- If the instructions of new owners do not coincide, the seller must vote in accordance with the instructions of new owners
- If the new owners receive power of attorney from the predecessor shareholder, the new shareholders must be registered in order to participate in the GMS and they must be given new voting ballots
- If voting shares are being circulated in foreign markets in the form of depositary receipts, voting must be based on the instructions of the depositary receipt holders.

➔ *For more information on depositary receipts, see Chapter 11, Section G.*

4. Providing Proper Notice

Once the procedures set out in Section B.3 are completed, all shareholders eligible for participation in the GMS must be notified of the GMS no later than fourteen working days prior to the opening date of the GMS,¹² without calculating the date of announcement and the date of GMS, For public companies, the announcement, invitation and time arrangement of the GMS is regulated under Bapepam LK Regulation No. IX.J.1 concerning the Main Substances of Articles of Association of Company Performing A Public Offering Having Equity Nature and Public Company.¹³



Best Practices

It is good practice that notification of the GMS:

- Allows sufficient time for all shareholders to prepare for the GMS
- Is given to all shareholders
- Allows sufficient time for shareholders to contact other shareholders
- Occurs at least 30 days in advance.

a) How to Notify

Article 82 of ICL regulates that invitation to the GMS may be issued by Registered Letter and/or by an advertisement in Newspapers.

If the company has a website, the company shall publish the notice of the general meeting on the company website together with the dispatch of the notice to shareholders.

For public companies, invitations to a GMS must be preceded by an announcement that invitations to a GMS will be issued.¹⁴ Further, under Bapepam LK Regulation No. IX.J.1 concerning the Main Substances of Articles of

¹² ICL, Article 82

¹³ This refers to Regulation No. IX.J.1 concerning the Main Substances of Articles of Association of Company Performing A Public Offering Having Equity Nature and Public Company.

¹⁴ ICL, Article 84 paragraph (1)

Association of Company Performing A Public Offering Having Equity Nature and Public Company, the announcement, invitation and time arrangement of the GMS is regulated as follow:

- 1) The announcement of the GMS shall be made at least 14 (fourteen) days before the invitation, excluding the announcement and the invitation date.
- 2) The invitation to the GMS shall be made at least 14 (fourteen) days before the GMS, excluding the invitation and the GMS date.
- 3) The invitation to the second GMS shall be made at least 7 (seven) days before the second GMS, excluding the invitation and the GMS date, with a notification that the first GMS has already been held but it did not reach the quorum.
- 4) The invitation to the GMS must include the date, time, location, agenda and notification that the materials to be discussed in the GMS are available at the Company's office as specified in ICL except the provisions of legislative regulations in the field of capital market stipulate otherwise.
- 5) The second GMS may be held no sooner than 10 (ten) days and no later than 21 (twenty one) days after the first GMS.

The company may also notify shareholders of a GMS by television or radio, or other methods such as the internet. These other methods may not, however, replace those required by ICL and those specified in the AoA.



Best Practices

Every reasonable effort should be made to inform shareholders of an upcoming GMS. A broader reach may be achieved by:

- Permitting the use of email and the internet
- Using widely read print media to disseminate notice
- Using no less than two and, ideally, several publications to give notice.

b) Information Included in the AGMS Notification

The AGMS notification should contain sufficient information to enable shareholders to participate and tell them how they will participate. It must include information required by the Article 82 of ICL Legal requirements and recommendations for this notification are summarized in Table 1.

Table 1. Information Included in the AGMS Invitation

Information	Mandatory	Recommended by the Practical Comparison Corporate Governance
1. Full Name and Company Location	✓	✓
2. Date, Location, and GMS	✓	✓
3. Name and Shareholders address or the proxy authorized by the Shareholders	✓	
4. Recoding Date of Shareholders		✓
5. Agenda	✓	✓
6. Proxy Forms	✓	
7. Information about place and time where shareholders can get the material which will be discussed on GMS		✓
8. Procedur to obtain information regarding the backound of the GMS		✓
9. Commencment time of shareholders registration(*)		✓
10. Registration place		✓
11. Reporting place on violation regarding the procedur of GMS		✓
12. Mailing address and identity of the person who's authorized by the shareholders to carry out the instructions provided in a written form		✓

c) **Information and Materials for the GMS**

Invitations to the GMS must include a notice that the materials to be discussed in the GMS will be available in the company's offices from the date on which invitations to the GMS is issued to the date on which the GMS is held. Company must give shareholders free copies of the materials to be discussed if asked.¹⁵



Company Practices in Indonesia

In most cases, the invitation merely includes instructions on where and when shareholders may get documentation for the meeting. In some companies, copies of documentation and handouts are provided at the meeting. Pursuant to ICL, The Company must give shareholders free copies of the materials to be discussed if asked.



Best Practices

Companies should identify materials that need to be provided to shareholders in their AoA.

¹⁵ ICL, Article 82 paragraph (3) and (4)

Recommended materials that should be made available to shareholders before the GMS by comparative corporate governance practices are summarized in Table 2.

Table 2. Material for GMS

1. Annual Report and Annual Financial Report
2. External Auditor Report
3. Report from supervisory Bodies (Board of Commissioner, Internal Auditor)
4. Company's Activity Report from Board of Director
5. Amendment draft of Article of Association, if there's any
6. Draft on GMS Resolution
7. Information regarding the candidate nominated as the member of Board of Director and Board of Commissioner
8. Board of Directors role on every and opinion differences
9. Material which shall be provided on GMS Agenda is Company reorganization: <ul style="list-style-type: none"> • Explanation of provisions and procedures of reorganization which contains the resolution to undertake a merger, acquisition, and separation • annual report and annual financial statements of all companies involved in the reorganization process during the period of three fiscal years or the ended fiscal years if the company established for less than three years • Quarterly accounting documents contained quarterly information prior the decision taken. • External auditor report • Report from Board of Commissioner, if there any

d) When and Where Materials Must Be Made Available

For non-listed companies, if the company has a website, the GMS materials should be posted on the website at the same time of sending the GMS notice. For public companies, it is recommended that the GMS materials, including meeting notice, proxy form, meeting agenda, discussion materials and draft resolution for each item in the agenda is posted on the website at least seven working days before the date of the GMS.



Best Practices

It would be good corporate practice to determine in the company's AoA the deadline for making all the materials for the AGMS available to shareholders. Thirty days prior to the AGMS could be an appropriate solution. ICL does not stipulate that the GMS materials must be delivered together with written notice to every shareholder, it is advisable that these materials be posted on the internet, preferably on the company's website as electronic dissemination is a simple and cost effective method of allowing broad public access. Besides, the GMS materials should also be made available at the company's headquarters during its working hours. Information and materials may also be made available at other places, preferably in an area where a significant number of shareholders reside, as long as the address is specified in the GMS notification.

Each shareholder of record has the right to receive copies of GMS materials. AoA or internal regulations can specify a short period, for example three days after the request, when copies must be provided to the shareholder.

e) **When and How Voting Ballots Circulated to Shareholders**

The regulatory framework in Indonesia does not provide any provision regarding this item. However, voting ballots are circulated to the Shareholders and/or its proxies when the GMS is conducted.



Comparative Practices

Voting ballots must be distributed to all shareholders of record:

- No later than 20 days prior to the AGMS
- By registered mail, if the AoA does not provide otherwise; or
- By hand with a delivery receipt.

In some countries, for companies with more than certain number of shareholders (for example, 500,000) with voting rights, the AoA may allow for the publication of voting ballots in the print media.

f) **When and How to Use an Option of Written Voting**

Although there are no guidelines under current law and regulations, the company should allow its shareholders and their proxies to use a written voting option. Written voting consists of giving written instructions to a person delegated by the company to vote in his/her name in his/her absence. When the company allows written voting, shareholders should be notified about the possibility of written voting and the identity of a person who is in charge of receiving written instructions.



Best Practices

When the company allows written voting, the Voting Committee should adopt the written voting manual. This manual should be applicable for every shareholders meeting where written voting is allowed. The company should publish the manual on its website and make available written copies to shareholders without charge.

5. Approving the Agenda - Shareholders' Rights to Amend the Agenda

ICL does not stipulate in detail regarding the agenda of the GMS. It only stated that the convenors of the GMS should issue invitations which include agenda of the GMS. Resolutions on items added to the agenda must be unanimously approved.

For non-public company, it is stipulated that the GMS shall have the right to alter the meeting agenda being enclosed with the invitations sent to all shareholders.

The agenda is composed of items that are:

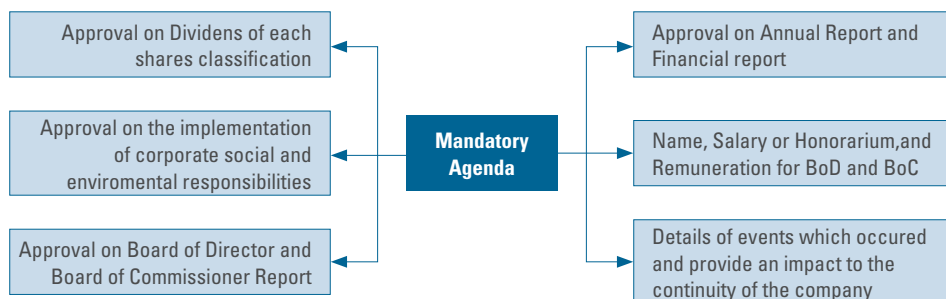
- Included upon the Board of Directors' initiative
- Proposed by shareholders.

The Board of Directors may include:

- Items in addition to those required by the law or those proposed by shareholders.

In addition to the meeting agenda, a shareholder or a group of shareholders may have the right to nominate candidates for governing bodies of the company. Figure 4 shows the items that the AGMS agenda must include.

Figure 4. Mandatory Agenda of Annual Meeting of Shareholders



For public companies, the AGMS shall also discuss and approve the short-term and long-term developmental plans of the company.

The GMS is bound by the determined agenda, Shareholders have the right to propose issues to be included in the GMS meeting agenda.

a. Who May Submit Agenda Items

A shareholder (or a group of shareholders) holding at least 10% shares in the company and member of the Board of Commissioners. In some cases, this provision is also stipulated under the company AoA where it regulates that for every submission of any agenda items for GMS, the Board of Directors must convene a meeting to discuss and to make the decision to conduct the GMS.

b. How and When to Submit Agenda Proposals

There is no specific regulation on the way of submission or how to determine the date of submission. It is good practice that the company AoA stipulates these matters in detail.



Comparative Practices

Shareholders may submit the proposals of agenda items in writing:

- By regular mail to the Chairman of the Board of Directors. Proposals are considered submitted as of the postmark date
- By hand to the Chairman of the Board of Directors (or to the Corporate Secretary, or any other person entitled to receive mail on behalf of the company). The delivery must be verified by dated receipt. The date of receipt of such a proposal is deemed to be the date of submission
- By other means, such as email or fax (if allowed by the charter and/ or internal regulations). In this case, the charter or internal regulations determine the date of submission.



Best Practices

Shareholder proposals should be included as separate items on the agenda. However, certain agenda items should be grouped together. For example, a decision on reorganization through spin-off may only be approved if the GMS also approves the following related issues:

- The spin-off procedure
- Terms and conditions of the spin-off
- The establishment of new companies as a result of reorganization
- The procedure to convert the reorganized company's shares into shares of new companies
- The approval of a transfer balance sheet.

c. **Information to be Included in Candidate Proposals**

Members of Board of Directors shall be appointed by the GMS. Initially, members of Board of Directors shall be appointed by the founders in the deed of establishment. GMS authority to appoint members of Board of Directors may not be delegated to company organs or other parties.¹⁶ Based on Article 79 paragraph 2 (a) and (b), a shareholder (or a group of shareholders) owning at least 10% of shares or the Board of Commissioners may request to conduct GMS in order to propose candidates for the Board of Directors and the Board of Commissioners.

The number of candidates that may be proposed is limited to the size of the body specified in the Company AoA. In practice, the majority shareholders often control the election and removal of board members. The number of candidates that can be nominated by majority shareholders to the Board of Directors or the Board of Commissioners is not expressly stated in ICL. Companies may determine the procedure of proposing candidates and the number of candidates that can be nominated in the AoA. The determinant to propose candidates of the Board of Directors and the Board of Commissioners usually based on total shares or the classification of shares own by the shareholders.



Best Practices

Candidates should be informed of their nomination. In addition, the GMS documents should contain an agreement that, if elected, candidates will accept the position. In the absence of such an agreement, it is recommended that the candidate physically attend the GMS and verbally confirm his/her acceptance if elected, before shareholders vote on his/her candidacy.

¹⁶ ICL, Article 94 paragraph (1) and (2)

d. Review of the Board of Directors on the Proposal of GMS by the Shareholders

The Board of Directors must decide whether to accept or reject shareholder proposals. It may reject a proposal only when:

- The proposal is incomplete or is in relation to an irrelevant matter
- The items proposed do not fall within the authority of the GMS for discussion and approval.

It is a good practice that the Board of Directors is entitled to refuse if the proposal does not otherwise comply with legislation, such as if the shareholder proposes to declare dividends when this recommendation may only be made by the Board of Directors. The regulatory framework in Indonesia does not provide any provision regarding this item.

The convenors of the GMS shall put all shareholder proposals that were not rejected in the proposed meeting agenda and contents. The proposed items will be officially added to the agenda upon the approval of the GMS. For public companies, any decision of the GMS Chairman on the order and procedures or on events arising outside the agenda of the GMS shall be final.

e. The Notification of Shareholders of Rejected Proposals

The Board of Directors should notify shareholders if their proposals are rejected or accepted. The ICL does not specify when this decision has to be made and how shareholders should be notified. However, the regulatory framework in Indonesia does not provide any provision regarding this item.



Best Practices

The Board of Directors should notify shareholders within three days of making the decision if their proposals are rejected. It must provide them with the text of its decision stating the reasons for the rejection. Shareholders should be notified by registered mail.



The rejection of or failure to make a decision on shareholder proposals may be appealed to a court. The court is authorized to issue an order, at request of such shareholders, and render a decision to that effect within 48 hours from receipt of the request.

6. Preparing Draft Resolutions on Each of the Items on the Agenda

The Board of Directors must prepare draft resolutions on each of the items on the agenda and make GMS minutes.¹⁷

Approving the annual report and financial statements are some of the most important decisions made by the AGMS. Therefore, it is a good practice that the Board of Commissioners preliminarily approves the annual report and financial statements. Before it does so, the company's Board of Directors should verify the annual report and financial statements.

¹⁷ ICL, Article 100

C. Conducting the General Meeting of Shareholders

The company may conduct the GMS once all the preparatory steps have been completed. The GMS is a key corporate governance event and its proper implementation thus takes on added importance.



Best Practices

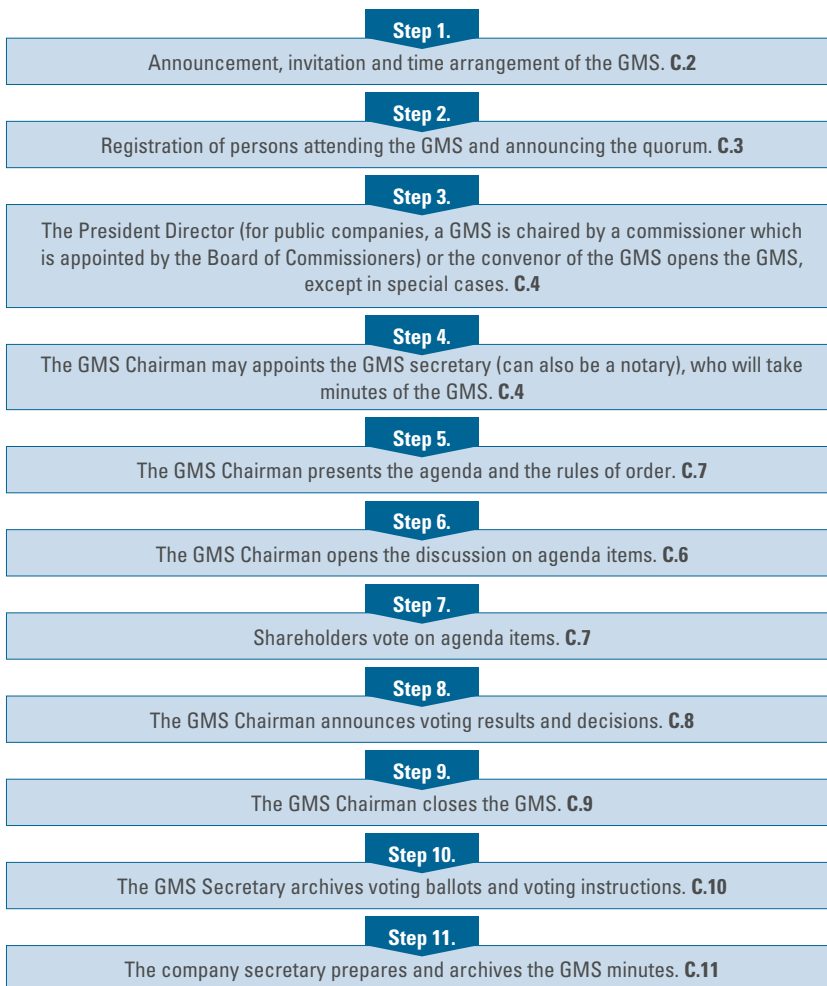
The GMS should be used to inform shareholders about company activities, achievements, plans and to involve shareholders in important decisions. For a minority shareholder, the GMS is often the only chance to obtain detailed information about the company's operations, and to meet management and directors.

Convening and conducting the GMS is a complex task and a number of steps must be followed to ensure that the GMS meets legal requirements and good corporate governance recommendations.

Clearly, one should steer away from a marathon GMS in order to avoid exhausting participants. This may pose considerable organizational challenges when the issues to be decided are either complex, contentious and/or numerous. The overriding principle for organizing the GMS is that it should be conducted in such a manner so as to facilitate effective shareholder participation and decision-making.

An overview of the steps necessary to organize the GMS is provided in Figure 5.

Figure 5. Steps for Conducting the GMS



ICL, CG Code and the AoA of the company do not provide provisions regarding detail steps for conducting the GMS. The common practice is that the company stipulate it in internal company regulations using best practices as its reference.

1. Shareholder Participation Options

Shareholders may attend the GMS in person or grant a power of attorney to a representative (proxy) who attends the GMS on the shareholder's behalf.

If participation is by proxy, letters of proxy shall be in writing in the form as prescribed by the company with adequate signatures and need not be notarized. Any person authorized to attend a GMS must submit his/her written authorization prior to entering the meeting room.

The current law and other related regulations are silent on the case where an individual shareholder dies or a legal entity shareholder reorganizes after the record date. Comparative practice suggests that in this case the legal heir or the new shareholder should be entitled to attend the GMS.

2. Shareholder Registration

The company registers shareholders and shareholder representatives before the GMS may begin. Participants must be registered to verify the quorum.



Best Practices

To avoid company officials preventing shareholders from participating in the GMS, e.g. by blocking registration, the registration procedure should be described in detail in the internal regulations of the company and in the GMS notification.

a) Who Registers Shareholders

Under the ICL, there is no guideline on how the registration will be conducted and who is responsible for these actions.



The AoA, the internal regulations or other internal corporate documents should specify the body or the person who is responsible to conduct the registration of participants of GMS. Registering shareholders can be seen as a Corporate Secretary authority, because this corporate body is responsible for GMS preparations.

b) What Documents Must Be Verified for the Registration

The Board of Directors or those who convene the GMS may require shareholders or authorized representatives entitled to attend the GMS to be checked or subject to other security measures which it considers appropriate. They may also ask competent agencies to maintain the order of the meeting, expel those who do not comply with the Chairman's instructions or intentionally cause disorder and hinder the smooth progress of the GMS or refuse to comply with the security checking requirement. However, no specific regulations on how to check and what documents must be verified are given.

It is a normal practice that in the notification of the GMS, a company usually states the documents that a shareholders or authorized person need to bring to and present for the registration at the GMS, including ID card, passport or copy of business registration certificate, invitation letter and letter of proxy (in case of being authorized).

c) Registration of Participants and Voting Ballots

Where a shareholder is registered, the company shall grant such shareholder or his/her authorized representative with voting rights.

d) The Time for the Registration of Participants

The registration of participants of the GMS officially starts at the time stated in the notice of the GMS and ends after the discussion of the last agenda item. Any shareholder or authorized representative who comes after the opening of the GMS shall be entitled to register and shall have the right to vote after registration. The effectiveness of votes that have already been made shall not be affected.



The registration of participants should be carried out on the same day just prior to conducting the GMS. Poorly organized registration may result in shareholders having to wait in line while the GMS starts. Accordingly, companies should make every effort to ensure that the registration process is quick and efficient, and that participants are not prevented from participating in the GMS due to administrative delays. This means that the registration desk needs to be adequately staffed and open well in advance of the GMS.

e) **Where Participants Must Be Registered**

Registration must take place where the GMS is held.

3. Verifying and Announcing the Quorum

There is no regulation or guideline under ICL or AoA for these activities. It is best practice that the AoA, the internal regulations or other internal corporate documents should specify the body or the person who is responsible to verify and announce the quorum. The quorum should be announced after the registration completed and before shareholders may vote.

ICL provides the following minimum quorum and voting thresholds (applicable at the first shareholders meeting called):

- **Simple majority quorum/simple majority vote:** increase of issued and paid up capital; approving annual business plan; approving annual report; the use of net profit (after 20% reserves); distribution of interim dividends; the disbursement of special reserves; hiring and firing a member of Board of Directors and Board of Commissioners; determination of salaries of Board of Directors and Board of Commissioners;
- **2/3 quorum/2/3 majority vote:** Change of company's articles of association; Increase of Authorized Capital; Decrease of capital, i.e. by way of re-purchase by the company of company's issued shares or decrease of authorized capital;

- **3/4 quorum/3/4 majority vote:** Merger; consolidation; acquisition; spin-off; voluntary bankruptcy; extension of the duration of company's operation and dissolution of company; disposing or creating security interest over its assets which represents 50% or more of the Company's net assets.

The shareholders participating in the GMS are those who are registered (in person or by proxy).

When the number of attendees required is insufficient, the meeting shall be reconvened within a period between 10 (ten) days after the first GMS to 21 (twenty one) days at the latest, as of the first GMS is held. The second GMS invitation must be sent off to the shareholders at the latest 7 (seven) days before the GMS is held. The second called GMS shall be conducted when the number of attending shareholders and authorized representatives represent at least 1/3 of the voting shares. In the event that the second GMS cannot be convened, the invitation for the third GMS must explain that the second GMS has been convened but the quorum is not sufficient to proceed the second GMS and also inform that the third GMS will be conducted with quorum stipulated by the head of the relevant district court.

For the third GMS, the company may propose to the head of district court of its domicile to determine the quorum. The same period of time is applied for the third GMS in case the second GMS cannot be convened.

4. Opening the General Meeting of Shareholders

A GMS session shall be deemed valid where it is attended by a number of shareholders that own at least 1/2 of the voting shares.

For a GMS convened by the Board of Directors, the Chairman of the Board of Directors shall chair the meeting. When the Chairman is absent or temporarily lost the ability to work, the remaining members shall select one of them to be the GMS Chairman of the meeting. In case none of the Board of Directors members can be the GMS Chairman, the highest ranking member of the Board shall guide the GMS to vote for a GMS Chairman. In other cases, the person who signs the decision to convene the meeting shall guide the GMS to vote for a GMS Chairman.

For listed companies, in every case, a commissioner which is appointed by the Board of Commissioners shall preside over the GMS. In a case where the no commissioners is available, the director which is appointed by the Board of Directors or shall preside over the GMS. Where none of such persons is able to preside over the GMS, then

a shareholder who attend the GMS and which is appointed by other attending shareholders shall preside the GMS.¹⁸

5. Electing the Voting Committee

The Chairman of the GMS must request the GMS elect Voting Committee members at each GMS. It is recommended that the company establish a Voting Committee, conditions and method for the election of its members and to determine its authority and procedures in the charter, the internal regulations or some other general internal documents of the company. The Voting Committee must have at least three members and it is advisable that one of them is a graduated lawyer. The voting committee provision is not regulated in the regulatory framework in Indonesia. However, voting committee may be regulated in the GMS order stipulates by the company.



Best Practices

It is recommended that at least one member of the Voting Committee is the representative of the minority shareholders.

6. Inviting Outside Guests as Observers

As a practical matter, the company may invite a notary and/or a legal consultant to the GMS. The role of the notary is to take minutes of the GMS and assisting the management to conduct the GMS. The AoA and internal regulations may specify procedures on inviting the notary and/or legal consultant to the GMS.

¹⁸ Regulation IX,J.1, paragraph 15 clause 3

7. Presenting the Agenda and the Rules of Order

The meeting agenda must define details and timing for each of the issues to be discussed. The agenda which has been sent to shareholders together with the GMS invitation may be amended once the GMS is held in the case where all the shareholders approve such amendment.

For public companies, any decisions by the GMS Chairman on the order and procedures or on events arising outside the agenda of the GMS shall be final.

8. Discussing Agenda Items

Although there is no regulation under current law, beside shareholders, the Chairman of the Board of Directors should invite Board of Directors and Board of Commissioners members to the GMS. Good corporate governance suggests that auditors or representatives of audit companies be invited to attend and express their opinions on audit issues at GMS meetings.



Best Practices

It is good practice that:

- Shareholders have the opportunity to question members of the Board of Commissioners, the Board of Directors and the External Auditor.
- Shareholders receive clear answers to questions.
- Questions from shareholders are answered immediately. If a question cannot be answered immediately, a written response should be given as soon as possible after the GMS.
- The GMS be conducted so that all shareholders have an opportunity to make balanced and informed decisions on all agenda items.
- The External Auditor, the President Director, and members of the Board of Commissioners, the Board of Directors, other subcommittees of the Board of Directors (if any) and members of the Management Board are present at the GMS. If they are not, the GMS Chairman should explain their absence.

- Key officers of the company, including the Chairmen of Board of Directors committees, speak at the GMS.
- To set aside some time for presentations by shareholders.
- The Chairman of the GMS interrupts speakers only to maintain order or comply with procedural requirements.

9. Voting

After one or several agenda items have been thoroughly discussed, the Chairman of the GMS invites shareholders to vote. Voting is based upon the principle of “one voting share—one vote,” except for voting preferred shares and cumulative voting.

Any shareholder who comes late shall be registered and shall have the right to immediately participate in voting at the GMS. There is no regulatory framework on this matter. However, this matter may be regulated in the GMS order stipulates by the company.

Each shareholder with voting rights or his/her authorized representative may vote corresponding with the number of issues to be voted in the meeting. Under the ICL, there is no regulation on whether the vote shall be public or secret and no regulation on the specific format and details to be included in the voting ballots. However, the voting ballot mechanism may be determined pursuant to the GMS order.

Information recommended to be included in the voting ballots is summarized in Table 5.

Table 3. Information That Must or Should Be Included on the Voting Ballot

1. The full name and location of the company
2. The form of the GMS
3. The date, place and time of the GMS
4. Issues to be voted on in the order given in the agenda
5. Voting options “for”, “against” or “abstained” on each issue
6. In the case of the appointment of Board of Directors or Board of Commissioners members, the name of each candidate
7. Deadline prior to which completed ballots must be sent to the company (if they have to be sent to the company)
8. The mailing address to which completed ballots must be sent (if they have to be sent to the company)
9. The instruction that the ballot must be signed by the shareholder, unless the voting ballots are used as a method of secret voting
10. An explanation of cumulative voting with the following text: “When Board of Directors members are elected with cumulative voting, the shareholder may cast all his/her votes for one candidate or for several candidates”
11. The ballot must have a designated area where shareholders must insert the number of votes they cast for each candidate
12. The ballot must show the number of votes each shareholder may cast to decide on each decision based on information from the shareholder list
13. Instructions on how to complete the ballot
14. The instruction that an individual who completes the ballot on behalf of a shareholder that is a legal entity must indicate his/her name and position and the full name of the legal entity which he/she represents
15. The instruction that a copy of the power of attorney must be attached to the ballot, and that the representative of the shareholder must sign the voting ballot (if the voting is by proxy).

A ballot is valid if a shareholder marks only one of the possible options for a particular item. A failure to do so invalidates the ballot with regard to that item. Improperly completed voting ballots with respect to one or more items do not cause the voting ballot to be invalid for other agenda items. Again, this provision may be applied in the GMS pursuant to the GMS order.



Best Practices

The procedure for counting votes should be transparent. To avoid any perception that the voting results have been manipulated, the Voting Committee should be independently monitored when counting votes. The charter and other internal regulations should provide for such monitoring and, additionally, define the authority of those persons appointed to monitor the counting process.

10. Counting and Documenting Votes

The votes which agree with the resolution shall be collected first, thereafter the votes which do not agree with the resolution shall be collected, and finally the overall number of votes which agree and do not agree with the resolution shall be counted for a final decision.



Best Practices

The Voting Committee must summarize voting results in its minutes. The Voting Committee minutes should contain specific information. All Voting Committee members must sign the minutes of the voting results.

→ *See Section C.15 of this Chapter.*

11. Announcing the Voting Results and Decisions

Although the ICL is silent on this matter, it is recommended that for public, non-public companies, the voting results shall be announced by the GMS Chairman before the meeting is closed. For a public company, the overall numbers of votes which agree, do not agree and abstentions shall be announced immediately after an issue is voted on.

12. Closing the General Meeting of Shareholders

The GMS Chairman closes the GMS when:

- All agenda items have been discussed and voted upon
- The voting results have been announced.

13. Archiving Voting Ballots

Basically, there are no obligations to maintain archiving of the voting ballots after the GMS is held. However, it is most likely that the secretary of the GMS will keep the voting ballots and then document them in the companies' document control along with other GMS documents.

14. Preparing the General Meeting of Shareholders Minutes

In each GMS convened, GMS minute must be made and signed by the chair of the meeting and at least 1 (one) shareholder appointed by and from the participants in the GMS. However, signature shall not be required if the GMS minutes are made by notary deed.¹⁹ The signature by the chair of the meeting and at least 1 (one) shareholder appointed by and from the participants in the GMS is intended to ensure the certainty and accuracy of the contents of the GMS minutes.²⁰

¹⁹ ICL, Article 90

²⁰ ICL, Elucidation of Article 90 paragraph (1)



The GMS should appoint two shareholders to verify the minutes. These two shareholders should also sign the minutes.

→ *For more information on the information that must be contained in the GMS minutes, see Section C.15 of this Chapter.*

The GMS minutes are inserted in the minute book. The company must provide a copy of the GMS minutes to shareholders upon request. Shareholders may be asked to reimburse the company for reasonable copying costs.

The GMS minutes can be in Indonesian or a foreign language with equal value and must include specific information.

The following documents should be attached to the GMS minutes:

- list of shareholders registration
- documents approved and decisions adopted by the GMS
- all materials attached with the meeting invitation.

15. Documents of the General Meeting of Shareholders

Table 6 presents a summary of information that must be included in the GMS minutes and information that is recommended to be included in the minutes on the voting results.

Table 4. Information Related to the Results of the GMS

Information	Must be included in the GMS Minutes	Recommended to be included in the Minutes on the Voting Results
1. Full name and location of the company	✓	✓
2. GMS address, i.e. location where it was held	✓	✓
3. Date of the GMS	✓	✓
4. Number of votes cast on each agenda item	✓	✓
5. Number of votes on each agenda item and the required quorum	✓	✓
6. Agenda	✓	
7. Voting results (number of votes "for", "against", and "abstained" on each agenda item with a quorum)		
8. Type of GMS (AGMS or EGMS)		
9. Time when registration of participants started and ended		
10. Number of votes on each agenda item that were not counted because they were invalid		
11. Method of voting		✓
12. Names of Voting Committee members		✓
13. Date of writing the Voting Committee minutes on the voting results of the GMS		✓
14. Name of the GMS Chairman and Secretary		✓
15. Name of the two appointed shareholders (verifiers of the minutes)		✓
16. Text of approved decisions	✓	
17. Summary of speeches and discussions	✓	
18. Time when the GMS was opened and closed	✓	
19. Time when the calculation of votes started, if the decisions approved by the GMS and the voting results were announced during the meeting		✓
20. Date when the GMS minutes were prepared	✓	

D. An Overview of the Extraordinary General Meeting of Shareholders

According to article 78 of the ICL, other GMS may be held at any time based on need for the Company's interests. An EGMS may be convened for the company to make important decisions between two AGMSs. The organization of an EGMS is mostly the same as the procedure for preparing and conducting the GMS explained in Parts B and C. (The particularities in the organization of an EGMS are the focus of this section.)

1. When to Conduct an Extraordinary General Meeting of Shareholders

The convention of EGMS can be performed upon the request of 1 (one) person or more shareholders jointly represent 1/10 (one tenth) or more of the total shares with legal voting right, except the AoA stipulates a less number; or the Board of Commissioners.²¹

The power to request an EGMS is an important shareholder right. Though rarely exercised in practice, it allows the controlling bodies of the company to convene an EGMS when they deem it necessary and appropriate.

2. Preparatory Procedures

Under the ICL and the AoA, there is no difference in preparing and conducting the EGMS and AGMS except for the timing of the meeting.

a) Initiating Preparation

The Board of Directors initiates preparations if required by the ICL or at its own discretion.

The Board of Directors has the right to reject the request when:

- The request to conduct the EGMS is inconsistent with the requirements of the ICL

²¹ ICL, Article 79 paragraph (2).

- A shareholder (or a group of shareholders) do not own or do not represent the required percentage of votes (at least 10% of shares giving them the right to vote on the issue put before the EGMS)
- The proposed agenda items do not fall within the authority of the EGMS.



Comparative Practices

Rejection may be appealed to the courts. The court should be obliged to render a decision, in extra-judiciary proceedings within a regulated period of time from receipt of the request.

All expenses arising from the convocation and process of the GMS as mentioned above shall be reimbursed by the company. This provision is not stipulated in Indonesia regulatory framework.

b) Drafting the Agenda

The convention of GMS can be performed upon the request of 1 (one) person or more shareholders jointly represent 1/10 (one tenth) or more of the total shares with legal voting right, except the AoA stipulates a less number; or the Board of Commissioners.

It is recommended that the proposal has to be made in writing and forwarded to the company no later than three working days prior to the opening date of such meeting.



Best Practices

The agenda may contain different items, including the election of directors. However, in the event that the number of directors becomes less than the quorum as specified by the charter, the EGMS agenda may only include a single item, that is to elect the new Board of Directors. For another mandatory EGMS, the agenda may include additional items.

c) **Specific Requirements Depending on the Agenda Item**

In Indonesia, all time periods for procedural steps in connection with the EGMS convocation are equal. The specific agenda issue does not change this rule.



Comparative Practices

Different time periods can exist for different procedural steps, depending on whether the election of Board of Directors members, which must be conducted by cumulative voting, is on the agenda. Time periods are longer in case of cumulative voting. These differences are connected with the following procedural steps:

- Maximum period between the decision to conduct a mandatory GMS and the meeting
- Maximum period between the request to conduct a voluntary GMS and the meeting
- The record date
- The notification of shareholders.

3. Circular Resolution of the Shareholders

Pursuant to Article 91 of ICL, shareholders may take a binding decision outside a GMS through a resolution. This draft resolution must be circulated to all of the shareholders. This resolution must be unanimously approved and signed by all of the shareholders in order to create a valid and binding resolution.

The draft resolution and documents explaining it must be sent by registered mail to the permanent address of each shareholder.

The draft resolution must contain the following basic particulars:

- Name and head office address
- Purpose of the resolution

- Full name, permanent address, nationality and the numbers of the people's identity cards or passports or other lawful personal identification, number of shares of each class and number of votes of the shareholder
- Issue on which it is necessary to obtain approval in order to pass a resolution.

This circular resolution shall have the same validity as a resolution passed by the GMS.

E. Decisions of the General Meeting of Shareholders

It is important to follow procedures for preparing and conducting the GMS to ensure the validity and lawfulness of decisions reached by this governing body. However, resolutions approved during GMS sessions by shareholders and their authorized representatives representing 100% of the voting shares shall be lawful and take immediate effect even in the case where the order and procedures of convention, the meeting agenda and the conducting procedures are not in accordance with regulations.

1. Decisions Requiring a Simple Majority Vote

Article 87 of the ICL states that GMS resolutions shall be adopted on the basis of deliberation to reach a consensus. In the event that resolutions on the basis of deliberation to reach a consensus cannot be achieved, resolutions shall be lawful if approved by more than $\frac{1}{2}$ (one half) of the number of votes cast unless Statute and/or the AoA specify that resolutions shall be lawful if approved by a greater number of affirmative votes.



Comparative Practices

In some countries such as Serbia, most GMS decisions can be approved by a simple majority vote of participating shareholders.

2. Decisions Requiring a Supermajority Vote

All resolutions of the GMS shall require approval by more than one half of total votes of participating shareholders, except vital resolutions which require at least 65% and 75% of the total vote. Resolutions of the GMS that require approval of at least 75% of total votes of participating shareholders include to approve Mergers, Consolidations, Acquisitions, or Spinoffs, to file applications for the Company to be declared bankrupt

or extensions of its period of incorporation, and the dissolution of the Company.²² Unless otherwise stipulated in the AoA of the Company, the supermajority vote is applied for the assignment of Company assets and to make security debt over company assets which constitutes more than 50% of the assets in one or more transaction, or inter-related transactions.²³

3. Decisions Requiring a Unanimous Vote

Under the ICL, the decision that requires an unanimous vote is stipulated in Article 91. Based on the Article 91, the shareholders may have a decision outside RUPS through circular resolution. In this case, the resolution will be valid and binding if the resolution is approved unanimously by the shareholder.

4. Filing Lawsuit Against GMS Decision

Under certain circumstances, GMS decisions may be filed to (and potentially invalidated by) the courts. Pursuant to Article 61, every shareholder may file a lawsuit against the GMS decision to the court. The filing of the GMS decision to the court may occur in the event where the decision is deemed as unfair and decided without reasonable considerations which cause losses to the shareholders. The lawsuit may be filed to the district court in the company domicile.



Comparative Practices

Any of the following violations are significant enough to revoke a decision taken by the GMS:

- Failure to provide timely notice of the GMS to all shareholders
- Depriving a shareholder the opportunity to familiarize him/herself with materials for the GMS
- The GMS lacked a quorum
- The decision has been approved in violation of the GMS' authority
- The issue in question was not included in the agenda.

²² ICL, Article 89

²³ ICL, Article 102

The court may leave the contested decision intact when the:

- Violation of the charter or internal regulations requirements results in the minor infringement of a claimant's rights or some other person or if such a violation has no substantial legal consequences
- Contestation substantially restricts the rights of third parties acquired in good faith
- The grounds for contesting the GMS decision were contrary to law, charter or internal regulations, remedied in conformity with the law.

Chapter **9**

**CORPORATE
GOVERNANCE
IMPLICATIONS OF THE
CHARTER CAPITAL**

Table of Contents

A. GENERAL PROVISIONS RELATED TO THE CHARTER CAPITAL	335
1. The Definition of Charter Capital	335
2. Legal Capital or Minimum Charter Capital	335
3. Charter Capital and Share Capital	336
4. Full Payment for Shares	337
5. Contributions to the Charter Capital	338
B. INCREASING THE CHARTER CAPITAL	341
1. Methods of Increasing the Charter Capital	341
2. Methods of Placement	344
3. Internal Sources for Increasing the Charter Capital	344
4. Ownership Rights Protection When Increasing the Charter Capital	345
5. Procedural Guarantees for Increasing the Charter Capital	346
C. PROTECTING THE CHARTER CAPITAL	349
1. Overview of Decreasing the Charter Capital	350
2. Share Buybacks	354
3. Reciprocal Shareholdings	358
D. STATUTORY AND VOLUNTARY RESERVES	359
1. The Statutory Reserve	359
2. Other Funds	359
3. Additional Paid-In Capital	360



The Chairman's Checklist

- ✓ Has the founding GMS established whether shares have been subscribed and paid up properly and whether the contributions in other forms have been brought in conformity with the law? Whether the founding GMS has decided that the company's founders have paid their initial contributions and that in-kind contributions have been properly valued?
- ✓ Does the Board of Directors understand the financial needs of the company and the different techniques of corporate finance? Is the Board of Directors authorized to increase the charter capital? Is the Board of Directors careful not to dilute the ownership of shareholders when deciding to restrict or preclude pre-emptive rights of shareholders?
- ✓ Are capital increases justified?
- ✓ Does the Board of Directors ensure that the charter capital and consequently the creditors are adequately protected in cases of charter capital decreases? Does the Board of Directors make decisions regarding the buyback of company shares? Has the Board of Directors ensured that all shareholders who submit their shares are treated equitably?
- ✓ How does the Board of Directors ensure that the reserve fund is utilized in the best interests of the company? What other funds has the company established?

The ICL and other related regulations attach certain protective functions to charter capital, protecting shareholders from dilution and providing a minimum guarantee that obligations toward company creditors will be fulfilled. Although the charter capital per se cannot fulfil that role, it is still considered one of the elements guaranteeing the interests of creditors. Regarding shareholders, the charter capital plays an important role since many shareholder rights are directly linked to the size of their investment in the charter capital.

Charter capital has a legal, rather than economic meaning. It only exists in accounting terms, as fixed in the balance sheet. For this reason, its protective function is often criticized as a formality. Regardless, it is a legal requirement when establishing and operating a company. Legislation provides for certain rules that govern both increases and decreases in the charter capital. In addition, there are other procedural guarantees of shareholder and creditor rights, such as the buyback by the company of its own shares, the redemption of shares, reciprocal shareholdings and the maintenance of statutory reserves, all of which are discussed in this chapter.

A. General Provisions Related to the Charter Capital

The charter capital is an important element of the legal definition of a limited liability company, which is defined as a commercial entity, whose charter capital is determined and divided into a specified number of shares, certifying the company shareholders' rights in relation to the company. The charter capital has important legal implications for:

- Determining the minimum amount of a shareholder's liability
- Determining shareholder rights in relation to their proportionate share in the charter capital
- Offering support to protect creditor rights by setting the minimum amount of assets a company must have. This is one of the legal instruments upon which creditors can rely when seeking to ensure that the company will fulfil its contractual obligations.

1. The Definition of Charter Capital

The charter capital is defined as the amount of capital that is contributed or committed within a specific period by all shareholders and is recorded in the company's AoA. For a limited liability company, the charter capital is divided into several equal proportions being called shares. Bonds and other credit instruments are not part of the charter capital.

2. Legal Capital or Minimum Charter Capital

Legal capital means the minimum level of capital as stipulated by law to establish a company. In Indonesia, the legal capital is regulated in the ICL. Article 32 stipulates that companies' charter capital shall be at least Rp. 50.000.000 (fifty million Rupiah). However, statutes regulating certain business activities may determine a minimum amount for companies' charter capital which is greater than the provision for charter capital contemplated above.

The legal capital requirement is to protect the benefits of consumers and creditors of companies operating in an industry.

3. Charter Capital and Shares Capital

Companies' charter capital shall consist of the total nominal values of their shares. However, this provision does not close off the possibility of legislative provisions in the field of capital markets providing for companies' capital to consist of share without nominal values.¹

The company is not required to issue all its authorized shares. Generally a much greater number of shares are authorized than required, to give the company flexibility to issue more shares as needed. If the company chooses not to issue authorized shares, these shares are referred to as authorized, but not issued.

Only those shares that are issued and fully paid constitute the charter capital.

The total charter capital that a company sets forth in its AoA is based upon the amount of money that the company requires at its establishment for further financial development. In addition, this decision is conditioned by the percentage of dilution its founders are willing to accept in the future.

During its business operation, the company may decide to issue additional shares to increase the charter capital. One of the purposes of authorized shares is to avoid costly and time-consuming GMS organization procedures every time the company seeks additional capital.



Best Practices

Good corporate governance practices stipulate that the AoA should authorize the Board of Directors to increase the charter capital by issuing authorized shares. When doing so, the AoA should include the following information:

- Maximum number of authorized shares. In general, the maximum amount must not exceed 50% of the charter capital at the moment of the authorization for the Board of Directors to issue authorized shares.
- Types and classes of authorized shares
- Form of payment for additionally issued shares.

¹ ILC, Article 31

4. Full Payment for Shares

Founding shareholders shall subscribe together and paid up in full at least 25% of the total common shares issued by the company as stipulated in the Article 33 paragraph (1) of the ICL. The capital subscribed and paid in full shall be proven by lawful evidence of deposit.² “Lawful evidence of deposit” means, amongst others, evidence of deposit by the shareholders into a bank account under the name of the company, data from financial reports audited by an accountant, or the company’s balance sheet signed by the Board of Directors and Board of Commissioners.³ Any further issuance of shares at any time to increase the subscribed capital must be paid up in full. This means that the ICL does not provide the possibility to pay up shares by means of installments.⁴

If any founding shareholder does not pay in full for his/her subscribed shares, the uncontributed shares shall be resolved by one of the following methods:

- All of the other founding shareholders will buy the unpaid subscribed shares corresponding to their share proportion owned in the company
- One or a number of founding shareholders agree to fully contribute the unpaid shares
- Call for other persons who are not shareholders to contribute the unpaid shares and that person shall become the founding shareholders of the company.

When all subscribed shares of all founding shareholders are not paid in full, all founding shareholders shall jointly responsible for all the debts and other obligations of the company to the extent of the value of the unpaid shares.

Although the regulatory framework in Indonesia does not provide any provision concerning procedure when a shareholder fails to pay in full and on time the committed amount to purchase shares, the AoA may stipulates that where a shareholder fails to pay in full and on time the committed amount to purchase shares, GMS shall notify and have the right to request such shareholder to pay the unpaid amount together with interest on such sum, plus costs arising from failure to pay in full to the company within a specified period of time (at least seven days from the date on which the announcement is sent). If the shareholders still do not pay for the shares purchased within this time period, the GMS shall have the right to withdraw the relevant number of shares before all amounts payable including interest and relevant costs are paid for in full. Any withdrawn shares shall be the assets of the company. GMS may directly sell or authorize

² ICL, Article 33 paragraph (2)

³ ICL, elucidation of Article 33 paragraph (2)

⁴ ICL, Article 33 paragraph (3)

to sell or re-distribute such shares to, or resolve them in favor of, the individuals who owned such withdrawn shares or to other entities, on conditions and in the manner the GMS considers appropriate.

Shareholders holding withdrawn shares shall be required to waive their shareholdership status with respect to such shares, but shall still be required to pay all relevant amounts plus proportional interest at the rate stipulated at the time of withdrawal, from the date of withdrawal up to the date of payment, in accordance with a GMS decision. GMS shall have full power to make a decision on enforcement of payment of amounts payable as at the time of withdrawal, or may make a decision on remission of part or all of such amounts.



Comparative Practices

Penalties or obligations in cases of non-payment or failure to pay in full should be stipulated in the company's AoA or shareholder agreement.

5. Contributions to the Charter Capital

In general, shares issued during the establishment of the company and in the course of business can be paid in the form of money and/or in other forms.⁵ Other forms contributions are, however, subject to certain rules. Other forms contributions upon the establishment of the company shall be appraised based on a reasonable value determined in accordance with market prices or by an expert not affiliated with the company.⁶

The assets used for capital contributions during the course of business need to be evaluated either as agreed upon between the company and the contributors or by a professional appraiser, in which case, the value of the assets should be accepted by both the company and the contributors. If the value of assets is appraised higher than

⁵ ICL, Article 34 paragraph (1)

⁶ ICL, Article 34 paragraph (2)

their actual value at the time of capital contribution, the contributors or the appraiser and the legal representative of the company shall jointly assume their liability with respect to the company's debts and other obligations by the difference between the value determined and the actual value of the assets at the time the valuation is completed.

For listed companies, the payment for shares in the form of other than money, either in the form of tangible or intangible assets, must fulfill the following requirements:⁷

- 1) assets used as payment for shares must be published on the invitation date to the GSM regarding the payment;
- 2) assets used as payment for shares must be appraised by an appraiser registered with the OJK and are not pledged as collateral in any way;
- 3) approved by the GSM attended by quorum as referred to in article 86 paragraph (1) and (4) of the ICL;
- 4) if the assets used as payment for shares are in the form of shares of another company listed on the stock exchange, the price of the shares is determined based on its fair market value;
- 5) if the sources of payment come from the Company's retained earnings, capital paid up in excess of par value, net profit and or other component of the Company's equity capital, then the retained earnings, capital paid up in excess of par value, net profit and or other component of the Company's equity capital must have been stated in the latest annual financial reports audited by an Accountant registered with the OJK with an unqualified opinion.



Best Practices

Any individual (or a legal entity) needs a license to be an Independent Appraiser. An Independent Appraiser cannot be a founder, an owner, shareholder, employee, contractor, or any other person affiliated with the company.

⁷ OJK Regulation Number IX.J.1

A company should use a licensed Independent Appraiser to determine the market value of property, value debts and assess liabilities. An Independent Appraiser can also play an important role in assisting management and shareholders during the company reorganization.

It is a good comparative corporate practice to insure an Independent Appraiser against civil liability.

B. Increasing the Charter Capital

A number of different factors, such as market conditions, reorganizations, development programs and growth, may necessitate an increase in charter capital. The charter capital can be increased from:

- Utilizing external sources, such as when the company attracts financial resources from existing shareholders or third parties
- From internal sources when the company uses its own funds to capitalize its internal reserves.

As discussed further in this subchapter, the most important questions when considering increasing the charter capital will be evaluated mostly from the public companies' point of view. In that respect, these questions will be observed through relevant legislature that regulates the organization and operation of companies, as well as the securities market.

1. Methods of Increasing the Charter Capital

Companies' capital may be increased with the consent of the GMS. However, the GMS may deliver to the Board of Commissioners the authority to consent to the implementation of the resolution of the GMS for a period of not more than 1 (one) year and may be withdrawn by the GMS at any time.⁸

A resolution of the GMS to increase the subscribed and paid up capital within the limits of the charter capital shall be valid if adopted with a quorum attending of more than $\frac{1}{2}$ (one half) of all the shares with voting rights and votes in favour from more than $\frac{1}{2}$ (one half) of all the votes cast, unless larger numbers are determined in the AoA. The MOLHR must be informed of increases in capital so that they can be recorded in the register of companies.⁹

For listed companies, Increases in charter capital that result in subscribed and paid up capital becoming less than 25% of the Company's charter capital shall refer to Regulation Number IX.J.1 point 7 item b.

⁸ ICL, Article 41 paragraph (1) and (2)

⁹ ICL, Article 42 paragraph (2) and (3)

Regarding the conversion of issued convertible bonds into shares, the increase of charter capital shall be affected only when the conditions for converting bonds into shares as prescribed by law and stated in the plan on issuance of convertible bonds are fully met.

In general, the increase in the charter capital can be conducted under three methods as follows:

- 1) A capital increase against contribution
- 2) A conditional capital increase
- 3) A capital increase out of a capital surplus, retained earnings and other funds available from internal sources.

Technically, every method of increasing the charter capital can be done by issuance of additional shares. In many countries, companies can increase their charter capital by issuing shares with a higher nominal value.

All methods to increase the charter capital are summarized in Table 1.

Table 1. Increasing the Charter Capital

	Capital Increase Against Contributions	Conditional Capital Increase	Capital Increase out of a Capital Surplus, retained Earnings and Other Funds
Source	External	External	Internal
Contributors	Shareholders and third parties	The owner of convertible bonds	The Company (using funds available from internal sources as defined by legislation)
Purpose	To attract additional funding. It will, however, dilute the holdings of existing shareholders if they are unwilling/ unable to make use of their pre-emptive rights.	To allow owners of convertible bonds to use their rights of conversion into shares	To increase the company's equity and to decrease the company's funds and reserves available for distribution
Recipients	Existing shareholders and third parties	The owners of convertible bonds	Only existing shareholders
Changing the Company's Ownership Structure	Possibly	Yes	No
Method of Capital Increase	Issue of additional shares	Issue of additional shares	Issue of additional shares
Method of Placement	Subscription (open or closed)	Conversion	Distribution
Approving Governing Bodies	The GMS, unless delegated to the Board of Directors	The GMS	The GMS
Pre-emptive Rights	Yes	No	No

2. Methods of Placement

There are three methods of placing shares:

- 1) Distribution among existing shareholders
- 2) Conversion of convertible bonds; and
- 3) Subscription by shareholders and third parties.

3. Internal Sources for Increasing the Charter Capital

Depending on the method chosen to increase the charter capital, the company can use the funds of shareholders and/or third parties. It can also choose to capitalize using its internal resources. The company may use the following internal resources for capitalization purposes:

- The capital surplus
- Funds for investment and development
- Retained earnings
- Other reserve funds as defined by specialized law and regulation.

All shares issued for an increase in capital must be first offered to each of the shareholders in proportion to their ownership of shares for the same classification of shares according to regulation No. IX.D.1 Number 4.¹⁰ However, this provision does not apply to issuance of shares:¹¹

- a) directed to the company's employees;
- b) directed to holders of bonds or other securities which are convertible into shares and which were issued with the consent of the GMS; or
- c) made in the context of re-organisation and/or restructuring with the consent of the GMS.

Public companies that wish to issue shares for payment of dividends to current shareholders to increase charter capital must have that issuance adopted by the GMS and have sufficient sources for issuance from after-tax profits which are reflected on their latest audited financial statements.

¹⁰ ICL, Article 43 paragraph (1)

¹¹ ICL, Article 43 paragraph (3)

Public companies that wish to issue bonus shares to current shareholders to increase charter capital must have that issuance adopted by the GMS and have sufficient sources for issuance from the internal resources.

Companies are not allowed to use the increased fixed assets value due to self-revaluation of assets (without the State's policies) to increase the charter capital.

The issuance of shares for payment of dividends or issuance of bonus shares must be supported by the GMS decision approving the issuance plan and the latest audited financial statements or other necessary documents proving lawful capital sources to be used for issuance of additional shares.

4. Ownership Rights Protection When Increasing the Charter Capital

The company's ownership structure will likely change if the charter capital is increased from external sources. As previously mentioned, issuing additional shares results in the dilution of the ownership rights of existing shareholders. Therefore, the default rule is that the existing shareholders have pre-emptive rights to protect them from dilution.¹²

→ *For a more detailed discussion on pre-emptive rights, see Chapter 7, Section B.5.*

When increasing the charter capital from internal sources, additional shares must be distributed to all owners of shares of each type and class. In addition, the number of new shares of each type and class that are distributed to each shareholder must be proportional to the number of shares already held by him/her. Market practice is that the number of additional shares issued will be rounded down to a unit of share. The GMS shall decide on how to treat the remaining shares due to rounding. Some companies may transfer the face value of those shares to fund for investment and development; some may repurchase those shares for treasury shares.

¹² ICL, Article 43

5. Procedural Guarantees for Increasing the Charter Capital

The ICL and securities legislation provide detailed procedures that public companies must follow to increase charter capital. These procedures are aimed at guaranteeing that shareholder rights are protected. OJK, by giving approval and registering share issues, plays an important role in overseeing the legality of the increase, thus enforcing proper corporate governance practices in such cases.

At a company level, the GMS plays the leading role in increasing the charter capital, depending on the method chosen and the authority for decision-making in the procedure for increasing the charter capital.

a) **The GMS Makes the Decision to Increase Capital**

As previously mentioned, the ICL stipulates that companies' capital may be increased with the consent of the GMS which consent may be assigned to the Board of Commissioners for a period of not more than 1 (one) year and the delivery of such authority may be withdrawn by the GMS at any time.¹³

However, it is required that the GMS approve the issuance of shares for payment of dividends and the issuance of bonus shares. There is no specific regulation on the issuance of additional shares for capital increases against contribution.

For listed companies, the approval of the GMS for the issuance of additional shares is needed.

➔ *For a more detailed discussion of shareholders right to amend the agenda, see Chapter 8, Section B.5.*

b) **The Board of Directors' Involvements in the Decisions to Increase Capital**

The regulatory framework in Indonesia does not provide any provision with regard to this item as the power to decide private placement of shares rests with the GMS.

13 ILC, Article 41



The Board of Directors should conduct a meeting where directors are physically present to approve the decision to place shares. The Board of Directors may only approve the decision to place shares if the number of additional shares of each type and class to be issued does not exceed the total number of authorized shares of each type and class as set forth in the AoA.

c) **Information that Must Be Included in the Decision to Place Shares**

The ICL stipulates that the GMS shall decide the time, method and offer prices of shares within the shares to be offered. However, there is no requirement on what information needs to be included in the decision to place shares.

The public offering of shares shall need to be registered with the OJK which will then grant the company a public offering of shares certificate. For the registration of the public offering of shares, the issuing organization must submit the OJK with the following documents:¹⁴

- A written registration of public offering of shares
- A prospectus
- The issuing organization's article of association
- The GMS decision adopting the issuance plan and the capital usage plan generated from the public offering of shares
- An issuance underwriting commitment (if any).

Public offering of shares registration dossiers must be accompanied with Boards of Directors decisions approving those dossiers. For the public offering of credit institution securities those dossiers must be approved in writing by the OJK.

14 Decree of OJK Chairman No. KEP-39/PM/1997

d) Issue of Shares for Other Forms Contributions

Share capital of a limited liability company may be paid up in the form of money and/or in other forms. In the event that the share capital is paid up in some other form, the valuation of the share capital paid up shall be specified based on a reasonable value determined in accordance with market prices or by an expert not affiliated with the company. Shares paid up in the form of immovable property must be announced in 1 (one) or more newspapers within a period of 14 (fourteen) days after the deed of establishment is signed or after the GMS resolves on such paying up of shares.¹⁵

It is good practice that if the decision to place shares allows shareholders to pay for additional shares with other securities, or with other assets having monetary value, such a decision should include the:

- Detailed description of the other forms contribution
- Person from which they are to be acquired
- Number and nominal value (or accountable par in case of shares without nominal value) of shares which are to be acquired by such contribution.

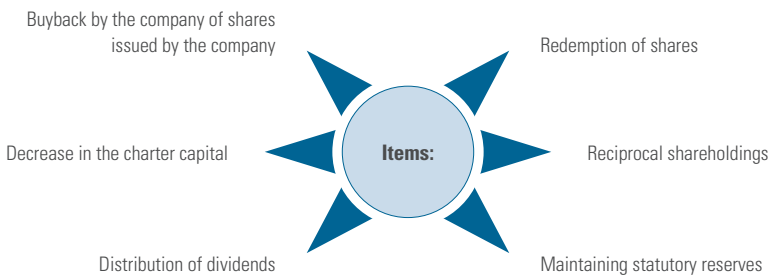
15 ICL, Article 34

C. Protecting the Charter Capital

One of the purposes of the charter capital is to provide a minimum guarantee that the company will fulfil its obligations toward creditors. However, this function will only exist in theory if it is not linked to preserving a minimum level of company assets. The company has to send a notice of the decision to reduce the company's charter capital to the authorized business registration body. The company has to commit that it will make payments to all debts and other obligations after the reduction of the charter capital. The Board of Directors must inform all creditors of the resolution of the GMS to reduce the company's capital by announcing it in 1 (one) or more newspapers within a period of not more than 7 (seven) days from the date of the GMS resolution.¹⁶ Where the company operates in an industry that requires legal capital, the company can only register to reduce the charter capital if the registered capital after reduction is not lower than the applicable legal capital.

There are other actions that may, in one way or another, affect the charter capital and net assets. Such actions and mechanisms, which protect against the distribution of the company's assets to shareholders or other parties to the detriment of creditors, are listed in Figure 1.

Figure 1. Protection of the Charter Capital



Source: IFC, March 2004

¹⁶ ICL, Article 44

1. Overview of Decreasing the Charter Capital

The question of decreasing the charter capital is of great importance because of the potential for abuse in practice, because it can be used as a tool to create returns for shareholders without paying dividends. A decrease in the charter capital can favor some shareholders at the expense of others. It is essential to ensure the equitable treatment of all shareholders. This holds particularly true if the company has several classes of shareholders with different rights or holders of other securities. At the same time, a decrease in the charter capital reduces the level of shareholders' liability and the minimum amount of assets intended to serve as a guarantee that the company will fulfil its obligations toward creditors.

Thus, any decrease in the charter capital can be:

- Real when it involves a share buyback from shareholders; or
- Nominal when the charter capital is decreased by writing off losses, intended to reorganize the company's financial position, or when the charter capital is transformed into reserves that can be used for future distribution.

a) Methods of Decreasing the Charter Capital

Resolutions of the GMS concerning reductions in subscribed and paid up capital shall be carried out by means of a withdrawal of shares or a reduction in the nominal value of shares. The withdrawal of shares may be carried out against shares which have been re-purchased by the company or against shares with a classification which may be withdrawn. Reductions in the nominal value of shares without repayment must be carried out in proportion against all shares of every classification of shares.¹⁷

The regulatory framework in Indonesia does not provide details provision on how to perform a capital reduction. In practice, the charter capital can be decreased using the following methods:

- The company shall purchase and cancel a number of treasury stocks with par value equal to the amount of capital planned to be reduced as approved by the GMS, or the company cancels the treasury shares which must be cancelled. By this mode, companies shall not have to return money to their shareholders.
- Companies shall withdraw and cancel a quantity of shares from shareholders with a total par value equal to the amount of capital reduced. By this mode,

17 ICL, Article 47 paragraph (1), (2) and (3)

the company shall buy back a number of shares from each shareholder in accordance with his/her equity proportion in the company. The company shall have to pay their shareholders an amount of money equal to the number of shares withdrawn times the par value of shares.

- Reducing the nominal value of shares without changing the number of shares. By this mode, the company shall withdraw shares from shareholders and issue new shares with reduced par value. The company shall have to pay to their shareholders an amount of money equal to the number of shares of each shareholder times the difference between old and new par values.
- Combination of the above methods based on the actual situation, joint stock companies may apply the above-mentioned methods in combination in reducing the charter capital.

For listed companies, in case a shareholder does not pay the full amount of shares purchased on time, these shares can be withdrawn under the request of the GMS. Any withdrawn shares shall be assets of the company. The GMS may directly sell or authorize to sell or re-distribute such shares to, or resolve them in favor of, the individuals who owned such withdrawn shares or to other entities, on conditions and in the manner the GMS considers appropriate.

b) Mandatory and Voluntary Decreases of the Charter Capital

The regulatory framework in Indonesia does not provide provision regarding this matter.

c) Procedures for Decreasing the Charter Capital

The ICL stipulated a general guideline for a limited liability company to follow in the case of capital reduction in fourth part article 44 until 47. The principles are including:

1. Conducted with the approval of the GMS;
2. The GMS shall be valid if adopted with due attention to the requirements for a quorum and number of votes in favour for amendments to the AoA in accordance with the provisions of the ICL and/or the AoA;
3. Notify all creditors of the company the resolution of GMS;
4. Must obtain the MOLHR approval.



Comparative Practices

The decision to decrease the charter capital must be taken by a simple majority vote of shareholders participating in the GMS.

The Board of Directors can make the following decisions in connection with the capital decrease:

- First, the decision to retire treasury shares, unless otherwise provided by the authorized or the internal regulations. Therefore, the Board of Directors is presumed to decrease the charter capital in the described manner.
- Second, the decision to decrease the charter capital using other ways (for example, by decreasing the nominal value of issued shares), if the authorized or the internal regulations authorize the Board of Directors for such a procedure.

If the GMS is authorized to decide on decreasing the charter capital, that is the legal presumption except for retiring treasury shares, the proposal to decrease the charter capital can be placed on the GMS agenda either by a shareholder proposal or a Board of Directors' initiative.

If the proposal to decrease the charter capital is submitted by the Board of Directors, a simple majority vote of its members participating in the Board of Directors meeting is required, unless the authorized or internal regulations require a higher percentage of votes.



Best Practices

The quorum for the GMS meeting proposing or deciding to decrease the charter capital should be defined as two-thirds of all directors.

d) **Information Included in the Decision to Decrease the Charter Capital**

Under the ICL and related regulations, there are no specific requirements on the information that must be included in the decision to decrease the charter capital.



Comparative Practices

The decision to decrease the charter capital must include information on:

- The amount of decrease
- The purpose of decrease
- The procedure for decreasing the charter capital
- The method of decreasing the charter capital.

e) **Decreases in the Charter Capital and Creditor Protection**

A decrease in charter capital typically affects creditor rights since it decreases the minimum amount of the company's assets serving as a guarantee that the company can meet its obligations toward creditors. The ICL regulates that the Board of Directors must inform all creditors of the resolution of the GMS regarding the company's capital by announcing it in 1 (one) or more newspapers within a period of not more than 7 (seven) days from the date of the GMS resolution.¹⁸



Best Practices

The company should notify creditors of a reduction in the charter capital. The announcement duties fall under the authority of the President Director who will commonly assign this task to the Corporate Secretary or another person.

¹⁸ ICL, Article 44 paragraph (2)

The ICL provide regulations regarding the creditors protection in the case of liquidation or winding up of a company. Within a period of not more than 30 (thirty) days as from the date the Company is wound up, the liquidator shall notify:¹⁹

- a. all creditors of the winding up of the Company by means of an announcement of the Company's winding up in a Newspaper and the State Gazette of the Republic of Indonesia; and
- b. the MOLHR of the winding up of the Company for it to be recorded in the register of Companies that the Company is in liquidation.

The notification of the creditors in the Newspaper and the State Gazette of the Republic of Indonesia shall contain:

- a. the winding up of the Company and its legal basis;
- b. the liquidator's name and address;
- c. the procedure for the submission of claims; and
- d. the period for submission of claims.

2. Share Buybacks

Under certain circumstances and conditions, companies have the right to repurchase their own shares. This is called a share buyback. Share buybacks may have a number of corporate governance implications. First, there may be a financial planning concern, since cash is used to purchase shares, fewer funds may be available for further business development. Second, shareholder rights can be abused if the company does not provide equal opportunities to all shareholders to sell their shares back to the company. In this respect, the ICL stipulates that each shareholder is entitled to request the company that the shareholder's shares be bought at a fair price if the shareholder concerned does not approve of actions by the Company which harm that shareholder or the Company, in the form of:²⁰

- a. amendments of the AoA;
- b. assignment or securing of assets of the company which have a value of more than 50% (fifty per cent) of the company's net assets; or
- c. Mergers, Consolidations, Acquisitions, or spin off.

19 ICL, Article 147 paragraph (1) and (2)

20 ICL, Article 62 paragraph (1)

In the event that the shares requested to be bought exceeds the limit on re-purchase of shares by the Company, the Company must endeavor that the remaining shares be bought by a third party.²¹

Companies may re-purchase issued shares provided that:²²

- a) the re-purchase of shares does not cause the net assets of the company to become less than the subscribed capital plus the mandatory reserves set aside; and
- b) the total nominal value of all the shares re-purchase by the company and any pledge of shares or fiduciary security over shares held by the company itself or by some other company whose shares are directly or indirectly owned by the company does not exceed 10% (ten percent) of the total amount of capital subscribed in the company unless otherwise provided in legislative regulations in the field of capital markets.

Third, the company distributes cash directly to selling shareholders and may, therefore, diminish the company’s ability to service its debts or otherwise meet its obligations to creditors.

Certain rules specify how to conduct a share buyback and are summarized in Table 2. They differ depending on whether the buyback is to decrease the charter capital (specific buyback) or for any other reason (general buyback).

Table 2. Types of Buyback	
Specific	General
The shares issued by the company are repurchased and retired to decrease the charter capital	The shares issued by the company are repurchased for any reason
The decision to decrease charter capital by retiring treasury shares is made by the GMS, unless otherwise provided by the charter or by-laws	The decision to purchase is carried out by the GMS. Under specific legal circumstances this decision can be made by the Board of Directors
Shares must be retired upon the buyback.	Purchased shares must be re-placed or retired within a certain period.

21 ICL, Article 62 paragraph (2)

22 ICL, Article 37 paragraph (1)

➔ *For a more detailed discussion on the specific buyback of shares see previous section of this chapter.*

a) Buyback Procedures

To repurchase its own shares, a company must follow the steps summarized in Table 3.

Table 3. General Buyback Procedure	
Procedural Steps	Buyback
Initiation	All the discretion of the Board of Directors or a shareholder proposal
Decision-making	The Board of Directors shall have the right to decide a buyback of 10% or less of each type of shares offered for every 12 months. In other cases, buyback of shares shall be decided by the GMS
Limitations	A joint stock company is entitled to buy back no more than 30% of its issued common shares, a portion or all of its sold preferred shares
Share Retiring	Must be retired within a certain period (three years) or re-placed in case the capital contributed by shareholders is smaller than the charter capital.

The company must have a plan on redemption clearly stating the redemption time and pricing principles.

The company must have sufficient capital from the following sources for redemption of treasury shares, a capital surplus, retained earnings and other sources stipulated by law.

b) Information Included in the Buyback Decision

There is no specific regulation regarding the required information to be included in the decision to buy back shares. In practice, the following information that may be included in the notice of such decision to be sent to all shareholders are as follows:

- Name and head office’s address of the company
- Total number and type of shares to be repurchased
- Price of such repurchased
- Procedures and time-limit for payment
- Procedures and time-limit for a shareholder to offer his/her shares to the company

c) **Limitations on Share Buybacks**

Under Article 37 paragraph (1) of the ICL, a company is not allowed to repurchase its own shares if the re-purchase of shares cause the net assets of the company to become less than the subscribed capital plus the mandatory reserves set aside and the total nominal value of all the shares re-purchase by the company and any pledge of shares or fiduciary security over shares held by the company itself or by some other company whose shares are directly or indirectly owned by the company exceed 10% (ten percent) of the total amount of capital subscribed in the company.

In practice, a company is also not allowed to repurchase its own shares in the following cases:

- It is conducting business operations at a loss or owes overdue debts
- It is offering shares to mobilize more capital
- It is splitting up or splitting down shares
- Its shares are subject to public bids.

A company is not allowed to purchase shares from the following entities for use as treasury shares:

- Its manager and spouse, parents, adopted parents, children, adopted children or blood siblings of that individual
- Share owners subject to transfer restrictions according to law and its AoA
- Shareholders holding controlling shares, except for cases where the State sells its shares to reduce its ownership percentage.

d) **Implementing a Share Buyback Pro-Rata**

The regulatory framework in Indonesia does not provide details provision regarding this item.



Comparative Practices

In other countries, the company shall purchase shares from all shareholders in a number that is proportionate to the number of shares that have been offered by shareholders for sale.

e) **Reporting and Information Disclosure on Share Buybacks:**

The regulatory framework in Indonesia does not provide details provision regarding this item.

For public companies, a report and written information disclosure shall contain the following principal contents:

- Purpose of shares redemption
- Maximum amount of shares expected to be redeemed
- Capital sources for redemption
- Pricing principles
- Transaction time
- Name of the securities company designated to conduct the transaction
- Price quoted in the written information disclosure (if any).

When repurchasing their own shares, public companies that have their shares listed on the IDX shall concurrently report such to the IDX and disclose information via the disclosure media mechanisms of IDX.

3. Reciprocal Shareholdings

Reciprocal or cross-shareholdings are quite common between different companies and may be set up to establish mutual influence or diversify portfolios. Such shareholding structures between two or more companies often cause governance problems. For example:

- If companies increase their charter capital by means of reciprocal subscriptions to shares, the same initial contribution serves to cause two capital increases
- When two companies create a reciprocal shareholding by acquiring issued shares of each other, they are causing, at least partially, an indirect distribution or repayment to shareholders whose shares are purchased
- Reciprocal shareholdings can decrease the normal influence of independent directors in both companies, and replace the normal control exercised by the shareholders over directors and officers, with a self-controlling system.

Indonesian legislation, however, does not provide any specific rules regarding reciprocal shareholdings.

D. Statutory and Voluntary Reserves

Protecting the charter capital to safeguard creditor rights is further extended by the possibility of creating certain additional reserves. As with the charter capital, such reserves only exist in accounting terms.

1. The Statutory Reserve

Article 70 of The ICL requires companies to have a mandatory reserve fund (statutory reserve). The mandatory setting aside as a reserve applies if the company has a positive balance of profits. Net profits shall be set aside until the reserve reaches at least 20% (twenty per cent) of the total subscribed and paid up capital. Its main purpose is to protect creditors by ensuring that part of the company's assets, in addition to the charter capital, cannot be distributed among shareholders.

2. Other Funds

Beside statutory reserves, a company may also establish other funds (voluntary, non-obligatory reserves).

a) **Employees' Fund**

The GMS can establish a special fund from its net profits for company employees. The ICL does not require or define specific requirements for such a fund. Its establishment is, therefore, optional and all provisions governing such a fund should be specified in the AoA or in the internal regulations. For example, this fund can be used for acquiring shares, provided that such shares are to be transferred to the company's employees.

b) **Other Funds of a Company**

The AoA, internal regulations or a GMS decision may establish other internal funds, such as financial reserve, investment and development funds. Such internal funds are financed through a deduction from the company's net profits.

3. Additional Paid-In Capital

Additional paid-in capital is part of the company's equity and is typically composed of the following sources:

- Any increase resulting from the re-valuation of non-current assets
- The positive difference between the nominal value and the placement value of the company's shares.

Additional paid-in capital has an accounting meaning only and there is no actual accumulation of funds. Additional paid-in capital can be used, for example, to:

- Offset the losses as the result of re-valuating non-current assets
- Increase the charter capital from internal resources of the company.

Chapter **10**

DIVIDENDS

Table of Contents

A. GENERAL PROVISIONS ON DIVIDENDS	365
1. The Definition of Dividends	365
2. Distributable Profit	365
3. Dividend Rights	366
4. Types of Dividends	366
5. Forms of Dividend Payments	367
6. Decision-Making Authority Regarding Dividends	368
7. The Amount of Dividends	368
8. The Importance of Receiving Stable Dividends	369
B. PROCEDURES FOR DECLARING AND PAYING DIVIDENDS	370
1. How Dividends are Declared	370
2. The Shareholder List for Dividends	372
3. When Declared Dividends are Paid	372
4. When the Company Cannot Declare Dividends	373
5. When the Company Cannot Pay Declared Dividends	373
C. THE DISCLOSURE OF INFORMATION ON DIVIDENDS	375
D. DIVIDEND POLICY	377



The Chairman's Checklist

The Chairman's Checklist (in Indonesian company, the Board of Director is responsible to prepare a dividend policy and should be approved by the Board of Commissioners).

- ✓ Has the Board of Directors developed a dividend policy and has the Board of Commissioners approve it? What are the primary issues addressed in this policy?
- ✓ Does the Board of Directors properly weigh using net profits for the payment of dividends versus re-investing these profits?
- ✓ Does the Board of Directors properly communicate its dividend policy to shareholders and potential investors, and, if it deviates from this policy, the reasons for doing so?
- ✓ Does the company properly disclose information about its dividend policy and dividend history in a timely manner?
- ✓ Does the Board of Directors propose intermediary dividends and approved by the Board of Commissioners? How does the Board of Commissioners ensure that this is done in the best interests of the company?
- ✓ How does the company calculate its dividends? Does the Board of Commissioners ensure that preferred and common shareholders are treated equitably when distributing dividends?



Does the Board of Commissioners ensure that creditor rights are protected when it declared and paid dividends to shareholders?

Successful companies produce profits that can either be retained in the company or distributed to shareholders as dividends. In Indonesia, there is an expectation, in particular among minority shareholders with small holdings, for companies to make (a reasonable amount of) dividend payments, and not exclusively retain its earnings. The vast majority of Indonesian companies need additional capital, and in the case which there is no immediately alternate source other than company earnings, paying dividends is still a difficult decision to make since internally generated financing is one of the few viable sources of funding.

This chapter discusses dividends from both the shareholder and creditor protection perspectives, the procedure for declaring and paying dividends, as well as a company's dividend policy.

A. General Provisions on Dividends

1. The Definition of Dividends

Under the ICL, shares bestow on their owners the right to receive payment of dividends.¹ This means that shareholders have a right to share in the profits of the company. They may do so by enjoying capital gains (an increase in the market value of shares they hold in the company) and/or through receiving dividend payments. From this perspective, dividends are an important shareholder right.

The Indonesian CG Code stated that the rights of the shareholders shall essentially include the right to receive shares of profit appropriated for shareholders in the form of dividends and other profit sharing, in proportion to the shares owned.²

In addition, the payment of dividends means paying out cash to shareholders, which may decrease the company's cash and equity (profit balance or reserved profit) needed to service debt on a timely basis. From this vantage point, dividends are also viewed in light of preserving creditor rights by following certain rules. To protect creditor rights, legislation imposes certain limitations on the types and payment of dividends.

From the company's point of view, paying dividend should also be seen as company's obligation to its shareholders. The ICL stipulates that all net profits after the deduction to be set aside as reserves shall be allocated to the shareholders as dividends unless determined otherwise in the GMS.³

2. Distributable Profit

The accounting treatment of dividend payments is determined both by the ICL and accounting standards. Under Article 70 of the ICL, the company shall form a mandatory reserve and other reserves. The mandatory reserve is a certain amount of the net profits each financial year as a reserve. The mandatory reserve need not always be in the form of cash, but may take the form of other assets which are easily liquidated and cannot be allocated as dividends. The dividends may only be allocated

1 ICL, Article 52 paragraph (1) point b

2 CG Code Part V.1.1

3 ICL, Article 71 paragraph (2)

if the company has a positive balance of profits. “Positive balance of profits” means the Company’s net profits in the current financial year have covered the Company’s accumulated losses from previous financial years.

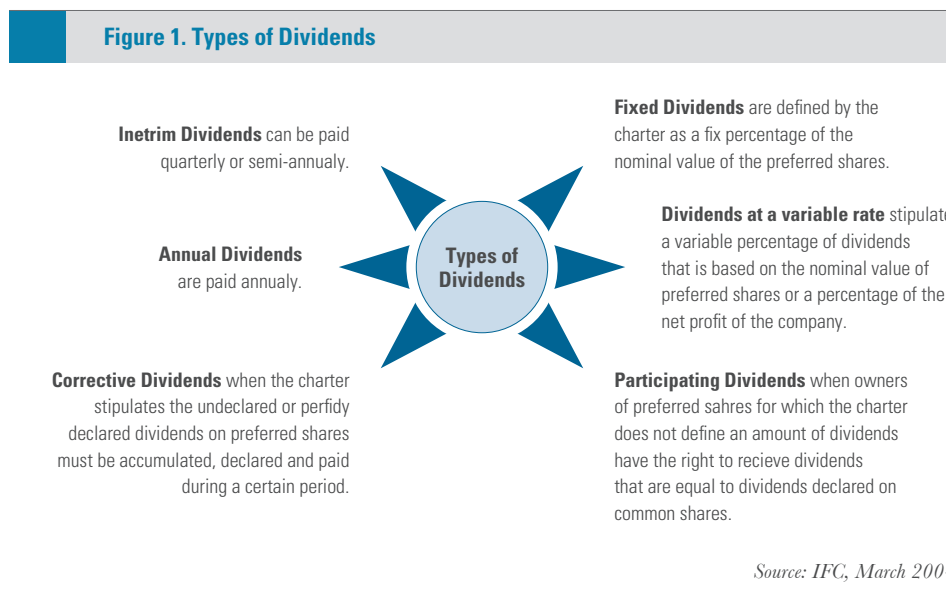
Dividends on preferred shares can, however, be paid out of funds that are specifically established for that purpose. Under no circumstances can dividends be paid out of the charter capital.

3. Dividend Rights

Owners of common and preferred shares have different dividend rights. Distributing dividends is solely at the discretion of the GMS. On the other hand, owners of shares possessed by a company because of re-purchase, transfer by operation of law, by grant, or by bequest are not entitled to any allocation of dividends.⁴

4. Types of Dividends

A company may declare dividends for common and preferred shares as shown in Figure 1.



4 ICL, Article 40

Moreover, the ICL has provisions regarding Interim Dividends as stipulated in Article 72 paragraph (1) to (6). These provisions include:

- Companies may allocate interim dividends before the company's financial year ends unless determined otherwise by the AoA.
- Interim dividends may be allocated if the company's total net assets do not become less than the total subscribed and paid up capital plus the mandatory reserve.
- The allocation of interim dividends may not disrupt or cause the company to be unable to fulfill its obligations to creditors or disrupt the company's activities
- The allocation of interim dividends shall be determined by a resolution of the Board of Directors after obtaining the consent of the Board of Commissioners
- In the event that after the financial year ends it transpires that the company has suffered losses, the interim dividends allocated must be returned to the company by the shareholders
- The Board of Directors and the Board of Commissioners shall be jointly and severely responsible for the company's losses in the event that the shareholders do not return the interim dividends

5. Forms of Dividend Payments

As a rule, dividends are paid in cash. Both the ICL and the Capital Market Law do not specifically stipulate any provisions regarding the forms of dividend payments. However, the OJK Regulation Number IX.D.5 recognizes stock dividend and cash dividend. Stock dividend is part of retained earnings distributed to shareholders in form of shares. While cash dividend is the part of retained earning distributed to shareholders in form of cash.

However, according to Article 73 paragraph 1 of ICL, if the dividends paid by the company are not taken by the shareholders 5 (five) years as from the date determined for the payment of dividends, such dividends shall be placed in a special reserve.⁵ Furthermore, the GMS shall provide a procedure for the collection of dividends which have been placed in the special reserve and if it is not taken within 10 (ten) years, the dividend shall become the right of the company.⁶

⁵ ICL, Article 73 paragraph (1)

⁶ ICL, Article 73 paragraph (2) and (3)



Companies should pay dividends in cash, since non-cash transactions are generally unsuited for dividend payments.

6. Decision-Making Authority Regarding Dividends

The procedure for the use of profits and allocations of dividends is contemplated in the AoA.⁷ The Board of Directors with the Board of Commissioners' approval has the authority to recommend the amount of dividends to pay out to the GMS. The authority to approve dividends rests with the GMS. However, for dividend interim, its allocation shall be determined by a resolution of the Board of Directors after obtaining the consent of the Board of Commissioners.⁸ The GMS approves or disapproves the Board's recommendation by a simple majority vote of participating shareholders. The amount of dividend interim declared by the GMS may not exceed that recommended by the Board of Directors and the Board of Commissioners.

7. The Amount of Dividends

The Board of Directors should seek to maximize shareholder value when formulating its recommendation on the amount of dividends to be distributed. The target payout ratio—defined as the percentage of net income to be paid out as cash dividends—should be based on shareholder preferences. More specifically, the Board of Directors will want to determine shareholder preferences for capital gains (for example, using excess cash to buyback shares or re-invest in the company) versus receiving dividends. The Board of Directors will then need to define its optimal dividend policy, which ideally should strike a balance between current dividends and future growth.

⁷ ICL, Article 15 paragraph (1)

⁸ ICL, Article 72 paragraph (3)

For any given company, the optimal payout ratio is determined by four factors:

1. Investor preference for capital gains versus dividends;
2. The company's investment opportunities (for example, companies with excess cash but limited investment opportunities would typically distribute a large percentage of their income to shareholders via dividends, while companies in high-growth sectors typically reinvest their earnings in the business);
3. The company's target capital structure; and
4. The availability and cost of external capital.

8. The Importance of Receiving Stable Dividends

The stability of dividends is important to shareholders. Dividend payments tend to vary over time, since company cash flows may fluctuate. Many shareholders rely on dividends to meet expenses, however, and would consequently suffer from unstable dividend streams. A company needs to carefully balance between the stability and dependability of its dividend policy.



Best Practices

Ideally, the company should formulate and communicate a dividend policy to its shareholders, for example to “pay approximately 30% of its current year’s earnings as dividends, which will permit the company to retain sufficient capital to provide for future growth.”

B. Procedures for Declaring and Paying Dividends

To declare and pay dividends, the company must follow specific steps, summarized in Figure 2.

Figure 2. The Procedure for Declaring and Paying Dividends – Best Practices

In the case of Indonesian company's practices, the steps are as follows:

Step 1.

The Board of Directors with the approval from the Board of Commissioners recommends that the GMS declare dividends, as well as the amount of dividends and procedure for their distribution.

Step 2.

The Board of Directors prepares a list of shareholders entitled to receive dividends.

Step 3.

The GMS votes to declare a dividend payment.

Step 4.

The company pays declared dividends.

1. How Dividends Are Declared

A company may declare dividends annually, or more frequently if stipulated in its AoA. The decision to declare interim dividends, can only be done if the company's total net asset do not become less than the total subscribed and paid up capital plus the mandatory reserve.⁹ The decision to declare annual dividends is based on the decision regarding the distribution of profits (losses) of the company and can be taken by a simple majority vote of shareholders participating in the GMS.

⁹ ICL, Article 72 paragraph (2)

In other words, until the company has declared and paid all dividends (including accumulated dividends) for preferred shares in full, as specified by the AoA, it cannot declare and pay dividends for other preferred or common shares. Further, the company cannot declare dividends if the claims of a higher priority shareholders are not satisfied in full.



Best Practices

In order to help shareholders properly assess a company's capacity to make dividend payments, companies are advised to:

- Establish a transparent and shareholder-friendly mechanism for evaluating the payment of dividends;
- Provide sufficient information to shareholders to enable them to understand the conditions that must be met before the company will pay dividends;
- Provide sufficient information to shareholders to enable them to understand the procedures for the payment of dividends;
- Prevent the dissemination of any misleading information on the company that might influence shareholders' assessment of policies governing dividend payments;
- Provide simple dividend payment procedures; and
- Impose (financial) sanctions on the President Director and Board of Directors' members for incomplete or delayed payments of declared dividends.

Dividend reports are a useful tool for assessing a company's dividend policy and its dividend payment record. Dividend reports are published by commercial firms that track the dividend performance of companies. These reports are usually available for a fee.

2. The Shareholder List for Dividends

The list of shareholders entitled to receive dividends for a specific period includes shareholders of record entitled to participate in the GMS. This date upon which such record is to be compiled is called the “ex-dividend date”. Shareholders included on this list as of the ex-dividend date are entitled to receive any dividends that the company pays out to shareholders. Consequently, shareholders who own shares on the ex-dividend date, and who sell them after that date, retain the right to receive dividends; shareholders who purchased shares after the ex-dividend date are not entitled to receive dividends until the next declaration of dividends. However, the contract of sale for the shares may provide that the right to receive declared dividends shall be transferred to the new owner of shares. In the event that dividends on shares of a specified type and class are declared, each shareholder must receive dividends in accordance with the number of shares of the type and class he owns.

3. When Declared Dividends Are Paid

A company is obliged to pay dividends once they have been declared. The period for paying dividends is established either in the AoA or by decision of the GMS.

The accumulation of declared but unpaid dividends gives shareholders the right to file a claim in court against the company demanding payment.



Best Practices

Although it is not regulated under the Indonesian laws and regulation, it is recommended by the FCSM Code that companies penalize the President Director, Board of Directors members, or the External Manager when dividend payments are incomplete or in arrears. In particular, it is recommended that the Board of Commissioners have the authority to reduce the remuneration of the President Director, Board of Director members, and/or the External Manager, or to terminate their authorities, when the company fails to pay declared dividends in full and/or on time.

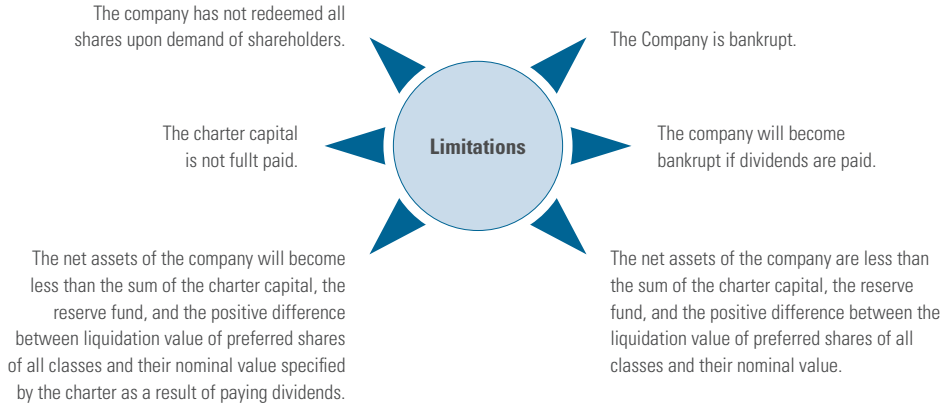
4. When the Company Cannot Declare Dividends

The company is prohibited from declaring dividends under the circumstances illustrated in Figure 3.

This list of circumstances is not exhaustive.

Both the AoA and the company’s debt instruments can specify circumstances under which the company is prohibited from declaring dividends.

Figure 3. When the Company Cannot Declare Dividends



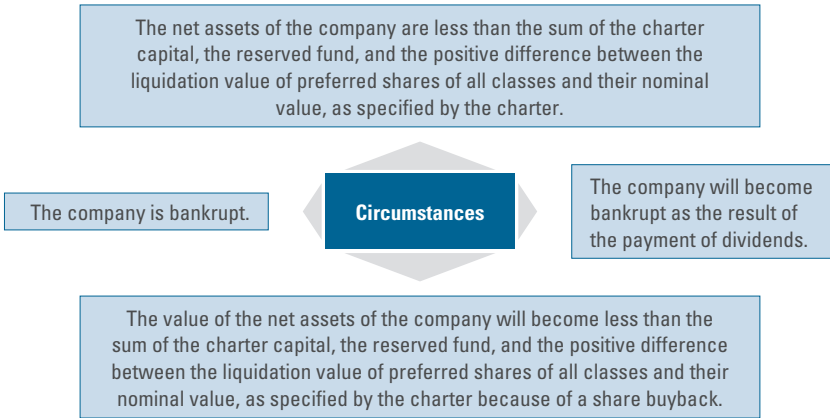
Source: IFC, March 2004

5. When the Company Cannot Pay Declared Dividends

As some time may pass between the decision to declare dividends and the actual payment, the company may find itself in contravention of some of the requirements for the declaration of dividends noted above. The company may not pay declared dividends under the circumstances illustrated in Figure 4.

This list of circumstances is not exhaustive. As mentioned above, legislation may specify further grounds, as can the AoA and corporate debt instruments. As soon as the specified conditions cease to exist, the company is obliged to pay declare dividends.

Figure 4. When the Company Cannot Pay Declared Dividends



Source: IFC, March 2004

C. The Disclosure of Information on Dividends

A company must make available to all its shareholders the recommendations of the Board of Commissioners regarding the distribution of profits, including the amount of proposed dividends on all types of shares, and the procedure for the payment of such dividends. Securities legislation regulates the information disclosure as pertaining to dividends. For listed companies intending to conduct the distribution of cash dividend, stock dividend, and or bonus stock, the company must submit a report to the IDX, the relevant GMS resolution specifying details of such distribution at the latest 2 (two) exchange days as of the GMS.¹⁰ The same provision also apply for the distribution of interim dividend. In the event a listed companies intends to distribute an interim dividend, the resolution of the Board of Directors meetings pertaining to the distribution of the said interim dividend must be submitted to the IDX at the latest 2 (two) exchange days as of the said meeting of the Board of Directors is convened.¹¹

A company needs to address two basic issues in deciding to declare dividends:

- 1) The percentage of profits to be distributed; and
- 2) The frequency of payments, i.e. should the dividends vary from year to year, or remain stable over time.

A company is also required to provide a report on its dividend payment record in its annual report.

¹⁰ Decision of the Board of Directors of the Jakarta Stock Exchange Inc. Number Kep-565/BEJ/11-2003 concerning Rule II-A concerning Securities Trading.

¹¹ Decision of the Board of Directors of the Jakarta Stock Exchange Inc. Number Kep-565/BEJ/11-2003 concerning Rule II-A concerning Securities Trading.



Although it is not regulated under the Indonesian laws and regulation, it is recommended by the FCSM Code recommends that the company adopt a by law on information disclosure, and that this by-law include a list of information, documents, and materials that must be submitted to shareholders to enable them to make decisions regarding dividends. The information should refer to agenda items for the GMS, such as:

- Recommendations of the Board of Commissioners regarding the distribution of profits;
- Recommendations of the Board of Commissioners on the payment of dividends; and
- Reasons for each recommendation.

Companies should also disclose information on dividend payments, or when dividends have not been paid, the reasons for dividend non-payment.

D. Dividend Policy

Companies are best served by adopting a clearly stated and rational dividend policy, in-line with shareholder preferences.



Best Practices

Companies should inform the markets of their dividend policy, for example, through the print media. This disclosure should be in the same publication specified by the AoA for publishing notice for the GMS. The company should also consider using the internet for this purpose. It is essential that shareholders receive information—at a very minimum—on the following issues:

- The method the company uses in determining the portion of profits that may be paid as dividends;
- The conditions under which dividends may be paid;
- The minimum amount of dividends payable for shares of each type and class;
- The criteria the Board of Commissioners uses in deciding on the recommendation to declare dividends; and The procedure for dividend payment, including the time, place, and form of payment.

Companies should further implement a transparent and easy-to-understand mechanism for determining dividends. To do so, the company should approve a by-law on dividends that includes information on:

- The percentage of net profits for dividend payments;
- The terms and conditions for dividend payments;
- The amount of dividends payable for shares of a specific type and class if this amount is not specified by the AoA;
- The minimum amount of dividends payable for shares of each type and class;

- The procedure for the payment of dividends, including the schedule, place, and methods; and
- Circumstances when dividends will not be declared, or when dividends may be partially declared on preferred shares.

Companies are free to change their dividend policies at any time; however, corporate officers should be aware that this may cause inconveniences for their shareholders and send adverse, if unintended, signals to the markets.

Chapter **11**

**CORPORATE GOVERNANCE
IMPLICATIONS OF
CORPORATE SECURITIES**

Table of Contents

A. AN OVERVIEW OF CORPORATE SECURITIES	383
1. Basic Types of Securities - Shares and Bonds	383
2. Securities in Paper and Paperless Forms	386
3. Domestic Issuers on International Markets	386
B. TYPES OF SECURITIES	388
1. Shares	388
2. Bonds	389
C. ISSUING SECURITIES	395
1. Making the Decision to Place Securities	397
2. Registering the Decision to Issue Securities	398
3. Granting the Certificate for Public Offering of Securities	400
4. Public Offer of Securities	404
D. THE CONVERSION OF SECURITIES	410
E. DERIVATIVES	411
F. RAISING CAPITAL IN INTERNATIONAL MARKETS	413



The Chairman's Checklist

- ✓ When was the last time the company rigorously examined its financial needs?
- ✓ If the company is in need of external financing, what are the alternative sources? What are the advantages and disadvantages of debt versus equity financing? What are the costs? What is the company's optimal debt-to-equity ratio? What are the corporate governance implications of each of the alternatives?
- ✓ What is the most appropriate financing method for the company and why?
- ✓ Has the company explored international financing options?
- ✓ What are the advantages and disadvantages of accessing capital in foreign markets? What are the corporate governance implications of listing on foreign exchanges?
- ✓ What are the disadvantages and advantages of stock options?

Companies have a number of financing options. They may fund their investment needs from internally generated capital or seek external financing. Among external sources of funding, they may borrow from banks or issue securities.

Financing decisions are usually quite complex. The method(s) that a company chooses to finance its operations will depend upon a large number of internal and external factors. Some of the company specific factors include the intended use of the funds (whether for short-term working capital needs or long-term capital investment), the capacity to service interest payments and repay the principal, and the nature (and the degree of risk) of the business. Important external factors include the level of a country's economic development, political stability, its banking system and financial markets.

Each financing option, whether bank lending or the sale of shares or bonds, has different financial and legal characteristics and will have different corporate governance implications. In addition, each form of capital has a different cost. Equity finance has some important advantages for companies. Although it is not the cheapest source of funding, equity finance has the advantage of permitting companies to access large amounts of capital that do not need to be paid back in the same manner as debt financing.

However, access to the enormous potential of securities markets, with its millions of potential investors, comes at a price. Securities markets are traditionally tightly regulated to limit the manifest potential for abuse. Regulators, therefore, make significant demands on companies. They require that investors receive complete information on the risks of investment and they also go to great lengths to protect investor rights. While market regulators are often criticized for the burdens they impose on companies, real and potential abuses are, ultimately, the reason for the imposition of regulations and of corporate governance standards.

This chapter discusses the different types of securities that companies may issue and their corporate governance implications.

A. An Overview of Corporate Securities

1. Basic Types of Securities - Shares and Bonds

There are two basic types of securities that companies use to raise capital, shares (also referred to as stocks or equities) and corporate bonds. Shares represent an ownership position in the company and come with certain ownership rights. Bonds, on the other hand, represent a creditor relationship with the company.

Unlike shareholders, bondholders have no corporate ownership rights, although they may be accorded a significant degree of control over (certain) corporate activities during the life of the creditor/debtor relationship.

Bonds envisage the repayment of the principal as well as periodic interest payments until the bond reaches maturity and the obligation of the borrower (the company) to make any further payments of principal/interest is terminated. Corporate bonds come in many different forms and may be structured in a number of ways. For example, there is no provision for interest payments on “zero coupon” bonds. The bondholder, in such a case, is compensated by a discounted purchase price and the gradual appreciation in the price of the bond, which is then redeemed at its face value on its maturity date. Despite the many differences, bonds have one element in common in that they come with a predictable and contractually fixed repayment.

Shares function differently. Companies can use share capital for an unlimited period and are under no immediate obligation to repay investors. Investors are compensated for their investment either through the possibility of receiving capital gains (an increase in the value of their shares) and/or the possibility of receiving dividend payments in addition to governance rights. From an investor’s point of view, shares as an investment class, are normally riskier than bonds. Capital gains are never guaranteed (share prices go up and down) and dividend may not be distributed if the company does not have positive net income.

An important implication of the difference in risk is that share capital is often more expensive than bonds or bank lending. One of the most fundamental rules of finance is the higher the level of risk, the greater the level of return that investors will expect for taking such risk. Given, as mentioned, that the risk of receiving a return on one’s investment is higher for equities than for bonds or other types of loan transactions, investors will demand a higher price for the use of their capital by the company and will charge what is referred to as a “risk premium”.

One of the methods to manage equity risk is by granting shareholders governance rights, a full set of rights in the case of common shares and a limited set of rights in the case of preferred shares. Another method of managing risk and, by extension, of reducing the cost of capital is to ensure that these rights are uniformly respected and adequately protected. This, from a financial perspective, is what helps to define good corporate governance.

Shares and bonds offer different advantages and disadvantages for investors and companies as outlined in Table 1.

Table 1: Comparison of Shares and Bonds		
	Shares	Bonds
Duration of Investment	Unlimited. The company does not repay the investment. The company is not restricted in how it may invest funds.	Bonds have a maturity date. While bonds differ, the principal is generally repaid with interest. Repayment is predictable and regular, which reduces bondholder risks. Funds from bonds issuance must be invested in accordance with proposed funds utilization as stated in prospectus, unless the bondholder agreed to change the proposed fund utilization.
Obligations in Return for the Investment	Investors may expect dividend payments when the company have positive net income. However, dividend payments are made at the discretion of the company.	The company must repay the principal and generally makes coupon payments.
Governance Rights	If common shares are issued, the investor is granted governance rights. If preferred shares are issued, the investor holds governance rights only in specific circumstances (in case of voting preferred shares). Governance rights and their enforcement reduce the equity investment risk.	No governance rights are granted to bondholders.
Ease of Securing the Investment	The ease of securing equity investment depends on numerous external and internal factors. Ultimately, the attractiveness of a share offering depends on the company's future prospects and its ability to assure investors that good governance and, in particular, investor rights to the company's free cash	Bonds are attractive to investors interested in predictable, secure returns. The company's health, including compliance with good corporate governance practices, is important for the credit rating of the company and will influence the price at which it may borrow.

	Shares	Bonds
	flow will be observed. In addition, the company's health, including compliance with good corporate governance practices, influences the price it pays for equity capital.	
Cost	From the company's perspective, shares can be more expensive than bonds. Investors charge a risk premium for the higher risk associated with equities.	Bonds are less risky, and investors charge a lower risk premium. Bonds are, consequently, less expensive for the company than equities.
Advantages	Most investors are compensated through capital gains (the increase in share prices on the equities markets). If the company generates sufficient free cash flow, the shareholder may receive a dividend. The potential long-term returns on equities as an investment class are higher than bonds.	The bondholder receives his/her principal back with some compensation for the investment, usually in the form of interest. Generally, interest payments are fixed in advance and predictable. If the company defaults, the bond may, under certain circumstances, still be sold on the market at a discount, meaning that the bondholder may not lose the full amount of his/her investment.
Risks	The higher returns on equities are in exchange for a higher level of risk. Share prices go up and down, at times quite dramatically. Capital gains on shares are uncertain and dividend payments are not guaranteed. If the company becomes insolvent, shareholders are typically last in line to receive compensation. In practice, shareholders may lose the full value of their investment in case of bankruptcy or liquidation.	Once the company has the cash, it may use the money for riskier activities than those foreseen by the bondholder. In this case, the bondholder may have little recourse. In case of default, the bondholder is granted a set of legal mechanisms to enforce his/her contractual rights, including seeking the insolvency of the company. However, seeking insolvency is not generally in the interest of the bondholder. If the bond is secured, the risk of the bondholder may be minimized.

2. Securities in Paper and Paperless Forms

Securities must be issued in certain forms and comply with legal requirements. Securities may take two main forms, tangible securities issued in paper form and intangible securities (also known as “paperless” or “dematerialized securities”).

In Indonesia, shares and other securities (warrants, bonds) may be issued in both types of paper and paperless forms which must be stipulated in the company’s AoA. In other countries, the rights of the holders of paper securities are usually embodied in a certificate. However, in the case of Indonesia, even though the holders have tangible shares which are in paper form, they still have to fully and correctly register their information into the company’s shareholder book to allow their shareholders’ rights to become effective. The rights of the holders of paperless securities are based upon an entry into a bond or shareholder register (similar to an entry in a bank account reflecting the depositor’s rights to funds). The electronic trading of securities is allowed for. Therefore, securities can also be defined as transferable electronic documents. The Indonesian Company Law stated that Companies’ AoA shall specify the method of transferring rights over shares in accordance with the provisions of legislative regulations and that rights over shares shall be transferred with a deed of transfer of rights.¹

Securities of public companies must be registered in the Indonesian Securities Central Custodian (KSEI – Kustodian Sentral Efek Indonesia)s information system regardless of what form they take.

3. Domestic Issuers on International Markets

Companies may choose to raise capital in domestic as well as international capital markets. In doing so, they may issue shares and bonds directly on international capital markets, i.e. foreign stock exchanges. When issuing bonds on foreign stock exchanges, there are two forms of bonds that a company can issue which are government guaranteed corporate bonds and non-government guaranteed corporate bonds.

Another way for companies to raise international market capital is to issue shares indirectly through depositary receipts. Depositary receipts require the registration of the original security in the name of a foreign trust company or, more commonly, a bank. The bank holds the share in safekeeping and issues receipts against shares. These receipts are referred to as “depositary receipts.” This system was developed because investors in the world’s largest capital markets discovered it could take several months to

¹ ICL, Article 55 and 56 paragraph (1)

have their foreign share purchases registered in their name. The system is also attractive for companies, since it allows them to establish a presence in foreign markets without having to go through the process of a complete issue. The corporate governance implications of this system are that Indonesian issuers of depositary receipts must comply, to varying degrees, with foreign standards of corporate governance.

→ *Raising capital in foreign markets is discussed at slightly greater length in Section G of this Chapter*

B. Types of Securities

1. Shares

Shares (stocks or equities) entitle their holder to a set of property and governance rights. Shares mean a type of securities that certify their holders' legitimate rights and benefits to a portion of equity of an issuing organization/company and have several fundamental characteristics:

Name of the holder: Article 48 of the ICL stipulates that Companies' shares shall be issued under the name of their owner. Moreover, Article 50 of the ICL requires that Companies' BOD shall make and keep a register of shareholders with some required contents including information about the shareholders.² The shareholder identification and/or the register book of shareholders are stored at the headquarters of the issuing company, and may be entered into the information system at a custodian center, namely the KSEI Article 52 paragraph (2) of the ICL regulates that shares bestow on their owners the right after the shares are recorded in the register of shareholders under the name of the shareholder. Registered securities help to make the company's ownership structure more transparent and assist in protecting shareholder rights.

- **Rights of the holder:** Shares can be common or preferred shares. Rights of shares are specified in the ICL³ and the company's AoA.

Nominal value: Each share has a nominal value (also referred to as "par value" or "face value") or accountable par which should be stated in rupiah⁴ and shares without a nominal value may not be issued.⁵ However, it does not close off the possibility of the issuance of shares without a nominal value being provided for in legislative regulations in the field of capital markets. The nominal value or accountable par of shares is established in the AoA and is used to calculate the charter capital. The par value of all shares issued by the company must be the same, unless otherwise stipulated under the AoA. The company may issue shares after its formation to attract new investors. The BOD with approval from the BOC may decide the offer price of the shares, but the share price to be offered must not be lower than the book value or the market price of the share at the time of offer.

2 ICL, Article 50 paragraph (1)

3 ICL, Article 52 paragraph (1)

4 ICL, Article 49 paragraph (1)

5 ICL, Article 49 paragraph (2)

On the other hand, the Bapepam Regulation No. IX.D.6 stipulates that listed company may issue shares with different nominal value of shares in the event that the market price of the company's shares is below the nominal value. Subsequent to that, the issuance of different nominal shares value shall be complied with the following requirements:

- a. shares which have same classification with different nominal values is entitled with equal rights and level;
- b. shares with the old nominal value cannot be converted into new nominal value.

The nominal value of shares rarely reflects the market value of the company. The differences between the nominal value of shares and the price at which they trade on the market can be enormous. In addition, market prices constantly fluctuate and depend on a number of factors influencing the scope and prices of supply and demand.

The value of shares may be determined by investors and other professionals using different analytical methods, taking into consideration a great number of factors that can influence the investment decision, like the current performance and future prospects of the company, its dividend policy, the reputation of the company and its management, the macroeconomic situation and government support for, or interference in, business development. In that respect, one of the most important factors that has great influence on a potential investor's decision to invest in company shares is the quality of the company's governance, because it is directly connected with the investor's possibility to protect ownership rights in the company.

2. Bonds

Bonds (corporate bonds) are securities through which companies raise debt capital. A bond has the following legal characteristics:

a. **Registered and Bearer Bonds**

Companies can also issue bonds as bearer securities. Bearer bonds have the advantage of privacy for the bondholder. Bearer bonds are issued with certificates, which contain certain legal requirements. Bearer bonds may facilitate the transfer of bonds and reduce for the company the administrative costs of maintaining a bond register.

Despite these advantages, the use of bearer bonds may result in violations of securities and tax laws. Because they are easy to transfer, owners of bearer bonds may not be as precise about adhering to the laws when they sell bearer bonds to another person as they would need to be in the event of registered bonds. Thus,

for example, bearer instruments have the great disadvantage that they may conceal assets from creditors or tax authorities.

b. Nominal Value

Bonds are issued at a certain nominal value. The nominal value of bonds is most often referred to as their “face value”. The face value of bonds can be any value that the issuing companies find suitable



Best Practices

In the interests of bondholders and, one could argue, of shareholders as well, the face value of all bonds issued by the company must not exceed the value of the a guarantee submitted to the company by a third party for the purposes of the bond issue.

c. Rights of Bondholders

The bondholder has the rights of a creditor and is entitled to:

- Redeem the bond at maturity for its face value. A company can issue bonds with different redemption alternatives. It can issue bonds that have the same payment period or a series of bonds with different payment periods. The company can also envisage the possibility of early payment at the request of the holder.
- Receive interest payable on the bond. Interest payments on bonds are generally referred to as coupons. Historically, bonds were issued with detachable coupons that were submitted in exchange for payment.
- Convert into shares (for bondholders of convertible bonds). There are two types of bonds, convertible bonds and non-convertible bonds. Convertible bonds can be converted into shares in accordance with the term of issue of such bonds and stipulations in the AoA of the company, whilst non-convertible bonds cannot be converted into shares.

Since bonds are freely transferable, the bondholder can sell his/her bonds to another investor. As with equities, bonds are subject to a market pricing mechanism. This means that bond prices are constantly fluctuating and that bondholders can both make and lose money from buying and selling bonds.

d. Secured and Unsecured Bonds

Companies may issue both secured and unsecured bonds.



Comparative Practices

In some countries, companies may not issue unsecured bonds during the first couple of years of their existence. This rule is intended to protect bondholders from the risks associated with a new business.

Secured bonds provide additional protections to bondholders in case the company defaults on its obligations. The following guarantees can be applied:

- **Pledges of property.** Securities can be the subject of the pledge. All secured bondholders of the same issue have equal rights with regard to the pledged property.
- **A third party guarantee** can be submitted to the company for the purposes of the bond issue. This can be a bank guarantee or a corporate (for example, submitted by a parent company for bonds issued by a subsidiary) or personal guarantee. The guarantor is jointly and severally liable for the redemption of the bond.

The issue of secured bonds means that guarantee requirements must be fulfilled (pledges, mortgages or bank guarantees) in addition to the normal requirements associated with a bond issue.

e. Convertible Bonds

Companies can also issue bonds that can be converted into shares. Convertible bonds may be secured or unsecured.

Convertible Bonds are bonds exchangeable for a set number of common stocks at a pre-stated price. From the issuer's standpoint, the convertible feature is usually designed as a sweetener to enhance the marketability of the bond. Under the Minister of Finance Regulation No. 18/PMK.010/2012, PE is permitted to purchase the convertible bond, and it falls within the criteria of "Quasi Equity Participation" (investment through purchasing the convertible bonds). The Pre-IPO convertible bonds structures are commonly used in sectors closed or restricted

for foreign investors. Convertible bond structure will not trigger the Negative List restriction until it is exercised into equity. Provided however, under the Indonesian Investment Law, any investment in a public listed company through the market shall be considered as portfolio investment, as such it will not subject to Negative List restrictions. The rationale is that the portfolio investment shall be managed for gaining the capital gain purpose only, and it will not be intended for (long term) investment in nature. Provided however, Article 49 of the Head of BKPM Regulation No. 5 of 2013 provides that if one of the Controlling Shareholder (a party holding more than 50% of the total issued and paid up capital or a party that has an capacity to determine, either directly or indirectly, in any manner policy of the public company) of the public company is a foreigner, therefore such company is subject to the provision of foreign investment.

Commercially, while the benefits of holding the Convertible Bonds share similarities of the regular bonds such as interests, capital gains and the first right to claim, the clear benefit of holding this is the investors can convert the bond into stocks at a predetermined price, and will be entitled to have any benefits as stocks ownership. However, amongst the benefits holding Convertible Bonds also possess clear commercial risks such as default, capital loss and call-ability.

The total volume of bonds issued shall not exceed the approved limit of issuance. The time-limit for conversion of bonds shall be fixed by the issuing organization and publicly announced to investors upon issuance of bonds. The bond conversion ratio shall be fixed by the issuing organization at the time of issuance. If at the time of bond conversion, the share price fluctuation exceeds the share price fluctuation range announced at the time of issuance of the bonds, the company's owner shall have the right to make an appropriate adjustment to the bond conversion ratio.

f. Differences between Bondholder and Shareholder Interests

Both shareholders and bondholders are interested in the profitability and health of the company. For shareholders, a healthy company generates free cash flows that generally lead to a higher market valuation. Healthy companies are also more likely to pay dividends than unhealthy ones. For bondholders, a healthy company reduces the risk of default on its obligation to repay the bond principal and interest. In short, for both, a successful and profitable company can lead to an increase in the market value of its respective securities.

There are, however, some important differences between the interests of these two types of investors.

- **Interests diverge most distinctly during insolvency.** During insolvency proceedings, different priorities are assigned to different types of claimants. In general, creditor claims (including those of bondholders) are always satisfied before those of shareholders.
- **Another difference is in the conversion of bonds.** Shareholders are always interested in minimizing the dilution of their holdings. It is, in part, for this reason that they enjoy certain governance rights and that decisions that would result in the dilution of share ownership are always subject to the approval of the company's governing bodies. Similarly, holders of convertible bonds are interested in preventing the reduction of capital or the redemption of shares when this conflicts with the exercise of their conversion rights.
- **The interests of shareholders and bondholders also diverge with respect to risk.** Shareholders generally accept a higher level of risk than bondholders in exchange for potentially higher returns. If a company successfully takes greater risks, returns to shareholders will be higher. If a company fails in its risk-taking, the losses will be greater. Bondholders will, on the other hand, always receive the same contractually stipulated return regardless of the level of risk in projects the company undertakes. Bondholders only stand to lose if the level of risk to the enterprise ultimately results in corporate insolvency. This holds particularly true for holders of unsecured bonds. Bondholders always hope to see a predictable, stable cash flow and if possible, a reduction in the company's risk profile.



Best Practices

In some countries, company laws incorporate special measures for balancing the conflicting interests of shareholders and bondholders by:

- Granting bondholders consultation rights. In France, for example, bondholders meetings must be consulted with in a number of circumstances, such as the reorganization or issuance of bonds that are secured by significant company assets
- Allowing bondholders to inspect documents during the GMS, as is the case in Germany
- Prohibiting the redemption of shares or reduction of capital while bonds are open for conversion or offering, for example in France.

As in France, information can also be sent to bondholders on issues that may be of special concern to them. Companies may wish to develop specific policies with respect to bondholders and are encouraged to integrate them into their overall programs on corporate governance. The holders of convertible bonds and share warrants have the same rights as the shareholders with regard to information and inspection of the company books and documents, unless otherwise provided by the decision on the issuance of such securities or agreed otherwise.

C. Issuing Securities

Issuing securities is a complex process involving a transfer of funds in exchange for specific control and cash flow rights, all subject to different levels of assurances and guarantees. Efficient capital markets help companies raise capital for productive uses. They also allow investors to reap returns on capital that might otherwise lie dormant and to select investments that correspond to their desired level of risk and return.

Capital markets cannot bring users and providers of capital together efficiently if the markets are subject to misuse. Unfortunately, the history of international financial markets is rife with such examples. Securities legislation has developed largely in response to abuses and market failures. Its purpose is to protect the interests of companies and investors, and to enhance the function and efficiency of capital markets.⁶

In Indonesia, securities legislation determines the conditions and methods of the issuance of securities. During this proceeding, powers to ensure the transparency and legality of the issuance are delegated to the Indonesia capital market regulator. It is also important to take into consideration that the regulation is focused on the obligations to issue shares of the public companies and practically it means that conditions and methods for the private offer are different in comparison with private companies.

Legal requirements for issuing shares differ according to the method of placement, which are public placement and private placement. Every limited liability company can issue shares through public offer or private placement.

All public offerings must be registered with the Indonesia capital market regulator. However, for companies operating under special business conditions such as financial institutions or insurance companies, charter capital changes must be preliminary approved by relevant authorities before they can register the public offering with the Indonesia capital market regulator to implement changes in charter capital.

Table 2 summarizes private and public offering issuing method legal requirements for different types of companies.

6 At the same time, market regulators must make sure they do not strangle entrepreneurial drive or company growth. Companies are wealth generators in every economy and elaborate regulation usually entails costs. The challenge for regulators is to develop intelligent regulations that meet required goals, while imposing the minimum level of costs upon the economy and society.

Table 2: Overview of Legal Requirements for Securities Issue Methods

	Private Offering	Public Offering
Limited Liability Company (non-public)	<p>Both shares and bonds can be issued.</p> <p>In case of bond issuance, if the issuer is a state shareholding company, the bond issuance plan must be approved by the MOF.</p> <p>The decision to issue shares, and the report on the results thereof, are subject to registration with a business registration agency.</p> <p>The register book of shareholders shall be retained at the head office of the company.</p>	<p>Both shares and bonds can be issued.</p> <p>For shares issuance, an initial public offering (IPO) is subject to specific legal requirements for an IPO.</p> <p>After the IPO, the company will become the public company and must fulfill the obligations of a public company as required by the Capital Market Law</p> <p>Dossiers for registration of public offering of securities shall be regarded as public company dossiers.</p>
Public (non-listed) Company	<p>Both shares and bonds can be issued.</p> <p>The decision to issue shares, and the report on the results thereof, are subject to registration with the state authorities (the Indonesia capital market regulator).</p> <p>The private issuance of shares has to be registered with the Indonesia capital market regulator and the shares must be registered with KSEI.</p> <p>The change in the AoA for shares issued must be registered with the business registration agency.</p>	<p>Both shares and bonds can be issued.</p> <p>The dossiers of registration of the public offering of securities must be prepared and submitted to the Indonesia capital market Indonesia</p> <p>The securities must be registered with KSEI.</p> <p>The change in the charter capital for shares issued must be registered with the business registration agency.</p>
Listed Company	<p>Both shares and bonds can be issued.</p> <p>The decision to issue shares, and the report on the results thereof, are subject to registration with the state authorities (the Indonesia capital market regulator).</p> <p>The private issuance of shares has to be registered with the Indonesia capital market regulator and the shares must be registered with the KSEI</p> <p>The change in the charter capital for shares issued must be registered with the business registration agency.</p>	<p>Both shares and bonds can be issued.</p> <p>The dossiers of registration of the public offering of securities must be prepared and submitted to the Indonesia capital market regulator</p> <p>The securities must be registered with the KSEI. Efek harus terdaftar di KSEI (Kustodian Sentral Efek Indonesia).</p> <p>The change in the charter capital for shares issued must be registered with the business registration agency.</p> <p>The shares issued must be admitted to stock exchanges.</p>

The process of issuing securities involves a number of steps. They depend on the issuer, type of securities involved and the method used for the issuance. Figure 1 below only illustrates steps for the issuance of shares for a public company and they are divided into Option A and B. Option A illustrates the procedure for private offering and Option B for public offering.

Bonds have to be issued in conformity with the laws governing the securities market and the AOA of the company.

The following section discusses the above-mentioned steps in greater detail and highlights the differences between shares and bonds.

1. Making the Decision to Place Securities

The decision to place securities is made by different governing bodies, depending on the type of issue and the AoA requirements, as summarized in Table 3.

Table 3: The Decision to Place Different Types of Securities

Shares	<p>The GMS generally makes the decision.</p> <p><i>For more information on the decision to place shares, see Chapter 9, Section B.</i></p>
Convertible and Non-Convertible Bonds	<p>However, under the ICL and the Capital Market Law, there is no regulation on who shall have the right to make decision on the issuance of convertible bonds. Since convertible bonds will be converted into shares after expiry and make changes to the charter capital in the future, in practice the GMS will make the convertible bond issuance decision. The BOD makes the non-convertible bond issuance decision. Besides, if the issuing company is a State shareholding company, the private offering bond issuance plan needs to be approved by the MOF.</p>



Comparative Practices

The decision-making procedure for issuing bonds is simpler than for other securities, which may serve as an additional incentive for their use. However, the charter can provide for stricter approval requirements, for example, with regard to specific types of bonds.

The decision to issue securities is made by the GMS. The decision to issue securities becomes the main document certifying the rights of the holders of securities and of the company.

Although the contents of the decision depend on the circumstances of each issue, it must generally include information on the:

- Issuing company, i.e. full name, place of business and postal address
- Decision to issue securities, i.e. date and the decision-making body
- Securities to be issued, i.e. type and class, their nominal value, the rights of the holders of securities and number to be issued
- Conditions of the placement.

In the case of bonds, the decision must include additional information on the:

- Form of bond redemption (monetary or in-kind)
- Maturity date (and details regarding early redemption, where applicable)
- Other terms of redemption, i.e. the value of the payment, if early redemption is possible
- If convertible bonds are issued, the procedure for their conversion into shares
- If secured bonds are issued, information on the security or the person submitting the guarantee and the conditions of the guarantee (in the latter case, the decision must also be signed by the guarantor).

The Indonesia capital market regulator closely monitors the mandatory content of the company decision to issue securities, if their lawful issuance is conditioned upon ex-ante the Indonesia capital market regulator approval. Copies of the decision to issue shares are kept with the registration authority and the company.

2. Registering the Decision to Issue Shares

An issuing organization making the public offering of shares must register its decision with the Indonesia capital market regulator except for the following cases:

- The public offering of SOEs' stocks transformed into joint stock companies
- The sale of securities under court judgments or rulings, or sale of securities of property managers or recipients in the case of bankruptcy or insolvency.

The best practice is that the decision to increase the share capital may not be registered upon the expiration of six months from the date of its adoption.

Pursuant to Regulation No IX.C.1, the Registration Statement for a public offering of shares shall consist of at least:

- A cover letter;
- A Prospectus;
- A Summary Prospectus to be used in the Public Offering;
- A Preliminary Prospectus to be used for Book Building (if any); and
- Other documents, consist of:
 - the proposed issue schedule;
 - a draft of the Securities certificate;
 - the audited financial statement;
 - a comfort letter from the Accountant with respect to changes after the date of the audited financial statement;
 - a written statement from the Issuer with regard to accounting matters;
 - further information on a forecast and or projection, if included in the Prospectus;
 - a legal audit report and opinion;
 - the curriculum vitae of members of the BOC and BOD;
 - Underwriting agreements (if any);
 - Trust Agent agreements (if any);
 - Guarantee agreement (if any);
 - a preliminary agreement with one or more Securities Exchange (if Securities are to be listed on Exchange(s));
 - Other information requested by BAPEPAM as deemed necessary in reviewing the Registration Statement to the extent that it can be made available to the public without adversely affecting the interest of the prospective Issuer or others associated with the Public Offering process;
 - a rating published by a Securities Rating Agency on bonds or other debt Securities; and
 - a statement concerning the completeness of the Public Offering documents from: (i) the Issuer; (ii) the Managing Underwriter; and (iii) Capital Market Supporting Professionals

3. Granting the Certificate for Public Offering of Securities

The public offering of securities can only be made after the company submits Registration Statement to OJK and such Registration Statement has been stated Effective by OJK. Included in the dossiers submitted to the Indonesia capital market regulator, the prospectus is an important document through which investors obtain information about the issuer of securities, rights and duties deriving from those securities, including the risks, returns and any other relevant information associated with the investment. For this reason, legislation requires that a prospectus be prepared and published in the case of any public offering.

There are costs attached to the preparation of a prospectus that some companies may wish to avoid. However, the short-term costs of preparing the prospectus are likely to be greatly outweighed by the long-term benefits (e.g. lower cost of capital) that can be achieved by clarifying the risks and returns of the company to investors.

Investor interests are protected by the information that must be included in the prospectus, the liability attached to those who have signed it and the requirement for its registration.

a. The Contents of the Prospectus

Based on Article 1 Number 26 of Law No. 8 of 1995 on Capital Market (“Capital Market Law”) A prospectus is a written information in relation to the public offering to attract another party to purchase the securities .Regulation No IX.C.2 contains detailed provisions outlining what must be disclosed in the prospectus. These provisions are summarized in the introductory part of the prospectus and the main part of prospectus.

1. The introductory part of the prospectus consists of:

a. The First Part

- The effective date;
- The offering period;
- The allotment date;
- The refund date;
- The Securities submission date;
- The proposed listing date;
- The company’s full name, business address, logo (if any), telephone, telex, facsimile and PO BOX number (head office, the factory and any representative office) and its main business activity;

- The name of the Securities Exchange(s) (if any) where the Securities will be listed;
- The nature of offering, including a description of the essential elements, amount, nominal value and price of the Securities;
- The full name of the Managing Underwriter and other Underwriters, if any;
- The place and date of issuance of the Prospectus;
- The following statement in large type, which directly attracts the attention of readers: **BAPEPAM HAS NOT APPROVED OR DISAPPROVED THESE SECURITIES, NOR HAS IT PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY CONTRADICTING REPRESENTATION THERETO IS ILLEGAL.**
- A statement that the Issuer and Underwriter, if any, are fully responsible for the truthfulness of all information and fairness of opinions disclosed in the Prospectus as follows: **THE ISSUER AND UNDERWRITER(S), (if any), ARE FULLY RESPONSIBLE FOR THE ACCURACY OF INFORMATION OR MATERIAL FACTS, AND OBJECTIVITY OF OPINIONS INCLUDED IN THIS PROSPECTUS;** and
- A statement in capital letters which attracts the attention of readers, regarding the risk factors and possible illiquidity of the offered Securities.

b. The Second Part

- if there is an intention to stabilize a certain Securities price on a Securities Exchange in order to facilitate the Public Offering, there must be a statement with the following content in large type to attract the attention of readers: **IN ORDER TO MAINTAIN THE MARKET PRICE OF SECURITIES, OF THE SAME OR SIMILAR TYPE OR CLASS, AS THE SECURITIES OFFERED IN THIS PUBLIC OFFERING, THE ISSUER MAY STABILIZE THE PRICE AT A HIGHER PRICE THAN WHAT WOULD EXIST ON THE SECURITIES EXCHANGE IF PRICE STABILIZATION AS WELL AS THE PUBLIC OFFERING MAY BE TERMINATED AT ANY TIME;**
- Information that the Registration Statement has been submitted to BAPEPAM in accordance with Capital Market regulations;
- A statement that all the Capital Market Supporting Institution and Professionals mentioned in the Prospectus are fully responsible for the data presented, in accordance with the existing regulations as well as their respective codes of ethics and professional standards;

- A statement that no Affiliated Person is permitted to provide information or statements regarding data that are not disclosed in the Prospectus without written authorization from the Issuer or Managing Underwriter, if any; and
- Whether a Securities Exchange has given preliminary approval for the Securities to be listed and the action that will be taken if the Securities Exchange rejects the Issuer's listing application

2. The main part of prospectus consists of:

- The Public Offering;
- The use of funds obtained from the Public Offering;
- Statement of Liabilities;
- Discussing and Analysis by Management;
- Business Risks Arrange;
- Important event after the Date of the Auditor's Report;
- Description regarding the Issuer;
- Business Activities and Prospects of the Issuer;
- Summary of Important Financial Data;
- Stockholders' Equity;
- Dividend Policy;
- Taxation;
- Underwriting;
- Capital Market Supporting Institutions and Professionals;
- Legal Opinion;
- Financial Statements;
- Appraiser's report (if any);
- Articles of Association;
- Terms for orders to purchase securities;
- Distribution of Prospectus and Order Forms;
- Trust Agent and Guarantor.

Number 2 Letter B of Bapepam Regulation No. IX.A.2 is only required that Brief Prospectus must be published in at least 1 (one) daily national newspaper which Indonesian language, at the latest 2 (two) business days upon the receipt of OJK's statement which states that the company must announce the Brief Prospectus. However, in Regulation No. IX. A.12 stated that the Summary Prospectus shall be announced to public, at least one Bahasa daily newspaper having nationwide circulation no later than two (2) working days after receipt of OJK stating that the Company has announced the Summary Prospectus. Based on Regulation IX.A.12 the company must announce Brief Prospectus on one daily newspaper in Bahasa no later than 2 working days after a statement from OJK which regulates the company must announce the Brief Prospectus has received.



It is good practice to disclose all material information about the company in the prospectus. The company should seek to provide shareholders and potential investors with all information that may be important in valuing the company.

Besides, it is also good if in the prospectus of IPO and public offering of bond, the issuer gives information about the company's ratings to help investors make investment decisions. Ratings companies exist to help the issuer make the ratings and at the same time, help investors know about the credit worthiness of the company and the level of risk associated with their targeted investments through independent opinions.

The three top companies dealing with credit ratings for the investment industry are Standard and Poor's (S&P's), Moody's and Fitch ICBA. Each of them has different ratings systems, but share the same objective which is to help investors know about a company's ability and willingness to repay debt, hence to evaluate risks associated with the money investors intend to put into a company. An important note is that the ratings are just for reference, not equal to buy, sell or hold recommendations.

b. Prospectus Approval by the Company

The company (issuer) is responsible for the truthfulness and completeness of the information included therein. Beside all other people who participated in the preparation of the prospectus, including consulting companies, underwriter, appointed External Auditor, persons who signed the auditor's reports and any organizations or individuals who signed dossiers of registration, are liable for the damage caused by the publication of incomplete and inaccurate information in the prospectus and summarized prospectus. The additional condition of their responsibility is that they knew, or by the nature of their work, had to know that the information was inaccurate or incomplete (for example the President Director, the Chief Accountant or the person fulfilling this function, the External Auditor). They are jointly and severally liable with the issuer for any damage caused to investors because of untruthful, incomplete, and/or misleading information. In

some countries, if investors believe that they have suffered damages, they can file claims with a court.

c. Registration Dossiers Approval and Certificate Granting by the Indonesia Capital Market Regulator

Examining and approving the public offering of securities dossiers by the Indonesia Capital Market Indonesia is an important investor protection mechanism. This is a form of state control over the securities issuing process. Without proper approval and registration, securities cannot be issued and sold to investors.

In the course of examining the public offering of securities registration dossiers, the Indonesia capital market regulator may request issuing organizations to modify or supplement such dossiers in order to ensure that the disclosed information is accurate, truthful and complete and able to help protect legitimate rights and benefits of investors.

Within 45 days of receiving the valid dossiers, the OJK shall consider and grant a public offering of securities certificate. In case of refusal, the OJK shall reply in writing, clearly stating the reasons for the refusal. It may take a company a lot longer time than the 45-day period to get approval and the certificate if it cannot provide the OJK with valid information and documents as required.⁷ Therefore, the company should carefully prepare the public offering of securities registration dossiers. The company should select competent consulting company, underwriter and accredited auditing company, auditors to sign the audit reports and any organizations and individuals that certify the public offering of the securities registration dossiers that will be involved in this process.

4. Public Offer of Securities

Upon receiving OJK's Effective Letter of the prospectus and the certificate of the public offer, the issuer can begin placing securities after a public announcement of the securities issuance (i.e. within two days from effective date of the certificate).⁸

The placement is the actual transaction between the company and the investor. This transaction is subject to a number of legal requirements and only takes effect upon the registration of its results, as discussed hereinafter.

⁷ Regulation No. IX.A.2

⁸ Regulation No. IX.A.2

a. Number of Securities Placed

The number of securities placed should be no more than indicated in the decision to issue securities.

The number of securities placed may, however, be less than the number indicated in the prospectus. In practice, the ability of a company to sell securities depends on investor demand. The actual number of securities placed must be disclosed in the report on the results of the issue.

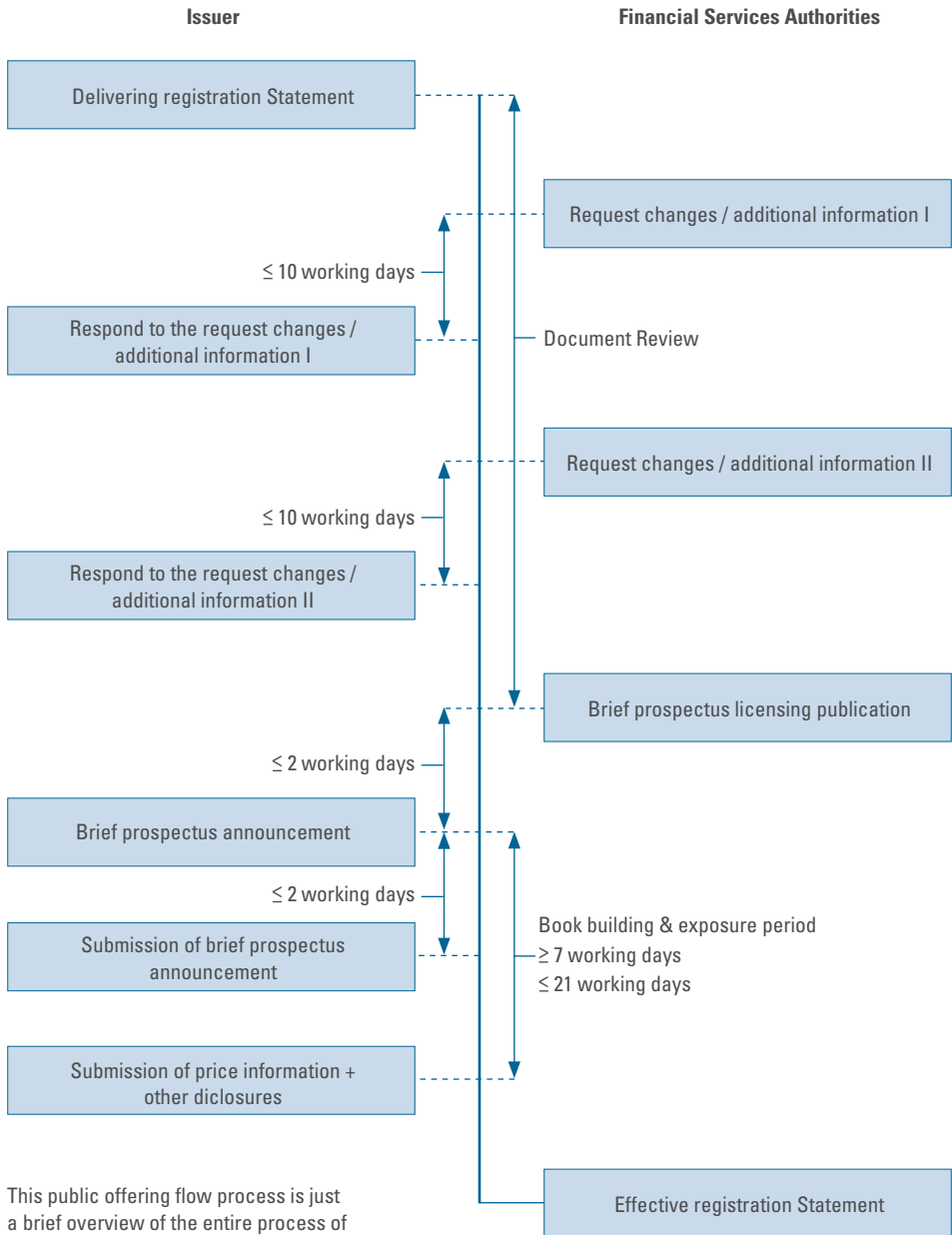
b. The Timing of the Public Offer for the Offering and Payment of Securities

- **The Publication of the Announcement:** After the effective date of the Registration Statement and prior to the Public Offering, an Issuer have to fulfil the following requirements:
 - Publish any correction and/or addition of Summary Prospectus, if any, in at least 1 Indonesian daily newspaper with a nation wide circulation no later than 1 working days after the effective date;
 - Distribute the formal Prospectus required as part of Registration Statement to the public or the prospective purchasers;
 - Submit 2 copies of Prospectus and its soft copy to OJK;
 - Submit the proof of announcement as referred in point (i) at the latest 2 working days after such announcement.
- **Beginning of the Offering:** The beginning of the offering of securities is determined by the public offer. The Issuer shall conduct Public Offering at the latest 2 working days after the Registration Statement become effective. The Public Offering period is 5 working days at the maximum. The payment of securities shall be made at the latest at the time of transfer of securities.
- **End of the Offering:** Underwriter or Issuer (in the event an Underwriter is not used) must submit reports on the results of Public Offering to OJK no later than 5 working days after the allotment date. Furthermore, an Underwriter or an Issuer (in the event an underwriter is not used) shall appoint an auditor registered in OJK to conduct examination on the receipt of fund from Public Offering by the Issuer. The examination report shall be submitted to OJK at the latest 30 working days after the expiration period of Public Offering.

To carry out a legally valid securities issuance several deadlines need to be met, as illustrated in Figure 1 and Figure 2⁹.

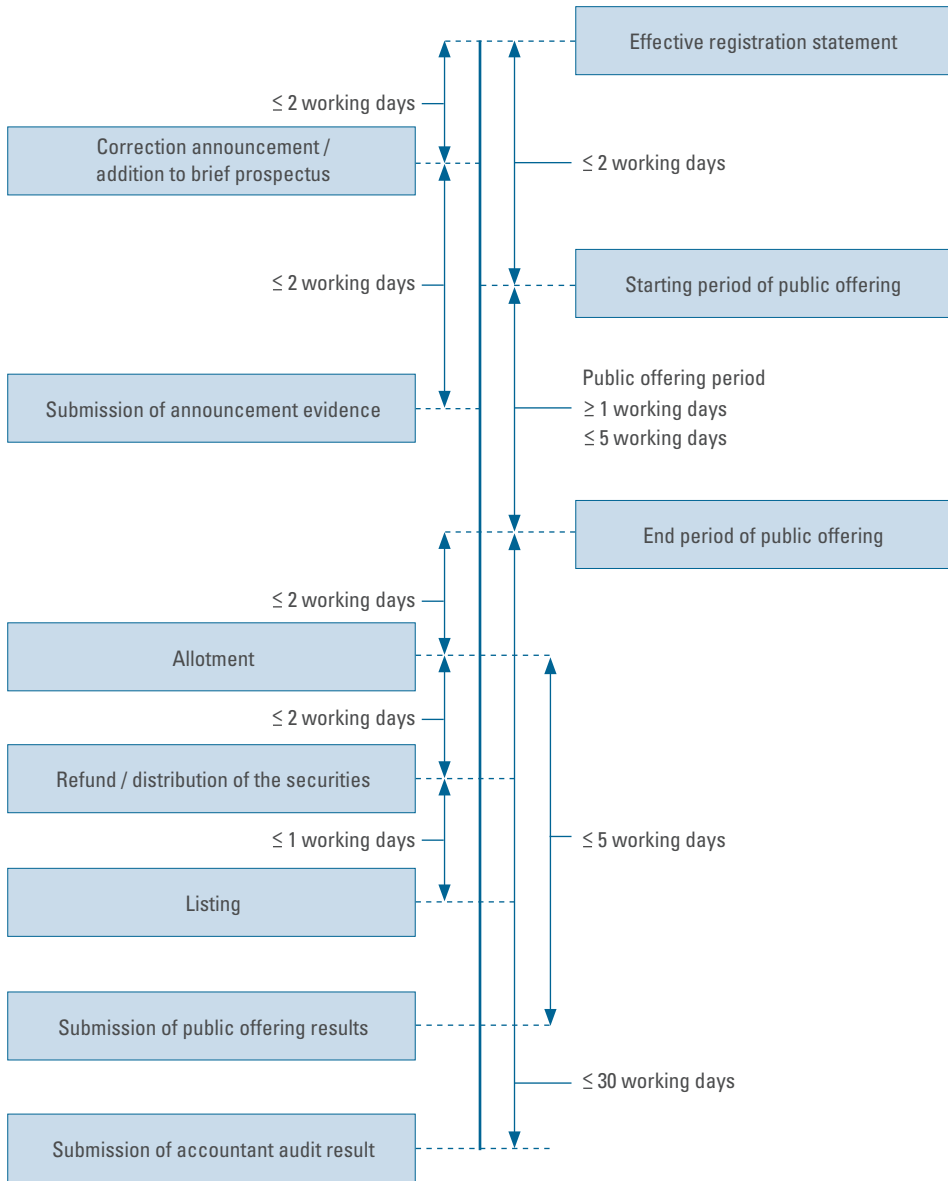
9 Regulation IX.A.2, Exhibit 12

Figure 1. Example of Public Offering Flow Process (Before Effective)



This public offering flow process is just a brief overview of the entire process of public offering. Registration procedures in the context of a complete public offering still refers to rule number IX.A.2

Figure 2. Example of Public Offering Flow Process (After Effective)



This public offering flow process is just a brief overview of the entire process of public offering. Registration procedures in the context of a complete public offering still refers to rule number IX.A.2

The Issue Price of Securities

The GMS has the right to determine the issue price of securities. The discretionary powers are limited to prevent directors or large shareholders from acquiring securities below market price when the issue is made by offering (see Table 4).

Table 4: Issue Price

Security	Price
Shares	<p>Nominal value of the shares of prospective listed company minimum Rp. 100 (one hundred Rupiah).</p> <p>The issue price must correspond to the market value.</p> <p>The issue price cannot be lower than the nominal value (only applied for companies transformed from SOEs).</p>
Convertible Bonds and Warrants	<p>The issue price must not be lower than the market price at the time of offering or the most recent book value recorded of the shares, except in the following cases:</p> <ul style="list-style-type: none"> • Initial offering of shares to persons other than founding shareholders • Shares offered to all shareholders in proportion to their current respective percentage of shares in the company • Shares offered to brokers or underwriters. In this case, the specific amount of discount or rate of discount must be approved by the shareholders representing at least 75% of the total number of shares with voting rights • Other cases and the rates of discount in such cases shall be stipulated in the company AoA. • The issue price must correspond to the market value. • Reference can be made by companies to the following comparable practices in Russia and Serbia: • The issue price cannot be lower than the nominal value or book value of shares into which they are to be converted. • When exercising their pre-emptive rights, shareholders can acquire convertible bonds or warrants at a price no more than 10% lower than the price determined for other investors.
Bonds (non-convertible)	<p>The value of bond is reflected by the bond yield. Depending on the nominal yield on the bond, compared with the market bond rates, the issue price of bond can vary quite flexible. Comparable practices in Russia and Serbia also indicate that the issue price does not have to correspond to the nominal value of bonds.</p>

10 IDX Regulation No. 1-A, Section III paragraph III.1.9

c. The Amendment to the Business Registration

Companies have to amend their AoA in the case any amendment of the amount of the charter capital is occurred. After the securities are issued, the company is required to register the increase in the charter capital with an authorized business registration agency.¹¹ The submission period to submit the increase of charter capital may vary depending on the provision provided by the relevant authorized business registration agency.

11 Law No. 3 of 1982 Company Registration Obligatory, Article 25 paragraph (1)

D. The Conversion of Securities

Companies not only issue securities when seeking to raise capital, but also when existing securities or rights embodied in them must be restructured. A conversion of securities occurs in the following circumstances:

- Decreasing the charter capital by decreasing the nominal value of shares without changing the number of shares. By this mode, the company shall withdraw shares from shareholders and issue new shares with reduced par value. The company shall have to pay its shareholders an amount of money equal to the number of shares of each shareholder times the difference between old and new par values. Currently, there is no specific regulation or guidance on increasing the charter capital by increasing the nominal value or accountable par of shares.
- Splitting shares
- Converting one type and class of shares into another type and class of shares.
- Converting bonds into shares.
- Reorganizing the company.

In these cases, new investors are not involved. Shares are placed with existing shareholders or other investors hold securities that grant them conversion rights. The procedure for converting existing shares is simpler and quicker than for issuing additional shares, because it does not change the charter capital of the company. The conversion of convertible bonds into shares does increase the charter capital of the issuing company, however, the change is anticipated beforehand.

E. Derivatives

Shares and bonds can be described as primary securities, which directly certify a set of rights. Companies can also issue derivative instruments that embody rights dependent on the performance of underlying or primary securities, assets or other property. Such instruments can, in international practice, relate to both equities and debt securities. According to the elucidation of Article 1 paragraph f number 5 of Capital Market Law, derivatives shall include options and warrants. However, there are several other kinds of derivatives in Indonesia such as rights and futures contracts.

For the purpose of fund raising, the company shall issue:

- **Rights:** A type of securities issued by a joint stock company along with an additional issuance of stocks to ensure that its existing shareholders can buy new stocks under specified conditions. Shareholders can transfer their rights to others within a specified period of time.
- **Warrants:** A type of securities issued along with the issuance of bonds or preferred stocks, entitling securities holders to buy a stated amount of common stocks at a designated price within a given period.
- **Stock Options:** A call option on the common stock of a company, issued as a form of non-cash compensation. In practice, stock options can play an important role in the context of executive remuneration programs and may have important corporate governance implications. Therefore, it is useful to make an overview of the comparative practice of using stock options as a method of compensating directors.

In the corporate governance context, a relatively mundane form of option — the incentive stock option — is used to provide performance-enhancing incentives to management and employees. In some countries, options are the primary component of remuneration packages for top executives. They are popular because the returns to executives can be large. They ostensibly align the interests of management and shareholders, and because the true cost of options (the dilution of other shareholders) is not readily apparent under current accounting standards. (need information on this issue in Indonesia)



Best Practices

Stock option compensation is a complex and contentious remuneration technique that requires close examination by the governing bodies of the company, GMS approval and disclosure in detail in the annual financial statements of the company. The BOD and shareholders need to be aware of the company's use of these tools since they could potentially expose companies to unexpected and significant risks.

The other types of derivatives (call options, put options, futures, securities classes or indexes) are usually used by financial institutions (banks, securities firms) for trading purposes or as a risk-reduction instrument. Derivatives in stock trading can be seen more commonly on the secondary market where the main players are securities companies, institutional and individual investors and other financial institutions such as banks, insurance companies. These derivatives are highly standardized and there are official markets for them. The issuance of derivatives is associated with the existence of mature capital markets. At the same time, their existence necessitates special regulations to ensure accounting and information transparency.

F. Raising Capital in International Markets

A company can also raise capital in international markets through the issuance of either bonds or shares providing it satisfies the conditions as regulated by the Indonesian Government, including:

- Not being on the list of business lines in which the participation of foreign parties is banned and ensuring participation ratios of foreign parties as specified by law
- Having the overseas offering of securities and the plan on the use of mobilized capital approved under its BOD or GMS decision
- Satisfying the offering conditions specified by a competent authority of the country where it registers the offering.
- In compliance with regulations on foreign exchange management.

Regulation No. IX.I.3 concerning Issuance of Foreign Depositary Receipts stipulates that any issuers or public companies who intent to issue its shares in Foreign Depositary Receipts (such as American Depositary Receipts, Singapore Depositary Receipts, and Global Depositary Receipts) must submit their plan to OJK. The report must contains complete information concerning the plan such as the involvement of issuer or public companies in the foreign depositary receipts and any additional requirements they might have to fulfill to issue the securities in the international market.

Issuers and the public companies also have to report their foreign securities activities to the Indonesia capital market regulator. Pursuant to Regulation No. X.K.7, it is stated that the issuers and public companies must submit report to OJK immediately in the same day the report is submitted in the country where the foreign depositary receipt is placed.

Listing on foreign stock exchanges brings advantages to listed companies such as a lower cost of capital, higher liquidity and greater prestige. The world's largest foreign markets tend to have much higher standards of corporate governance than Indonesian markets. The most popular markets are in the U.S., Hong Kong, and Singapore, which arguably have some of the most rigorous governance standards in the world. Therefore, Indonesian companies need to fulfil much higher corporate governance standards in order to enter or remain strong on these markets.

Chapter **12**

**MATERIAL CORPORATE
TRANSACTIONS**

Table of Contents

A. EXTRAORDINARY TRANSACTIONS	419
1. Definition	419
2. Valuing Extraordinary Transactions	422
3. Procedure for Approving Extraordinary Transactions	423
4. How Shareholders Can Protest Extraordinary Transactions	425
5. Disclosure Requirements	425
B. AFFILIATED (RELATED PARTY) TRANSACTIONS	427
1. Definition	427
2. Approving Affiliated Transactions	433
3. Identifying Affiliated Transactions	434
4. Disclosure Requirements	435
5. Invalidation of Affiliated Transactions	437
6. Liability for the Violation of Procedural Requirements	437



The Chairman's Checklist

Extraordinary Transactions:

- ✓ Do all commissioners and directors understand the concept of extraordinary transactions? Does the company AoA specify additional criteria for identifying transactions that are to be treated as extraordinary beyond the minimum criteria mandated by law? Does the Board of Directors distinguish between extraordinary transactions and those entered into in the ordinary course of business?
- ✓ How does the Board of Directors ensure that extraordinary transactions are properly evaluated and approved by the Board of Commissioners and shareholders?
- ✓ Does the Board of Directors ensure an Independent Appraiser is engaged to ascertain the market value of assets involved in the transaction?
- ✓ What steps are taken to protect the rights of shareholders who do not approve of extraordinary transactions?
- ✓ Does the company properly disclose information on completed extraordinary transactions?



The Chairman's Checklist

Affiliated Transactions:

- ✓ Does the Board of Directors ensure that related parties properly disclose their interest in transactions? Do related parties abstain from participating in discussing and voting on such transactions?
- ✓ Does the Board of Directors ensure that all legal requirements for the approval of affiliated transactions are adhered to?
- ✓ Does the Board of Directors take adequate measures to disclose information on affiliated transactions and related parties?
- ✓ Do all directors understand their liability for violating procedures while approving affiliated transactions?

Shareholders should be legally protected when the company is involved in extraordinary and/or affiliated transactions. Such protection is essential because of the impact that these transactions can have on the value of the company, the price of its shares and the property rights of shareholders. Nevertheless, corporate governance abuses in these types of transactions continue to take place. For example, beneficial ownership structures typically remain non-transparent, making it nearly impossible to identify related parties in a transaction. In the meantime, insiders continue to develop complex structures and sophisticated techniques that allow them to tunnel assets, profits, and corporate opportunities away from the company and its shareholders.

In this chapter, we have illustrated some international practices on extraordinary transactions and have also discussed all relevant situations implied by Indonesian laws and regulations as extraordinary transactions.

A. Extraordinary Transactions

1. Definition

Under the ICL, there is no specific definition of extraordinary transactions. ICL only regulates certain material transactions in which Board of Directors shall seek GMS approval which include assignment of company assets or making security debt over company assets, of which constitute more than 50% (fifty percent) of Companies' net assets in 1 (one) or more separate or inter-related transactions.¹ In addition, those transactions involve assigning company net assets which occur in a period of 1 (one) financial year or a longer period provided for in the company's AoA.²

However, Number 1 Letter a.2 Bapepam Regulation No.IX.E.2, Attachment of the Chairman of OJK Decree Number 614 of 2011 concerning material transactions and change of company's main business. The decree stipulated that material transactions are transactions which include:

- a. capital participation in a business entity, projects and/or certain business activities;
- b. procurement, sale, exchange, transfer of assets or business segment;
- c. rent of assets;
- d. loan of funds;
- e. encumber company assets; and/or
- f. provide company guarantee;

with value 20% (twenty percent) or more of the company's equity, in one or a series of transaction for a certain activities or objectives.³

The transaction stipulated above is valued based on the latest audited annual financial report, mid-term or other audited interim financial report if the company has any interim report other than mid-term report, which one is the most recent.

Company with material transactions valued of 20% (twenty percent) to 50% (fifty percent) of its equity is not obliged to seek GMS approval. However, the company

1 ICL, 102 paragraph (1)

2 ICL, 102 paragraph (2)

3 Regulation No. IX.E.2, General Provisions

should declare the information on the material transaction to the public in at least one national newspaper in Bahasa Indonesia and submit the transaction documents to OJK at the latest 2 (two) business days after the transaction agreement were signed.

If transaction valued of more than 50% (fifty percent), the company should seek for GMS approval.



Comparative Practices

In Russia, a transaction (or several related transactions) is extraordinary when it meets all five of the following criteria:

a) The Nature of the Transaction

- The transaction directly or indirectly involves the acquisition, sale, or the possibility of sale of corporate assets
- The transaction is a credit, pledge, or guarantee transaction
- The transaction is not related to the issue of additional common shares or securities convertible into common shares.

b) The Value of the Transaction

The assets involved have a value of 25% (twenty five percent) or more of the book value of the company's assets as determined by financial statements as of the most recent reporting date.

c) The Relation of the Transaction to the Business of the Company

The transaction is not carried out in the "ordinary course of business" of the company.

d) Related Transactions

Two or more related transactions involving the company's assets totaling 25% (twenty five percent) or more of the book value of the company's assets are considered a single extraordinary transaction. Factors that determine whether several transactions must be considered as a single extraordinary transaction include:

- The purpose of the transactions

- The market conditions under which the transactions have been concluded
- The sphere of activities of the company
- The duration of relationships between the company and its transactional counterparts.

e) Additional Charter Criteria

The charter may define additional transactions that should be treated as extraordinary transactions. For example, the charter may specify that transactions involving assets with a lower percentage of the book value be considered extraordinary transactions. The charter can also provide that certain types of contracts (e.g. all loan agreements or all pledges of company shares) must be treated as extraordinary transactions, regardless of their nature. However, the company has no right to change the legal definition of an extraordinary transaction to limit cases of extraordinary transactions. For example, the company cannot provide that only transactions involving assets with a value in excess of 30% (thirty percent) of the book value of the company's assets will be considered as extraordinary transactions.



Best Practices

There are many cases when transactions should be subject to special procedures for extraordinary transactions, even though they fall well below the legislated threshold. For example, the sale of a subsidiary of a large petroleum company that holds significant oil drilling rights may be of such size and strategic importance that it should be considered as an acquisition or disposal of high-value assets regardless of the percentage of asset value it represents.

Legislation establishes a minimum standard of behavior and there is some room for various interpretations regarding what is extraordinary and what is not. For this reason, it is good practice for charters to include provisions that "transactions that may have a significant effect on the company" be treated

as extraordinary (except for transactions that are concluded in the ordinary course of business).

It is also recommended that the sale of shares of a subsidiary where the company would lose its majority stake be considered extraordinary transactions.

When two companies are engaged in a transaction, each company must separately apply the criteria for an extraordinary transaction. This means that the same transaction may conceivably be an extraordinary transaction for one company, but not for the other.

2. Valuing Extraordinary Transactions

An important aspect in determining whether a transaction is a material transaction is based on the transaction value compared with the equity of the company. The value of the transaction must be determined in order to identify which corporate approval is required before the transaction can be implemented.



Comparative Practices

In Russia and Serbia, the basis of valuation for sales of assets is the value of assets involved in the transaction as determined by reference to the company's financial statements as of the most recent reporting date before the transaction. For the acquisition of assets, the acquisition price of assets involved in the transaction shall be used. The Board of Directors has the authority to determine the value of assets or services. In doing so, the Board of Directors must compare the book value of the assets involved in the transaction with the book value of the company's assets as a whole. This comparison depends on the nature of the transaction (whether it is an acquisition or a sale), as illustrated in Table 1.

Table 1: Determining a Transaction's Value

Type of Transaction	Basis of Valuation
Sale of Assets	The value of assets involved in the transaction as determined by reference to the company's financial statements as of the most recent reporting date before the transaction.
Acquisition of Assets	The acquisition price of assets involved in the transaction.



Best Practices

An independent appraiser should assist the Board of Directors in determining the value of assets.

3. Procedure for Approving Extraordinary Transactions

ICL does not specifically mention extraordinary transactions. The law only stipulated that transactions with valued of more than 50% (fifty percent) of the company equity should be approved by the general meeting of Shareholders.

The Regulation No. IX.E.2 provides more detail procedure for material transaction approval and disclosure.



Comparative Practices

In Russia, the laws define extraordinary transactions very clearly as well as the procedures for approving them. Extraordinary transactions must be approved by different governing bodies depending on the value of assets of the transactions as illustrated in Table 2.

Table 2: The Approval of Extraordinary Transactions

Value of Assets	Approving Governing Body
Between 20% and 50% of the book value of the company's assets	The Board of Directors
More than 50% of the book value of the company's assets	The General Meeting of Shareholders

The Board of Directors has the authority to approve extraordinary transactions that are defined as such by the charter.

a) Transactions Involving Between 20% and 50% of the Book Value of Company Assets

Unanimous approval of all Board of Directors members is required to approve an extraordinary transaction involving assets with a value between 20% (twenty percent) and 50% (fifty percent) of the book value of the company's assets.

If the Board of Directors is not able to reach a unanimous decision, it can request that the GMS approve the transaction. The Board can do this by a simple majority vote of directors participating in the Board meeting, unless the charter or internal regulations require a higher percentage of votes. The GMS can then approve the transaction with a simple majority vote of participating shareholders.

b) Transactions Involving More Than 50% of the Book Value of Company Assets

The GMS must decide on whether to approve transactions involving more than 50% (fifty percent) of the book value of company assets by a $\frac{3}{4}$ (three-fourths) majority vote of participating shareholders.

c) Required Information for the Decision to Approve an Extraordinary Transaction

The decisions of the Board of Directors or the GMS must include information on:

- The parties that are involved in the transaction
- Other beneficiaries of the transaction (if any)
- The price of the transaction
- The object of the transaction
- Any other significant terms and conditions related to the extraordinary transaction.

4. How Shareholders Can Protest Extraordinary Transactions

ICL does not stipulate in details on how shareholders can protest extraordinary transactions. ICL only stated that each shareholder is entitled to request the company that the shareholder's shares be bought at a fair price in the event where the said shareholder is dissented to any company activities which deemed as harm to the shareholder or the company, in the form of the amendment of AoA and assignment or encumbrance of assets of the company which have a value of more than 50% (fifty percent) of the company net assets.



Best Practices

If a shareholder does not agree with an extraordinary transaction conducted in full compliance with procedural requirements and the law, he/she may:

- *Sell his/her shares:* Practically, this is only possible if the company's shares are liquid, i.e. there are interested buyers and shareholders are able to sell their shares at a fair price; or
- *Demand redemption of shares in part or whole:* Taking into consideration the GMS decision to approve acquisitions and disposal of high-value assets of the company is one of the reasons which gives shareholders with voting shares the right to dissent and the right to have shares redeemed by the company.

5. Disclosure Requirements

Disclosure requirements for company undertaking extraordinary transactions are not regulated in ICL. It is stipulated in the decree of Regulation No. IX.E.2 that company should disclose its material transaction with value of 20% (twenty percent) to 50% (fifty percent) of its equity by announcement to the public in at least one national daily newspaper and submit its supporting documents to OJK not more than 2 (two) business days after the transaction agreement was signed.

The information contemplated above includes:

- Description of the material transaction involved, such as the object of the transaction, its value and parties involved in the transaction (name, address, contact number);
- Reasons for undertaking the transaction and its implication to the financial condition of the company (in the event where the sale and purchase transaction causing the company losing its control over the company, this must be served in proforma financial information which reviewed by accountant);
- Summary of the appraiser report;
- Statement from the Board of Commissioners and the Board of Directors of the company that all material information provided are correct and not misleading;
- Place and address for shareholders to contact for information;
- Declaration from the Board of Directors stating that there are no conflict of interests in the transaction and such transaction is not an affiliated transaction.



Best Practices

Companies are required to include the following information about extraordinary transactions in their annual reports:

- A list of all extraordinary transactions concluded by the company during the reporting year
- A list of transactions that are considered extraordinary based on the definition in the charter
- Key terms of each extraordinary transaction.

B. Affiliated (Related Party) Transactions

Affiliated transactions involve insiders, such as directors, managers, large shareholders, or parties related to them. Some affiliated transactions have legitimate purposes and can be conducted fairly, others cannot. Regardless, they are easily abused and warrant particular attention since they may reduce the value of the company and expropriate shareholder rights. Legislation contains detailed procedures to discourage insiders from entering into related party transactions and to help ensure fairness when a related party transaction does take place.

affiliated transactions not only occur between the company and its directors, managers, and large shareholders, but more importantly, within groups of companies (holding structures), where transactions between the parent and subsidiary companies frequently occur. In other words, related party transactions are traded amongst related parties of the company.

1. Definition

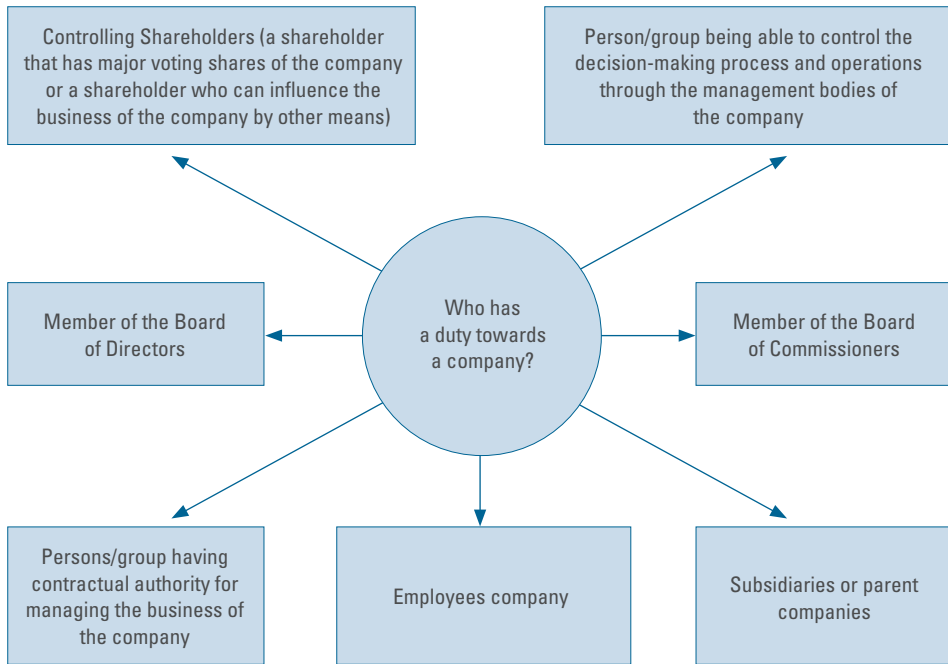
According to Regulation No. IX.E.1, affiliated transaction is a transaction undertaken by a company or controlling company with affiliation of the company or affiliation of the members of the Board of Commissioners and the Board of Directors, and controlling shareholders of the company.

For a transaction to be considered an affiliated transaction, each party involved in the transaction must check whether two conditions are met.

a. **Potential Related Parties-Persons that Have a Duty Towards a Company and Connected Persons**

A number of parties can be defined as related if they play a role in a transaction. Such parties are presented in Figure 1.

Figure 1. Example of Public Offering Flow Process (Before Effective)



Best Practices

The OECD Principles of Corporate Governance provide a general definition of related parties, including entities under common control, significant shareholders including members of their families and business associates and key management personnel.⁴

International Accounting Standard (IAS) Number 24 provides a more detailed definition and thus parties are considered to be related if one party has the ability to control the other party or to exercise significant influence or joint control over the other party in making financial and operating decisions.⁵ A party is related to an entity if:

- 4 See 2004 OECD Principles of Corporate Governance <http://www.oecd.org/dataoecd/32/18/31557724.pdf>
- 5 See also: the International Accounting Standard Plus' website under <http://www.iasplus.com/standard/ias24.htm>

1. Directly, or indirectly through one or more intermediaries, the party:
 - Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries, and fellow subsidiaries)
 - Has an interest in the entity that gives it significant influence over the entity; or
 - Has joint control over the entity.
2. The party is an associate (as defined in IAS 28 Investments in Associates) of the entity⁶
3. The party is a joint venture in which the entity is a venture (see IAS 31 Interests in Joint Ventures)⁷
4. The party is a member of the key management personnel of the entity or its parent
5. The party is a close member of the family of any individual referred to in (1) or (4)
6. The party is an entity that is controlled, jointly controlled, or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (4) or (5); or
7. The party has a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

At the same time, IAS 24 specifies which parties are not deemed to be related:

- Two enterprises simply because they have a director or key manager in common
- Two parties who share joint control over a joint venture
- Providers of finance, trade unions, public utilities, government departments and agencies in the course of their normal dealings with an enterprise

6 See also: the International Accounting Standard Plus' website <http://www.iasb.org/NR/rdonlyres/8E1664C6-AD47-4B84-A8D7-88476F1D83AC/0/IAS28.pdf>

7 See also: the International Accounting Standard Plus' website under <http://www.iasb.org/NR/rdonlyres/13E1409D-1100-4AF5-A7D9-B5AC69E40CB1/0/IAS31.pdf>

- A single customer, supplier, franchisor, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence.

The Financial Accounting Standards Board's (FASB) Statement No. 57 finally defines a related party as affiliates of an enterprise, trusts for the benefit of employees, owners and their family members, investment entities accounted for by the equity method by the firm, management and other large shareholders or parties that influence a firm's policy.

b. Related Parties Are Involved in the Transactions

For the purposes of defining affiliated transactions, the parties specified in the previous section must be involved in the transaction in one of the following capacities:

- Act as a transaction party in a legal transaction with the company
- Has a financial relationship with a party to a legal transaction, who has concluded a contract with the company or who has financial interests in that transaction, which can reasonably be expected to make him/her act contrary to the company's interests
- Is controlled by a party to a legal transaction or a person having a financial interest in that legal transaction, so that the mentioned party/person can be reasonably expected to get him/her to act contrary to the company's interests.

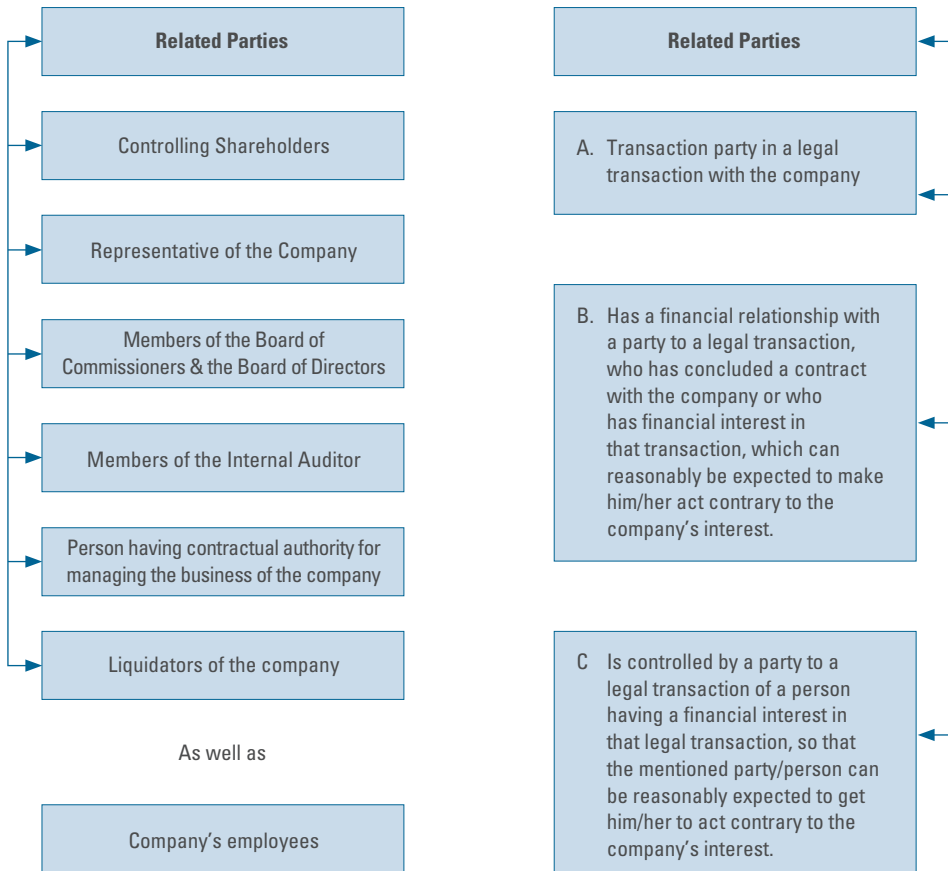


Mini-Case 1

Company (X) concludes a contract with Company (Y) that Company (Y) will sell products of Company (X) on-line. Mr. (A) is a member of the Board of Directors of Company (X) and is also the General Director of Company (Z), which will receive a special discount on products of Company (Y) sold to Company (Z) if the transaction between Company (X) and Company (Y) is concluded. In such a transaction between Company (X) and Company (Y), Mr. (A) is considered a related party who is a beneficiary of the transaction. The transaction will be affiliated transaction for Company (X) and will require approval. At the same time, it is not a affiliated transaction for Company (Y).

As illustrated in Mini-Case 1, it is important to note that the same transaction can be an affiliated transaction for one company but not for another. In this case, only one company needs to approve the transaction as an affiliated transaction. Figure 2 depicts components of affiliated transactions, which must be present in a transaction.

Figure 2. Components of Related Party Transactions



To determine whether a transaction is a related party transaction, it is necessary for an interested party from the left column of Figure 2, to be involved in the transaction as indicated in the right column of Figure 2. In practice, this means that a company must create a list of related parties and always check whether any of these parties (1–6 of the left column) or their affiliated persons (7 of the left column) is involved in each and every transaction carried out by the company, as mentioned in A-C of the right column.



Comparative Practices

Related party transactions are common in the context of groups of companies, e.g. in parent-subsidary relations. If one company dominates another, there is a risk that the parent will utilize the subsidiary for its own business objectives, without care for the subsidiary's long-term financial viability. In these cases, the creditors and shareholders of both the subsidiary and parent may be put at risk often unknowingly.

- The risk for creditors at the subsidiary level is obvious. But the risk is present at the parent level as well, as the subsidiary's insolvency can greatly damage the surviving parent.
- Shareholders are also put at risk, although the position of shareholders at the subsidiary level is weaker. On the one hand, shareholders at the subsidiary level often benefit from being part of the parent's business. While they may have to contribute to the parent's welfare to their own detriment.

2. Approving Affiliated Transactions



Best Practices

There are different means of regulating related party transactions. Prohibitions of specific types of transactions are found in the U.K., where the U.K. Companies' Act prohibits directors from entering into certain transactions that are deemed detrimental to the company.⁸ The advantage of this first approach is clear, all practitioners know where the boundaries are. There is no definitive analysis on the possibilities to circumvent the prohibition. The disadvantage is the rule's lack of flexibility, even economically useful transactions may not come into being when the law contains a flat prohibition. Additionally, parties may also make great efforts to circumvent the rule.

In some jurisdictions there have been calls to change the approach and foster more substantive criteria of fairness. Transactions with conflicting interests should always be open to challenge on the basis of unfairness, at least gross unfairness. This second approach is frequently found in U.S. law and in the U.K.⁹

Indonesian Company Law and other regulations including decrees of the Chairman of OJK do not stipulate in details on the approving of affiliated transactions. ICL and the OJK Regulation only stated that transaction with value of more than 50% (fifty percent) of company's equity should be approved by the GMS.

c. Required Information for the Decision to Approve Affiliated Transactions

According to Regulation IX.E.1, for affiliated transaction, a company is obliged to submit evidence of disclosure and supporting documents to OJK at the latest 2 (two) business days after transaction occurred. The information includes:

- Description of the transaction (object, value, parties involved and their relation with the company and the nature of the affiliation);
- Summary of the appraiser report (identity, purpose, objects, assumptions,

⁸ Section 330(2), U.K. Companies' Act

⁹ Commonly seen in the U.K. See The Law Commission and The Scottish Law Commission's report "Regulating Conflicts of Interests and Formulating a Statement of Duties", September 1999, p.282, document Law Com. No. 261

approach and method of appraisal, conclusion on the value and appraiser fairness opinion);

- Explanation, consideration and reasons for the transaction compare with similar transaction is engaged with non-affiliated parties;
- Company's business plan, data of the acquired company and another related information in the event of acquisition transaction;
- Statements from the Board of Commissioners and the Board of Directors that all material information has been disclosed and not misleading; and
- Summary of report from experts or independent consultants, if necessary.

3. Identifying Affiliated Transactions

Any related party transaction that involves conflict of interest and/or the transaction value exceeding 50% of the company's equity should be properly approved before it can be concluded. However, in practice not all transactions follow such procedures. There are different reasons for this, including the fact that the Board of Commissioners, Board of Directors and shareholders may not always know whether the transaction involves related parties, in particular when insiders concealed their affiliation and personal interest. In such cases, independent commissioners will need to play the lead role in identifying and disclosing related party transactions. Creating the list of related parties and their position in the transaction is but one aspect, made difficult by the fact that most ownership structures remain opaque. The materiality of these transactions is another important issue. Indeed, while the nature of some related party transactions is easily identifiable, others are structured in an elaborate manner, involving complicated off-shore schemes.



Best Practices

The Board of Commissioner' composition and experience will largely determine the success of identifying such related party transactions., Independent commissioners who enjoy an arms-length relationship with directors will certainly play a key role in this respect. The External Auditor also plays a key supporting role, and the Board of Commissioners and its Audit Committee will want to ensure that the company's External Auditor

uses the full range of audit procedures to evaluate managerial self-dealings. For example, the American Institute of Certified Public Accountants' (AICPA) Statement of Auditing Standard No. 45, AU Sec. 334 (2001) sets forth criteria for identifying material transactions, such as interest free borrowing, asset sales that diverge from appraisal value, in-kind transactions, and loans made without scheduled terms.

4. Disclosure Requirements

Board of Directors and Board of Commissioners members, the President Director or director and other managers of the company must declare their relevant interests to the company, including:

- Name and address of the head office, field of business, number and date of the issuance of the business registration certificate, place of business registration of any enterprise in which they own contributed capital or shares, ratio and period of such ownership of contributed capital or shares
- Name and address of the head office, field of business, number and date of the issuance of business registration certificate, place of business registration of any enterprise in which their related persons jointly own or separately own shares or contributed capital of more than 35% (thirty percent) of the charter capital.

The declaration is reported to the GMS and is filed at the head office of the company. Shareholders have the right to review the contents declared at any time considered necessary.

In addition, public companies must follow disclosure requirements on related party transactions as stated in Regulation No. IX.E.2.



Best Practices

Company laws of many countries require persons who are related parties to disclose information to the Board of Directors, the Audit Committee, internal supervisory body and the External Auditor regarding:

- Legal entities in which they, either independently or together with affiliated persons, own a certain percentage of voting shares

- Legal entities in which they hold managerial positions
- Pending or planned transactions in which they may be considered a related party.

Moreover, the disclosure of beneficial ownership is an important aspect in detecting related party transactions. If the identity of the company's true owners is hidden, then it is difficult, if not impossible, to establish whether the parties in the transaction are related (as mentioned in Section C.1.a of this Chapter).

To protect shareholder interests, the Board of Commissioners members (especially independent commissioners) should demand that all owners of 5% (five percent) and more of common shares comply with the relevant disclosure requirements.

The companies should be required to include the following information regarding related party transactions in their annual report:

- A list of related party transactions concluded by the company during the reporting year
- Significant terms and conditions of each related party transaction
- The governing body that approved related party transactions.

In addition, securities regulations should require that companies disclose the following information on related party transactions:

- Copies of the minutes of the meeting of the approving body, including information on the quorum and the voting results
- The list of persons, with whom transactions may be qualified as related party transactions and the list of those persons with whom transactions have already been approved by the company
- Information on related parties before the placement starts, in case of an open subscription
- The prospectus and quarterly reports must provide information on related party transactions.

Finally, accounting legislation requires companies to disclose information on operations with related parties in their accounting documents.

5. Invalidation of Affiliated Transactions

A related party transaction which has not been approved in conformity with the law or for which the proof of being in the company's best interests at the time of its conclusion or at the time of its execution has not been presented, is null and void. Furthermore, OJK has the authority to apply sanction for any violation to the provisions stipulated in the regulation.¹⁰



Best Practices

If the company can seek to invalidate a transaction that was not concluded in accordance with its internal approval procedures then this may create undue problems for the counterpart. It is recommended to follow the example of some western jurisdictions where the company needs to prove that the counterpart in the transaction knew or must have known of the irregularity in its approval.

6. Liability for the Violation of Procedural Requirements

Not with standing any sanctions stipulated under the capital market laws and regulations, OJK has the right to impose sanction to any violation of Regulation No. IX.E.2 provisions.



Best Practices

A company may wish to codify its policy regarding related party transactions in its company-level corporate governance code, AoA, or internal regulations. More importantly, the company may codify a director's duty to properly handle related party transactions, i.e. not to authorize, or permit the company to enter into a transaction if he/she has an interest in the transaction and has not disclosed this interest.

¹⁰ Regulation IX.E.2, Closing Provision paragraph c

Chapter **13**

**INFORMATION
DISCLOSURE**

Table of Contents

A. AN INTRODUCTION TO INFORMATION DISCLOSURE	443
1. Definition and Rationale	443
2. Principles of Disclosure	443
3. Confidential Information (Business Secret)	445
4. Inside Information and Insider Dealing	447
5. Disclosure in Listed and Public Non-listed Companies	448
6. Disclosure Versus Transparency	449
7. Personal Liability for Non-Disclosure	449
B. DISCLOSURE ITEMS	451
1. Financial and Operating Results	454
2. Company Objectives	461
3. Major Share Ownership and Voting Rights	462
4. Information on Commissioners and Directors	467
5. Material Foreseeable Risk Factors	470
6. Employees and Other Stakeholders	470
7. Corporate Governance Structures and Policies	470
8. Disclosure During the Placement of Securities - Prospectus	473
C. VOLUNTARY DISCLOSURE	474
1. Corporate Websites	474
2. Mass Media	475



The Chairman's Checklist

- ✓ Does the company have a written disclosure policy? Does the policy fully express the company's commitment to transparency? Is the disclosure policy easily available to market participants and other interested parties?
- ✓ Does the company fully comply with its legal disclosure obligations? What systems are in place to ensure that full and timely disclosure of material information occurs?
- ✓ Are commissioners and directors fully aware of the personal and corporate repercussions of false or incomplete disclosure? Do commissioners and directors act accordingly to ensure good disclosure?
- ✓ Is the company's ownership structure transparent?
- ✓ What steps are being taken to ensure that the company's financial position is communicated clearly to the markets?
- ✓ Is the disclosure fair? For example, does the company ensure that all investors receive information at the same time, not giving special access to a privileged few individuals or institutional investors?

- ✓ Does the company have a policy on insider trading and does it enforce this policy? What systems are in place to manage the flow of insider and other sensitive information?
- ✓ Does the company appreciate that it is in its own interest to make voluntary disclosures to the market? If so, how does it ensure the veracity of this information and that its disclosure is not merely for marketing or public relations purposes?
- ✓ Does the company truly understand the definition of commercially sensitive information? Or, does the company hide behind protections provided for sensitive information in order to withhold important material facts from the markets?
- ✓ In the case of joint stock companies with the capital participation of foreign shareholders, how does the company's disclosure compare to international disclosure requirements, for example, the OECD Principles of Corporate Governance?

There are two basic forms of market regulations, substantive rules-based regulations and disclosure-based regulations. Both regulatory approaches seek to protect shareholders and provide for fair and stable financial markets. Rules-based regulations set down what companies can and cannot do, and seeks to establish a wide-reaching set of regulations that cover a number of potential circumstances. Disclosure-based regulations rely more heavily upon market mechanisms to punish and reward certain types of corporate behaviour, and shifts part of the responsibility for protecting investors to market participants, according to the motto *caveat emptor* or *buyer beware*. Disclosure-based regulations are partly predicated upon the faith that markets are better at policing corporate misconduct than regulatory agencies, and that disclosure is an effective and inexpensive substitute for substantive regulations. In practice, the two approaches are

almost always used in combination with one another, though some countries rely more heavily on disclosure than others.

For disclosure-based regulations to work effectively, a number of elements and incentives need to work together. These include a proper legal and regulatory environment, combined with effective enforcement mechanisms such as regulators that screen financial information for misstatements and courts that provide effective redress. Independent External Auditors also play an important role, providing assurance to the markets, as does an active and interested medium that questions company strategies and communications. Finally, a competent and vigilant Board of Commissioners is crucial. It is broadly accepted that even the best disclosure system cannot thwart individuals who are intent upon defrauding a company and its shareholders. Without a Board of Commissioners that is uniformly intolerant of obfuscation, disclosure cannot be fully effective.

While disclosure based-regulations may function imperfectly in an emerging financial market such as in Indonesia, disclosure is, nevertheless, important and is only likely to grow in importance as Indonesia's financial markets mature. Among the broad palette of disclosures, particular importance must be attached to financial and operating results, related party transactions and ownership structures.

A. An Introduction to Information Disclosure

1. Definition and Rationale

Disclosure is defined as ensuring access to information for all interested parties, regardless of the purpose of obtaining the information, through a transparent procedure that guarantees information is easily found and obtained in a timely manner.

Timely and accurate disclosure is essential for shareholders, potential investors, regulatory authorities and other stakeholders. Access to material information helps shareholders protect their rights and improves the market participants' ability to make sound economic decisions. Disclosure makes it possible to assess and oversee management, as well as to keep management accountable for the company and shareholders. Disclosure benefits companies since it allows them to demonstrate accountability towards shareholders, act transparently towards the markets, and maintain public confidence and trust. Good disclosure policies should also reduce the cost of capital. Finally, information is also useful for creditors, suppliers, customers and employees to assess their positions, respond to changes and shape their relations with companies.

The power of a sound disclosure regime is expressed clearly and eloquently in the following quote:

*“Requiring disclosure of information can be a powerful regulatory tool in company law. It enhances the accountability for and the transparency of the company’s governance and its affairs. For those who participate in or do business with companies, information is a necessary element in order to be able to assess their position and respond to changes that are relevant to them.”*¹

2. Principles of Disclosure

Indonesia, through its Law on Capital Market has regulated the disclosure of information and reporting obligation for issuer, public companies and all capital market supporting professions and institutions.

1 Report by the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002. (See also: http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf).

The Law on Capital Market defines the Disclosure Principle as the general guidelines that obliged public companies and all other capital market member institutions to disclose within a certain time, material information regarding its businesses or securities which may impact the investors' decisions in such securities and/or the securities' price.²

Furthermore, OJK as the Indonesia capital market supervisory agency had issued several decisions regarding the disclosure of information obligation for public companies, namely:

1. Decision of the Chairman of OJK Number Kep-82/PM/1996 dated 17 January 1996 concerning Disclosure Requirements for Certain Shareholders (OJK Regulation Number X.M.1);
2. Decision of the Chairman of OJK Number Kep-86/PM/1996 dated 24 January 1996 concerning Disclosure of Information that must be made Public Immediately (OJK Regulation Number X.K.1);
3. Decision of the Chairman of OJK Number Kep-39/PM/1997 dated 26 December 1997 concerning Documents That Are Open To the Public (OJK Regulation Number II.A.1);
4. Decision of the Chairman of OJK Number Kep-346/BL/2011 dated 5 Juli 2011 concerning Obligation to Submit Periodic Financial Statements (OJK Regulation Number X.K.2); and
5. Decision of the Chairman of OJK Number Kep-431/BL/2012 dated 1 Agustus 2012 concerning Obligation to submit annual report for Issuers or Public Companies (OJK Regulation Number X.K.6).

These decisions will be further discussed in Section A subsection 5 of this chapter.



Best Practices

A more practical expression of what constitutes good disclosure follows in these four basic principles:

1. Provided on a regular and timely basis
2. Easily and broadly available
3. Correct and complete
4. Consistent, relevant and documented.

² Law on Capital Market, Article 1.25

3. Confidential Information (Business Secret)

Securities legislation requires publicly held companies to disclose a broad range of financial and non-financial information. At times, information disclosure required by regulations can adversely affect a company's business and financial condition because of the competitive harm that could result from the disclosure. Despite the fact that many Indonesian companies often consider business related information commercially sensitive, in reality competitive harm only arises in a limited number of circumstances. Some examples of truly sensitive information include pricing terms, technical specifications and milestone payments. To address potential disclosure hardship, legislators and regulators develop systems for allowing companies to request confidential treatment of information.

With regard to protection of undisclosed information, Article 39 of the Trade Related Aspects of Intellectual Property Rights Agreement ("TRIPS") regulates that natural and legal person shall have the possibility of preventing information lawfully their control being disclosed to, acquired by, or used by others without their consent in a manner contrary to honest commercial practices. This provision applies for information which:

1. is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question;
2. has commercial value because it is secret; and
3. has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it secret.

As one of the countries that have ratified the TRIPS Agreement through Law Number 7 of 1994 concerning the Ratification of the Agreement Establishing the World Trade Organization, Indonesia has the obligation to implement the provisions of the TRIPS Agreement, in this case specifically related to business secrets. Following the ratification, the Government of the Republic of Indonesia enacted the Law on Trade Secret dated 20 December 2000.

Under the Law on Trade Secret, trade secret means information in the field of technology and/or business that is known by the public and has economic values as it is useful in business activities, and the confidentiality of which is maintain by its owner.³ Constitute as trade secret under this law are methods of production, methods of processing (preparation), methods of selling, or other information in the field of

3 Law on Trade Secret, Article 1 number 1

technology and/or business that has economic values and is not known by the public in general.⁴ Trade secret which shall be given protection, must meet the following characteristics:⁵

1. the information is confidential in a way that such information is only known by a certain people or such information is not known by the public in general;
2. the information has economic values in a way that the confidentiality of the information can be used to run commercial activities or business or can improve the benefit economically; and
3. the secrecy of which is maintained with necessary efforts in a way that the owner or the parties that control the information have taken necessary and appropriate efforts.



Best Practices

Companies should be clear on what truly constitutes confidential information and should not interpret the broad definitions provided for by law so widely as to withhold relevant information from investors. To guide practices with respect to commercially sensitive information, companies are well advised to develop written policies and procedures, and define what should be considered confidential in their internal regulations. For example, they can consider personal data as confidential information, and forbid the collection, storage, usage and dissemination of private information without the person's consent, unless otherwise provided by a court decision.

4 Law on Trade Secret, Article 2

5 Law on Trade Secret, Article 3

4. Inside Information and Insider Dealing

Insider trading encompasses both legal and prohibited activity. Insider trading takes place legally, every day, when corporate insiders buy or sell shares in their own companies within the confines of company policy, law and regulations.

There is also an illegal variety of insider dealing. It is the dealing that takes place when those with access to insider information use their knowledge to reap profits or avoid losses on the stock market. Investors lacking access to insider information often pay the costs of insider dealing.

Another, and far greater, cost of insider dealing is the damage done to the credibility of securities markets. One of the main reasons that capital is easily available in the world's most successful stock markets is that investors largely trust them to be fair. The common belief in some countries that privileged investors should be allowed to profit from their access to insider information may explain, in part, relatively low public share ownership in these countries. Governments cannot afford to ignore insider dealing if they hope to promote an active securities market and attract international investment. The same holds true for a Board of Commissioners that wish to protect shareholders and attract investment.

Insider information is defined as any information of a precise nature relating to a public company, which is not made public, and which can, directly or indirectly, have significant influence on the trade of the securities or on the prices of the company on the market. An insider is a person who possesses inside information knowing, or ought to have known, that it is inside information. Under the elucidation of Article 95 of the Law on Capital Market, individuals with access to insider information particularly include:

- a. a commissioner, director or employee of an issuer or public company;
- b. a substantial shareholder of an issuer or public company;
- c. an individual, who due to his position or profession, or due to a business relationship with an issuer or public company, has access to inside information; or
- d. an individual who within the last six months was a person defined in letters a, b or c above.

Insiders, with respect to an issuer or public company, who is in possession of inside information, is prohibited from buying or selling securities of the issuer or public company or another company engaged in transactions with the issuer or public

company.⁶ An insider is also prohibited to influence a person to buy or sell the securities in question, providing inside information to a person he has reason to believe may use such information to buy or sell the securities in question.⁷

Indonesian legislation also recognises criminal responsibility for insider information abuses. Namely, persons who may be considered insiders have an obligation to keep the insider information as a business secret and its disclosure is sanctioned as a criminal offence.



Best Practices

Disclosure of insider information may substantially affect the market value of shares and other securities of a company. Therefore, persons who have access to insider information may not use it to execute transactions, nor may they transfer insider information to a third party. Illegal use of insider information can damage shareholder interests and adversely affect the financial position and reputation of the company as well as securities markets overall. The company should have a written insider dealing policy in place and vigorously enforce it. The Internal Auditor of the company should monitor whether directors, managers and other officers comply with the law, regulations and internal rules on insider dealing.

5. Disclosure in Listed and Public Non-listed Companies

Disclosure requirements are different for publically listed companies, public (non-listed) companies and private joint stock companies. Private joint stock companies usually need only to comply with minimal disclosure requirements and are not subject to the reporting obligations determined by regulations governing the securities market. More stringent rules apply to listed and public companies. Tight regulation of information disclosure among listed companies is needed because of the greater impact of potential fraud when a company may have many thousands of shareholders. Given the importance of capital markets in a modern economy, governments are, understandably, keen on ensuring the integrity of the financial system. The increased number of

⁶ Law on Capital Market, Article 95

⁷ Law on Capital Market, Article 96

disclosure obligations for listed companies is the price to be paid to access the large funds available on capital markets.

The regulatory framework in Indonesia requires public companies to disclose information in accordance with the Decisions of Chairman of OJK as shown below:

As already mentioned, public companies' reporting obligations are greater than for non-public companies.

→ *For more general information on the differences between forms of joint stock companies, see Chapter 2, Section A.2.*

6. Disclosure Versus Transparency

Disclosure is sometimes confused with transparency. Unfortunately, these two terms are frequently and erroneously used interchangeably. While disclosure and transparency would at first glance, appear to be the same, they are not. Companies may disclose an enormous amount of information that is of no particular value to the users of such information. Important pieces can be withheld. Disclosure can be irrelevant or, worse, manipulated in such a way as to conceal the true picture of the state of the enterprise. For example, while many companies may disclose their ownership as required by law, the true owners and the extent of their control often remain hidden behind complex legal structures such as special purpose entities, off-shore holding companies and trusts.

A strong disclosure regime that promotes real transparency is a pivotal feature of market-based monitoring of companies and is central to shareholders' ability to exercise their ownership rights on an informed basis.

7. Personal Liability for Non-Disclosure

As a rule, companies are liable for damages caused to shareholders and third parties by providing false, incomplete or distorted information. Beside the company, all other people who participated in the preparation of disclosed information are liable for the damage caused by the publication of incomplete and inaccurate information. The additional condition of their responsibility is that they knew or by the nature of their work had to know that information was inaccurate or incomplete (for example, the President Director, the Chief Accountant or the person fulfilling this function, the External Auditor). They are jointly and severally liable with the issuer for any damage caused to investors because of untruthful, incomplete, and/or misleading information. If investors believe that they have suffered damages, they can file claims with a court.

Organizations and individuals who violate provisions of the law on information disclosure shall, depending on the nature and severity of their violation, be disciplined, administratively sanctioned or examined for penal liability. If damage is caused, they shall pay compensation in accordance with the law.

Regarding violation of information disclosure regulations, violating individuals and organizations shall be subject to either of the following two principal sanctioning forms cautions and fines. Under the Law on Capital Market, violation of information disclosure shall be subject to imprisonment for a maximum of ten years and a maximum fine of IDR15,000,000,000.00 (fifteen billion Rupiah).⁸

In the case of a very dangerous violation when a person who has provided false, incomplete, or distorted information or has not disclosed all legally required information is subject to criminal prosecution.

8 Law on Capital Market, Article 104

B. Disclosure Items

The OECD Principles suggest that:

“...timely and accurate disclosure be made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.”⁹

The key concept that underlies the OECD’s recommendation is the concept of materiality. Material information is information the omission or misstatement of could affect economic decisions taken by the users of information. Materiality may also be defined as a characteristic of information or an event that makes it sufficiently important to have an impact on the company’s share price.

The application of the materiality concept allows companies to avoid overly detailed disclosure that is ultimately irrelevant to shareholders. For example, damage to IDR 130 million worth of paper in a large, publicly traded company is, clearly, of little importance to the investor. It may, on the other hand, be material to a small family-owned print shop. Materiality is, consequently, a relative concept that depends on the context. It is often difficult to define with great precision in practice. Companies and auditors may sometimes apply certain numerical thresholds (for example, 5% of earnings) to simplify its application. However, these thresholds can only serve as a starting point for a more rigorous application of the concept of materiality.

The concept of materiality is also recognised by Indonesian regulations which, in addition to mandatory, itemised information, prescribe all other matters relevant for the understanding of the legal, financial and profit situation of the securities issuer as contents of the document intended for informing the investment public. Thus, the assessment of circumstances, for example, “significant litigations” or “other circumstances that may significantly affect the price of securities” is left to companies themselves. The availability of that assessment should be provided to the public.

According to the Decision of the Chairman of OJK Number Kep-86/PM/1996 (Regulation No. X.K.1), public companies whose registration statement has become effective, should disclose to OJK and make public any material information regarding events that could affect the investors’ decision or the value of the companies’ securities, to OJK and public, as soon as possible, at the latest by the second working day after the event occurs. Constitute as event, information or material fact are as follow:

9 OECD Principles of Corporate Governance, Principle IV on Disclosure and Transparency. See also: <http://www.oecd.org/dataoecd/32/18/31557724.pdf>.

- a. a merger, acquisition, consolidation or establishment of a joint venture;
- b. a stock split or distribution of stock dividends;
- c. an unusual dividend;
- d. an acquisition or loss of an important contract;
- e. a significant new product or innovation;
- f. a change in control or significant change in management;
- g. a call for the purchase or redemption of debt securities;
- h. a sale of a material amount of securities to the public or in a limited manner;
- i. a purchase, or loss from the sale, of a material asset;
- j. a relatively important labor dispute;
- k. any important litigation against the company and/or the company's directors or commissioners;
- l. an offer to purchase securities of another company;
- m. the replacement of the accountant who audits the company;
- n. the replacement of the company's trust agent; and
- o. a change in the company's fiscal year.



Best Practices

The OECD Principles call for disclosure of all material information in the following areas:

- Financial and operating results of the company
- Company objectives
- Shareholdings and ownership structure
- Directors and key executives, as well as their remuneration
- Material foreseeable risk factors
- Material issues regarding employees and other stakeholders
- Governance structure and policies.

This list is comprehensive, if general. The Technical Committee of the International Organization of Securities Commissions (IOSCO) has developed more detailed, high-level principles for on-going disclosure and material development reporting for public entities. These principles are:¹⁰

- Materiality of information for an investor's investment decision
- Disclosure on a timely basis, immediate or periodic
- Simultaneous and identical disclosure in all jurisdictions where the entity is public
- Dissemination of information by using efficient, effective and timely means
- Disclosure criteria fairness, without misleading or deceptive content and containing no material omissions
- Equal treatment of disclosure, no selective disclosure to investors and others before public disclosure
- Compliance with disclosure obligations.

Indonesian legislation covers these essentials in considerable detail. The following subsections discuss Indonesia requirements and disclosure practices with respect to the above-mentioned OECD disclosure items as stipulated in the Decision of the Chairman of OJK Number Kep-346/BL/2011 (Regulation No. X.K.2) and Decision of the Chairman of OJK Number Kep-431/BL/2012 (Regulation No. X.K.6).

¹⁰ Principles for On-going Disclosure and Material Development Reporting by Listed Entities, OICU-IOSCO, October, 2002. See also: www.iosco.org.

1. Financial and Operating Results

a. Presenting Financial Information

Information about financial results, performance, the situation and operations of the company is of utmost importance for shareholders, potential investors, creditors and other stakeholders. The following list constitutes the most typical forms of, and additions to, financial reporting:

- **The balance sheet** provides a snapshot of the company's assets, capital and liabilities on a particular date. To skilled analysts, it provides important information on, inter alia, the degree of risk an investment in the company carries or the company's ability to pay creditors.
- **The income statement** provides information on the company's performance during a specified period of time. Income statements may be organized in a number of different ways. According to internationally recognized practice, income statements must show 1) revenues or sales, 2) the results of operating activities, 3) financing costs, 4) income from associates and joint ventures, 5) taxes, 6) profit or loss from ordinary activities and 7) net profit or loss. The income statement demonstrates business sustainability.
- **The cash flow statement** illustrates a company's sources and uses of cash. It lists all changes affecting cash in operations, investments and financing. For example, net operating income increases cash, the purchase of a plant is an investment that decreases cash and the issuance of shares or bonds is a financing activity that increases cash.
- **The explanatory notes to the financial statements** help explain the company's financial statements by providing important details and insights into how the company prepared its accounts. It also briefly describes features of the company's activities, its main performance indicators and factors that affected the company's financial results, as well as decisions on financial statements and distribution of net profit reviews. This refers to any relevant information that would enable users to receive a complete and objective picture of the company's financial condition, financial results for the reporting period and any changes in its financial position. The notes to the financial statements must specifically state the contents of related party transactions in accordance with the Indonesian Financial Accounting Standards (*Peraturan Standar Akuntansi Keuangan - PSAK*).

Furthermore, this part contains, when needed, *the statement of changes in owners' equity* that shows all changes in the AoA, additional paid-in and reserve capital, as well as retained earnings. In addition, it provides information on changes in statutory and additional funds and briefs on net assets.



Best Practices

International practice also calls for the Management's Discussion and Analysis (MD&A), which provides management's view of the performance and future prospects of the company. The MD&A, which is typically disclosed in the company's annual report, should:

- 1) Complement as well as supplement financial statements
- 2) Have a forward-looking orientation
- 3) Focus on long-term value creation
- 4) Integrate long- and short-term perspectives
- 5) Present information that is significant to the decision-making needs of users
- 6) Embody the qualities of reliability, comparability, consistency, relevance and understandability.

The MD&A presents a more analytical and qualitative view than the rest of the financial statements.

Finally, the External Auditor's report with conclusions enable an independent External Auditor to express an opinion on whether or not the company's financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework and whether they are reliable. This provides shareholders, managers, employees and market participants with an independent opinion about the company's financial position and, if performed properly, should attest to the accuracy of the statements. The annual financial statements of all public and listed companies must be audited by an independent and eligible audit firm. Annual audited financial statements must be submitted for approval by the GMS.¹¹

→ *For more information on the role of the External Auditor, see Chapter 14, Section B.*

¹¹ ICL, Article 66 paragraph (1)

b. Preparing Financial Information

Regulatory framework regulating financial reporting must recognize the following basic concepts and principles:

- **Accrual based accounting**, according to which revenues and expenses are booked over time and not at the point of payment or receipt of funds. This requires that sales and expenses relating or pertaining to a particular period be recorded in the period of occurrence irrespective of when the amount was received or paid.
- **Going concern assumption**, i.e. that financial statements are prepared on the assumption that the company is operating and will continue to operate for the foreseeable future and that it has neither the intention nor the necessity of liquidation or of materially curtailing the scale of its operations. The going concern assumption is a fundamental principle in the preparation of financial statements. For this reason, it is recognized that management has a responsibility to assess the entity's ability to continue as a going concern. However, management's assessment may not always involve detailed analysis, particularly when there is a history of profitable operations and ready access to financial resources.
- **Consistency**, which states that the presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new accounting standard.
- **Separation of assets and liabilities**, meaning that the assets (fixed and current) and liabilities (debt payables and equity of owners) of the company shall be separated from those of its owners and other organizations.

In addition, company accounting policies should ensure:

- **Completeness of information disclosure**, meaning that information contained in the company's financial statements should disclose all material business facts and results (actually and potentially) influencing economic decision-making by the users of these financial statements from the standpoints of materiality of such information and the cost of its preparation (an omission can cause information to be false or misleading and thus unreliable and imperfect from the standpoint of its relevance).

- **Timeliness**, i.e. the company needs to publish reports quickly, as up-to-date information is of much more value to users than older information that may have been superseded by events. For companies which financial report is audited by a public accounting, such reports shall be publicized not later than 7 (seven) days after they are ratified by the GMS¹²
- **Conservatism**, requiring a company to make prudent and deliberate accounting choices and estimate when future events would have negative impacts on its financial condition.
- **Substance over form**, meaning that for the faithful presentation of information in the financial statements it is necessary that transactions and events are accounted for and presented in accordance with their substance and economic reality (which should prevail) and not merely their legal form.
- **Balance between benefits and cost**, which, given the complexity and breadth of certain reporting requirements, allows smaller companies to tailor their financial information to be cost-effective. This concept, however, should not be used to deny information to users. The presumption must be that information required by law and accounting standards should be provided to users unless there is a clear indication that the cost outweighs the benefit.
- **Matching**. Expenses are matched to related revenues in determining earnings for the period.

Legislation, accounting and other standards will determine the specific content and format of financial statements. Taken together and compared over time, the financial statements should provide a well-rounded picture of the company's operations and financial position.



Best Practices

If companies plan to access international capital markets or, simply to improve upon the quality of financial reporting, they will need to prepare financial statements according to an internationally accepted body of accounting standards. The most recognized standards are the International

¹² ICL, Article 68 paragraph (5)

Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (U.S. GAAP).¹³

In addition to standard financial reporting according to the PSAK, a company may consider reporting in accordance with IFRS for the following reasons:

- IFRS have clear economic logic and provide better information to the company's management than the current Indonesian accounting standards do, allowing for a better comparison with a peer group of international companies.
- There is global convergence of national standards towards IFRS.
- All public companies in Europe with consolidated accounts were required to present their consolidated financial statements using IFRS as of 2005.¹⁴
- Unification of standards will allow users of financial statements to "read" financial statements under common rules.
- Implementing IFRS could help Indonesian companies decrease expenses in attracting investment.

Applying IFRS typically has the following impact on the balance sheet of a standard Indonesian company:

- The need to prepare consolidated financial statements Inventories can no longer be generally carried at cost, but at the lower cost or net realizable value
- A significant change in the value of fixed assets
- Use of a fair market valuation rather than the historical cost approach for many assets and liabilities
- The appearance of new financial instruments, derivatives in particular
- Recognition of assets and liabilities, the control over which does not stem directly from participation in equity.

13 U.S. GAAP is available on the Financial Accounting Standard Board's website under: <http://www.fasb.org>. A summary of IFRS is available on the International Accounting Standard Board's website under: <http://www.iasb.org>.

14 Regulation (EC) 1606/2002 of the European Parliament of the Council of 19 July 2002 on the Application of International Accounting Standards. See also: http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/l_243/l_24320020911en00010004.pdf.

Additional items are included in the income statement, such as fair value adjustment for financial instruments and recognition or recovery of asset impairment, amongst others. Disclosures also become more informative and user-oriented.

Depending on where the company intends to list, statements will likely need to be prepared according to one of these two standards.

c. **Disclosing Financial Information**

Financial information will typically be presented in different forms and at different times throughout the financial year. Financial and operating results will appear in the prospectus, annual report, annual, semi-annual and quarterly financial statements.

It is determined by Article 68 paragraph (5) of the ICL that all companies are obliged to disclose the annual audited financial statements no later than 7 (seven) days after ratified by the GMS. The date of completion of annual financial statements shall be no later than 6 (six) months from the last day of the annual accounting period in accordance with the ICL¹⁵. The annual financial statements must be in Bahasa Indonesia (accompanied by English translation if applicable), must also be disclosed in the publication and on the electronic information site of the company, and must be archived at the head office of the company to enable investors to refer to such items. Finally, all the contents and information about the annual financial statements must be disclosed on the information disclosure media of the OJK and IDX (in the case of a public company) and concurrently the full text of the auditors' report (as a part of the audited financial statements) must be published at least in one edition of a nationwide newspaper in Bahasa Indonesia.¹⁶

Public companies must disclose additional financial information as follows:

- Semi-annual financial statements must be disclosed within 30 days from the end of the second quarter of each year if not attach by the accountant report, at the latest at the end of the second month after the date of semi-annual financial report, if supported by an accountant report for limited audit and 90 days if audited report from accountant is required.¹⁷

15 ICL, Article 66 paragraph (1)

16 ICL, Article 68 paragraph (4)

17 Regulation No. X.K.2

- Semi-annual financial statements must be disclosed on the information disclosure media of the OJK and IDX, be disclosed in the publication and on the electronic information site of the company and must be archived at the head office of the company.



Best Practices

Companies should disclose all material information and do so in a timely basis and in such a manner as to make the information as clear and understandable to users as possible. Companies should adhere to the spirit of the law, not just the letter and should not limit themselves to the minimum standards of statutory disclosure.

d. Financial Information in Groups of Companies

Complete disclosure of intra-group relations, transactions and their financial terms, and consolidated accounts is a crucial pre-requisite to make the group's functions transparent.



Best Practices

When preparing consolidated accounts, companies should follow uniform accounting policies for the parent and its subsidiaries or, if this is not practicable, the company must disclose that fact and the proportion of items in the consolidated financial statements to which different policies have been applied. In the parent's separate financial statements, subsidiaries may be shown at cost, at re-valued amounts, or using the equity method. According to IFRS, a company's consolidated accounts should include, inter alia:¹⁸

- The name, ownership and voting percentages for each significant subsidiary
- The reason for not consolidating a subsidiary

18 Excerpt from International Accounting Standard No. 27. See also: <http://www.iasb.co.uk>.

- The nature of the relationship if the parent does not own more than 50% of the voting power of a consolidated subsidiary
- The nature of the relationship if the parent owns more than 50% of the voting power of a subsidiary excluded from consolidation
- The effect of acquisitions and disposals of subsidiaries during the period
- In the parent's separate financial statements, a description of the method used to account for subsidiaries.

Indonesian regulations also impose an obligation to prepare consolidated financial statements and to make separate reports on the companies that are the subject of consolidation. This data also presents an integral part of the required contents of the prospectus and are subject to disclosure obligations in the process of the mandatory informing of the public by the company. In that regard, the regulation on reporting stipulates special obligations in preparing the excerpt of the financial statement for legal entities that prepare consolidated financial statements, which relate to the basic data on the companies that are the subject of consolidation and to their individual financial statements.

2. Company Objectives

It is important for markets, shareholders and other stakeholders to be aware of the company's objectives. The communication of company objectives can be either in response to legal requirements or it can be voluntary.



Best Practices

Comparative legislation requires that company objectives (such as the issuance of securities, acquisition plans, replacement and sales of assets, or research and development) be disclosed in the prospectus. In addition, quarterly (semi-annual) reports must contain forward-looking information including sources of revenue, plans for new production procedures, expansion or reduction of production, new product development, substitution

of old products, modernization or repair of fixed assets and modification of the types of company activities. In addition, the annual report must outline the company's position in the industry, priority areas of activity and development trends.

Voluntary disclosure may cover issues such as the company's policies concerning corporate governance, business ethics, environmental issues and other public policy commitments. This information can help to properly evaluate the prospective performance of the company, its relationship with various stakeholders and communities in which it operates and the steps that the company has taken to implement its objectives. As with other types of disclosure, the quality of information provided to the public is greatly enhanced by adhering to a widely accepted standard.¹⁹



Best Practices

Companies may choose to voluntarily disclose their objectives in its AoA, company-level corporate governance code, and/or ethics code and annual report. Regardless of the form, companies should ensure that this information is readily accessible to the public, for example, on their websites.

3. Major Share Ownership and Voting Rights

a. Major Share Ownership

It is important that shareholders are informed about company ownership structures to understand their rights, role and authority in governing the company and influence its policy. Depending on the size of ownership, shareholders have various degrees of influence over decision-making in a company. Legislation provides greater rights to shareholders with larger holdings.

→ *For more information on the rights of shareholders according to their ownership percentage, see Chapter 7.*

¹⁹ For a general discussion of non-financial disclosure, see the OECD's Guidelines for Multinational Enterprises. See the OECD website at www.oecd.org or consult the Guidelines directly under: www.oecd.org/dataoecd/62/58/2438852.pdf.

Clearly, it is vital to know who is in a position to make (or influence) decisions within a company. For this reason, full information on the amount of the issued capital, its increases and decreases, the rights attached to shares of different types and classes, and the number of shareholders is crucial.

Shareholders with large stakes have the opportunity to exercise control over decision-making in a company. In practice, lower thresholds may suffice to exercise control over a company. In particular, in companies with dispersed ownership it is not necessary for a shareholder to hold the percentages of votes since the quorum for decisions of the GMS is counted based on votes cast. Since it is rare for all shareholders to vote at the GMS, a lesser percentage of shares usually provide the same degree of influence. In any event, the larger the ownership stake, the greater the ease with which shareholders can control the company.

Under Indonesian regulations, public companies must disclose periodically on every principle shareholder (i.e. who own more than 5% of the total voting right shares²⁰), including the following subjects:

- Full name, date of birth (as for individual shareholders)
- Contact address
- Occupation (as for individual shareholders), areas of business (as for institutional shareholders)
- Number and percentage of its ownership in the company
- Changes of ownership of principle shareholders
- Information that may cause big changes in terms of shareholders of the company
- The principle shareholders' increase, decrease or pledge of company's stocks

In addition, public companies shall be responsible to report quarterly to IDX and semi-annually as well as annually on the changes of shareholders ownership in accordance with the regulations of the OJK.

20 OJK regulation X.K.6



Companies seeking to disclose their ownership structure may wish to follow examples under U.S. and EU regulations. U.S. regulations define a beneficial owner as any person who, directly or indirectly, through any contract arrangement, understanding, relationship, or otherwise has or shares:

- Voting power, which includes the power to vote, or to direct the voting of such a security; and/or
- Investment power that includes the power to dispose, or direct the disposition of such security.

U.S. securities law states that any person who is directly or indirectly the beneficial owner of more than 5% of any equity security of a class, shall notify the issuer and each exchange where the security is traded of such acquisition within 10 days, as well as of any increase or decrease by 1% or more.²¹ If the beneficial owner acts in concert with other institutions or persons, their names and the relationship with the beneficial owner must be disclosed.

The EU Transparency Directive of 2004 provides a framework for disclosure.²² In summary:

1. Article 9 stipulates that investors must disclose the acquisition or disposal of major shareholdings in public companies, based on thresholds starting at 5% and continuing at intervals of 5% until 30% of voting rights, or charter capital or both.
2. Article 11(2) shortens the reporting obligation of the acquirer to the company and the competent regulatory authority from seven calendar days to five business days on the one hand and, on the other, of the company to the public from nine calendar days to three business days.
3. Article 2 extends the definition of “security holder” to include custodians and those holding securities for clearing and settlement purposes.

²¹ U.S. Securities and Exchange Act 1934, Sec. 13d-1, 2; 17 CFR 240, 13d-2.

²² See also: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0038:EN:PDF>

4. Finally, Article 11(5) extends notification requirements to various classes of shares, such as warrants and convertible bonds if the holdings reach or fall below the thresholds defined in Article 9.

Six member states have already introduced this directive by law or regulation. In addition, the EU Takeover Bids Directive's Article 10 regulates transparency issues, including the disclosure of beneficial ownership structures. Public companies in the EU are thus required to disclose information in their annual report on, inter alia:

1. The structure of their capital
2. Any restrictions on the free transferability of securities
3. Significant direct and indirect shareholdings (including pyramid schemes and cross-shareholdings)
4. The holders of any securities with special control rights
5. The system of control of any employee share scheme where the control rights are not exercised directly by employees
6. Restrictions on voting rights
7. Shareholder agreements that are known to the company
8. The rules governing the appointment and replacement of Board of Directors members
9. Significant agreements made by the company that take effect upon a change of control
10. Compensation agreements between the company and its directors in the case of a successful takeover bid.

Indonesian companies wishing to comply with good corporate governance practices should disclose their ownership structure, including beneficial owners, in a transparent manner.

b. Indirect Control

Shareholders owning less than the majority of shares can exercise indirect control over the company through pyramid structures and/or cross shareholdings. Relationships with related parties may also alter the control structure of the company.



Best Practices

Information on indirect ownership, related parties, and related party transactions should be fully disclosed, specifically in the annual, quarterly and material events reports and other notifications to regulators or creditors.

→ *For more information on the procedure to disclose the company's related parties, see Section C.5 of this Chapter and for more information on the disclosure requirements for related party transactions, see Chapter 12, Section C.5.*

c. Shareholder Agreements and Voting Caps

Shareholder agreements and voting caps can also impact on control.

Shareholder (voting) agreements typically oblige parties to vote as a block and may give first-refusal rights for the purchase of shares to another shareholder. Shareholder agreements can cover many issues including which candidates to nominate for the Board of Directors or the selection of the Chairman. Shareholder agreements are clearly of material interest to shareholders. While difficult to detect, companies should make reasonable efforts to obtain information about the existence of shareholder agreements and to disclose such information to all shareholders. In principle, parties to shareholder agreements should voluntarily disclose this information themselves.

Voting caps limit the number of votes that a shareholder may cast regardless of the number of shares he/she actually possesses. As such, caps go against the principle of one share, one vote and control that is proportional to ownership. Voting caps are often used to either entrench the position of existing controlling shareholders or management, and are rarely supported by good faith investors. The ICL has implicitly prohibited voting caps by adopting the mandatory one share, one vote principle.

23 ICL, Article 84 paragraph (1).

4. Information on Commissioners and Directors

a. Personal Data

Investors and shareholders should have access to relevant information relating to capability and qualifications of the Board of Commissioners and Board of Directors members to evaluate their experience and qualifications. Educational background, current occupation and professional experience of commissioners and directors should be disclosed and readily accessible to interested parties. It is also important that shareholders and investors have information about any (existing or potential) conflicts of interest that may affect the independence and decision-making capacity of the Board of Commissioners and Board of Directors. The right to access information is most important, that may protect shareholders in the market with the information asymmetry.

Shareholders should also be able to assess whether or not Board of Commissioners and Board of Directors members dedicate sufficient time to their duties and properly carry out their responsibilities. Accordingly, companies should disclose all the meeting attendance records.



Best Practices

Legal disclosure requirements clearly fall short of best practices. According to the best practices, a company should also disclose the following information in its annual report:

- Other key officials of the company, including their curriculum vitae
- Information about all transactions between these other key officials and the company
- Age, profession, employment and citizenship of each Board of Directors member, as well as all other positions, the date of initial appointment and the current term of appointment
- Information on all claims filed in courts (or arbitration tribunals) against Board of Directors members and executive directors and/or the General Director.

b. Remuneration

Incentive remuneration schemes are common in many countries and come in many varieties. Few companies have such arrangements that are identical to one another.

Executive remuneration plans are usually put in place in an effort to motivate executives, and better align their interests with the interests of shareholders. They normally include performance based bonuses. Incentive remuneration schemes may not be the most effective way of alleviating inherent conflicts of interests and, in any event, should always be subject to careful legal and financial examination and the approval of both the Board of Commissioners and the GMS. Remuneration plans for non-executive directors will differ considerably.

In Indonesia, the remuneration granted to each individual member of the Board of Commissioners and the Board of Directors over the relevant financial year should be disclosed as a separate item in the annual financial statements of the company and shall be reported to the GMS at its annual meeting.



Best Practices

Shareholders should be provided with a clear and comprehensive overview of the company's remuneration policy. Disclosure of information on the remuneration policy allows shareholders and investors to assess the main parameters and rationale for the different components of the remuneration package and the linkage between remuneration and performance. Such disclosure aims to strengthen the company's accountability to shareholders. The remuneration policy should be part of an independent remuneration report and/or be included in the annual financial statements and annual report or the notes to the annual financial statements of the company. The remuneration policy should also be posted on the company's website.²⁴

Companies should not only be transparent with respect to the levels of remuneration but also to the methods for determining remuneration. The criteria for determining the amount of remuneration for Board of Directors

24 More about disclosure of the remuneration policy see: European Commission Recommendation fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC), Section II. / Lebih lanjut tentang pengungkapan kebijakan remunerasi lihat: Rekomendasi Komisi Eropa mendorong rezim yang tepat untuk remunerasi direksi perusahaan yang terdaftar (2004/913/EC), Bagian II.

members, the President Director and/or Executive Board members — as well as the total amount of remuneration paid or to be paid depending on the results of the reporting year — must be disclosed in the annual report. The methods for determining remuneration are usually an integral part of the remuneration policy.

A large majority of EU member states have introduced high disclosure standards with regard to the remuneration of individual Board of Directors members and key executives, putting shareholders in a better position to assess the extent to which an individual's remuneration is justified in view of his/her responsibility and/or performance. It also allows shareholders to hold executives and Board of Directors members fully accountable for the performance of their duties.

- With respect to executive remuneration plans, shareholders and investors should have sufficient information to properly assess their costs and benefits to the company and the relations between the performance of the company, on the one hand, and the level of executive remuneration, on the other.
- At some point, the independence of non-executive directors may be compromised if they earn a significant amount of their total income from their Board activities. Some countries have monetary thresholds that serve as convenient “rules of thumb” or warning signals. While numerical thresholds may be a reasonable starting point, judgments on independence will, of course, require a much more sophisticated analysis. The disclosure of a non-executive director's remuneration remains critical in order to judge the extent to which his independence may be compromised.

➔ *For more information on non-executive and executive remuneration practices, see Chapter 4, Section H and Chapter 5, Section G, respectively.*

5. Material Foreseeable Risk Factors

Risk (along with return) is one of the most important considerations for any investor. Risks may include particular industry risks as well as political, commodities, derivatives, environmental, market, interest and currency fluctuation risks. In short, risk is an omnipresent feature of business activity.

Risk is, by its very nature, forward looking and extremely difficult to quantify. Nevertheless, specific industry, financial and legal risks as well as other material risks all need to be disclosed in prospectuses.

6. Employees and Other Stakeholders

Strictly speaking, most of the information on employees and other stakeholders may not be “material” according to the accounting or financial definitions of the term. On the other hand, information about the company’s employees, creditors and suppliers, as well as the company’s relationship with local communities can be “material” to other constituencies. Employees are also users of information, and disclosure helps them to make better employment decisions, protect themselves in the workplace and participate in other aspects of company life. Stakeholder disclosure is becoming increasingly common as an issue of interest and attention worldwide.



Best Practices

While some forms of stakeholder disclosure are required by law, it is good practice to provide stakeholders with other relevant information. For example, stakeholder disclosure might include health protection for employees, safety conditions in the workplace and environmental or community impact statements.

7. Corporate Governance Structures and Policies

When assessing a company’s governance structure, market participants may want to obtain information on the company’s governing bodies, including the division of authority between shareholders, commissioners and directors, as well as on the company’s corporate governance policy, its commitment to corporate governance principles and compliance mechanisms.

The AoA is the document that sets the rules and procedures of the company's governance system. It is a fundamental document of the company that is to be made publicly available. Company-level corporate governance codes also serve to highlight general corporate governance concepts and structures. Internal regulations provide more detailed guidance on processes.

Regulation X.K.6 requires that a public company must disclose information on its corporate governance practices in the AGM, annual reports, including the following contents:

- a. Name, position and a brief description of every member of the Board of Directors and the Board of Commissioners and its structure
- b. Actions performed by the Board of Directors and the Board of Commissioners
- c. Actions performed by independent members of the Board of Commissioners
- d. Actions performed by the committees of the Board of Commissioners
- e. Plans to enhance the efficiency of corporate governance
- f. Remuneration and expenses for the members of the Board of Directors, the Board of Commissioners
- g. Information on transactions of company shares by members of the Board of Directors, and the Board of Commissioners, major shareholders as well as other transactions by Board of Directors and Board of Commissioners members and related persons
- h. Number of Board of Directors and Board of Commissioners members who have attended training courses on corporate governance
- i. Matters which are not in compliance with the CG Regulations, causes and approaches to overcome.



Best Practices

It is necessary to disclose information about corporate conflicts resulting from improper implementation by the company of those corporate governance recommendations that the company declared binding upon itself in one form or another. Also, companies must adhere to the “comply or explain” principle in the application of accepted corporate governance rules and recommendations, and that respect, explain in their reports the reasons for possible deviations from their implementation in practice.

a. Commitment to Corporate Governance

Markets are keenly interested in understanding the level of a company’s commitment to good governance practices. They wish to determine whether a company sees governance as a public relations, “box-ticking,” or “window-dressing” exercise, or whether the company is in fact willing “to do right” by shareholders and to institute and implement real change as necessary and appropriate. While good disclosure, in and of itself, is not sufficient to consistently and uniformly ensure good corporate governance, it is clearly one way of demonstrating the commitment a company is willing and able to make to its shareholders and to its other stakeholders.

b. Corporate Governance Structures

Companies must describe their governance structures, including the authority of each governing body and internal control mechanisms, in their prospectus and reports. Also, companies should regulate and make publicly available through their internal documents the procedures for convening and conducting the GMS and make decisions made at the GMS publicly available through material events reports.



Best Practices

Companies should disclose information about changes in the identity of (or contractual arrangements with) the company’s External Auditor and other externally engaged persons that provide the company with material impact services on the company’s business operations (e.g. lawyer’s offices engaged for representation in major litigations).

c. Corporate Governance Policies

Companies should disclose their corporate governance policies and provide interested users with easy and inexpensive access to this information.



The CG best practices recommend companies develop disclosure policies that should be approved by the Board of Directors and be binding upon the company. Some of the provisions suggested for inclusion in company policies include:

- List of information the company intends to disclose
- Rules for communicating with the mass media, as well as the sources and regularity of communications
- Media contacts, including press conferences, publications, brochures and booklets
- The requirement for executive bodies to conduct meetings for shareholders and analysts
- Procedures for answering questions from all shareholders
- List of information, documents and materials to be provided to all shareholders for the GMS
- List of confidential information
- Procedures for the identification and treatment of insider information.

In addition, companies should consider disclosing other internal policies or internal regulations such as a code of ethics, environmental policies, and the internal regulations for the Board of Commissioners and its committees amongst others.

→ *For more information on company policies and internal regulations, see Chapter 3.*

8. Disclosure during the Placement of Securities - Prospectus

The public offer of securities may only be performed with prior registration of the prospectus with the OJK. A prospectus provides material information on the company so that investors can make informed decisions on the merits of potential investments. Prospectuses set forth the nature and object of shares, debentures, or other securities, and the investment and risk characteristics of the issue. Investors must be furnished with a prospectus before purchasing securities.

→ *For more detailed information on the prospectus, see Chapter 11, Section C.*

C. Voluntary Disclosure

It is good practice for companies to voluntarily disclose material information beyond formal legal requirements. This holds particularly true for companies operating in emerging markets that are often marred by weak legal and regulatory environments and poor enforcement mechanisms. To the extent possible, companies are encouraged to use existing forms of disclosure and adhere to the same quality standards that are demanded for these forms of reporting. They are also encouraged to use existing channels of communication, such as the internet and the print media.

1. Corporate Websites

Corporate websites are easily accessible to the public at low cost and can be an exceptionally powerful means of communication. At present, the internet is beginning to be accepted as an official disclosure channel.



Best Practices

The following information should be placed on the company's website:

- The company's AoA and amendments thereto
- Information on the company's development strategy
- Business reports with financial reports
- Prospectuses
- External Auditor's reports
- Information on material events
- Information regarding the GMS
- Important Board of Directors decisions.

The internet is an effective tool for rapid and cost-effective communications and is increasingly used by Indonesian companies for voluntary disclosure.



Comparative Practices

Public companies place their annual and financial reports and governance information (such as information on Board of Directors members and key executives) on their websites. The better websites have special sections devoted to corporate governance and include contact addresses and telephone numbers for inquiries.

Some companies are already following best practices and disclose additional information on their websites, including:

- Financial statements for the last three years
- Financial ratios for the last three years
- Internal corporate documents
- Structure, authorities, and composition of the governing bodies
- List of affiliated persons for the last year
- Annual and quarterly reports for the last three years
- Materials and decisions of the GMS for the last three years
- Information on corporate securities
- Corporate news ticker.

2. Mass Media

The print media is an additional channel for disclosure. Although publication may entail additional costs, it is a recognized legal channel for disclosure and (unlike the internet, which is passive) ensures the active dissemination of information among the public.

Most companies disclose information about new products, major contracts, acquisitions, financial results, production plans and securities issues in the print media.



Best Practices

Financial statements are the most important document for shareholders and potential investors to understand the financial position of the company. In this respect, companies with a larger number of shareholders (for example, 10,000 or more) should publish their financial statements in at least two newspapers distributed throughout the entire territory of the country. In principle, these newspapers should be accessible to the majority of the company's shareholders.

Chapter **14**

**CONTROL AND AUDIT
PROCEDURES**

Table of Contents

A. THE BOARD OF COMMISSIONERS	484
B. THE INDEPENDENT EXTERNAL AUDITOR	485
1. When an Annual Audit is Required	485
2. The Rights and Duties of the External Auditor	485
3. The Rights and Duties of the Company	487
4. The Appointment of the External Auditor	488
5. Compensation	491
6. Reporting	492
7. The External Auditor’s Liability	493
C. THE AUDIT COMMITTEE OF THE BOARD OF COMMISSIONERS	495
1. Functions	497
2. Composition	498
3. Meetings	499
4. Access to Information and Resources	500
D. INTERNAL CONTROL FUNCTION	501
1. Internal Control Principles	502
2. Elements of the Internal Control System	503
3. Bodies and Persons Responsible for Internal Control	505
4. The Internal Auditor	506



The Chairman's Checklist

The External Audit:

- ✓ Does the company have an independent External Auditor? Does the External Auditor provide other, non-audit services to the company that could compromise his/her independence? Are audit partners rotated?
- ✓ How is the External Auditor selected? Does an open tender process take place? If so, who organizes this tender process?
- ✓ To whom does the External Auditor report?
- ✓ Does the External Auditor participate in the Annual GMS and answer all questions posed by shareholders?

The Board of Commissioners' Audit Committee:

- ✓ Should the company's Board of Commissioners have an Audit Committee? What are the costs and benefits? What needs to be done to ensure that there are no significant conflicts between the Board of Commissioners and the Audit Committee in relation to the use of the internal audit function?
- ✓ If the company has an Audit Committee, is it staffed with individuals who are independent, able and willing to do the job properly and effectively?

- ✓ Does the Head of the Audit Committee have the requisite professional and human relations skills? Are members of the Audit Committee publicly recognized financial experts?
- ✓ Does the Audit Committee meet often enough to perform its duties effectively? Does it place the necessary and appropriate issues on the agenda?
- ✓ Does the Audit Committee add value to Board of Commissioners' discussions covering audit, risk, internal control and financial reporting?
- ✓ Does the Audit Committee receive the necessary information to perform its duties effectively? Does it have resources to hire outside accounting or legal advice?
- ✓ Does the Audit Committee perform self-evaluations on a regular basis?

The Internal Control System:

- ✓ Does the company have an internal control system in place? Does the company have a formal document that regulates the internal control system and procedures? Is this document periodically reviewed?
- ✓ Does the company have a risk management system in place? Does this system cover risk at the subsidiary level as well? How are business, operational and financial risks identified?

An internal and external audit system is an important tool in the management and oversight of a company, which also contributes to transparent and sound financial reporting. There are a number of internal structures and external agents involved in the management and oversight of company finances and operations. These bodies are diverse in their nature, functions and reporting lines. Some are mandatory, while others are optional.

ICL has specific provisions for the establishment of the Board of Commissioners. The Board of Commissioners shall supervise in general or any specific focus in accordance with the AoA of the company and give advise to the Board of Directors ¹. The specific focus may be to supervise Board of Directors to control financial and business activities of the company as well as monitoring compliance with laws and regulations.

In addition, considering the development of business activities based on sharia principles, ICL also stipulates that any companies who carry out its business activities with sharia principles, other than establishing Board of Commissioners, shall also establish the Sharia Supervisory Board.

The Sharia Supervisory Board gives advise and suggestions, and also supervise the company activities to be in accordance with the sharia principles.² In carrying out their duties, the Board of Commissioners should be independent of the Board of Directors. Board of Commissioners members must act diligently in the best interests of company shareholders. The Board of Commissioners reports directly to the GMS and in theory, it should have the ultimate inspection role to ensure proper controls are established by the company.

The independent External Auditor examines a company's financial and accounting records, as well as supporting documents, in all material respects. Shareholders depend upon the External Auditor to express an independent opinion on whether the financial statements of a company are reliable.

In case of having an ineffective performance of the Board of Commissioners, the Board of Commissioners should consider the establishment of an Audit Committee. The Board of Commissioners' Audit Committee safeguards the company by questioning executive bodies regarding the way in which financial reporting responsibilities are handled, as well as by ensuring that corrective actions are taken. The Audit Committee oversees the company's relations with the External Auditor. It may consider the appointment of an External Auditor, review the internal audit plan, review the effectiveness of internal control systems, consider major findings of internal audit investigations and management responses to these and promote co-ordination between

1 ICL, Article 1 number 6

2 Elucidation of ICL, General Elucidation number 1 paragraph 7

the Internal and External Auditors. The Audit Committee is part of the Board of Commissioners, and as such, develops recommendations for their consideration. The Audit Committee consequently has no independent decision-making authority.

The Internal Auditor is responsible for the on-going daily appraisal of the financial health of a company’s operations. The internal control system is jointly designed by the Board of Directors, the management and employees to provide reasonable assurance regarding the achievement of the company’s objectives with regards to the effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations. The main objective of the Internal Auditor is to advise management if the company has sound internal control systems to protect the organization against loss. The Internal Auditor evaluates internal control systems, assess risks and components of risk management, communicate and make suggestions for improvement. An internal audit not only covers the finance function, but also the company’s operations and systems.

This chapter discusses the role, authority and duties of these various bodies in detail and how they specifically contribute to company transparency and information disclosure. For an overview of these bodies and their reporting lines, see Figure 1 for Indonesia’s current model and see Figure 2 for the best practice model used in many other countries.

Figure 1. Example of Public Offering Flow Process (Before Effective)

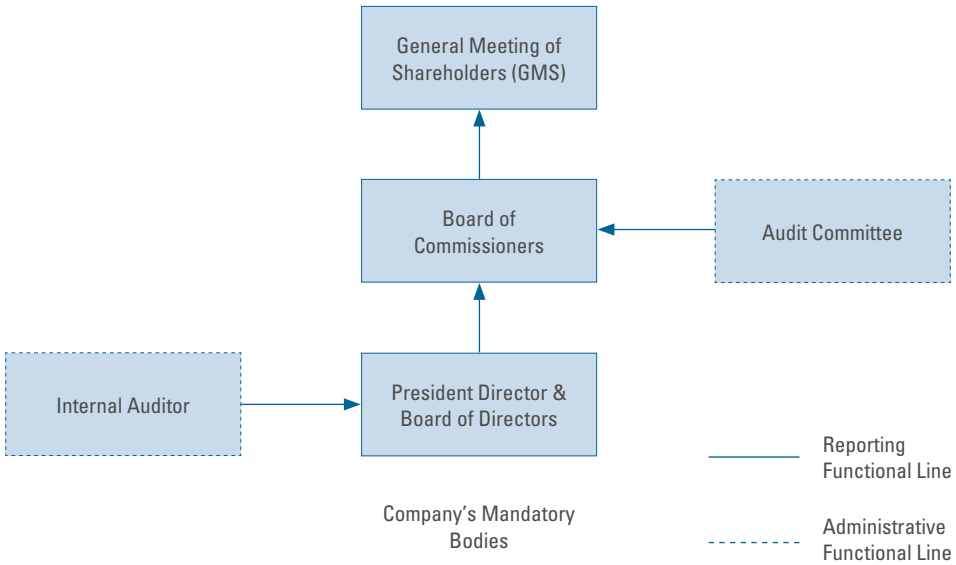
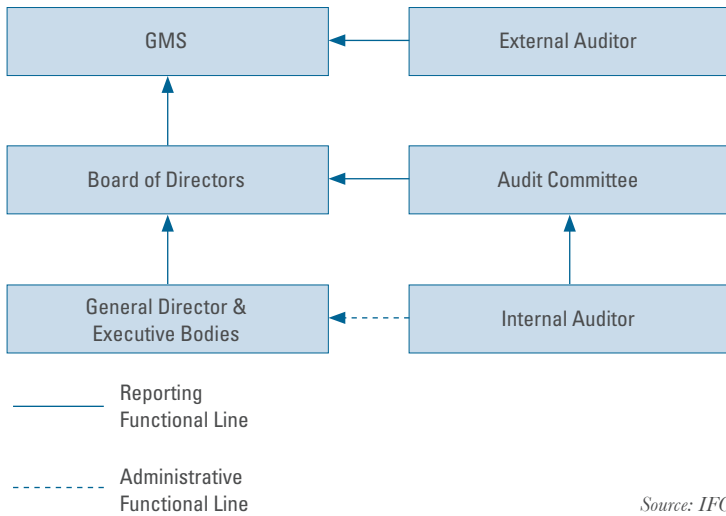




Figure 2: Best Practice Model of Governing Bodies for Control and Audit



A. The Board of Commissioners

The Board of Commissioners controls the operations and financial activities of the company. Its primary function is to supervise the work of the Board of Directors, the director or President Director, as well as the company's compliance with laws and regulations during business operations.³

→ *Refer to Chapter 4 for more detailed narrative description on the roles and responsibilities, structure and functioning of the BOC.*

³ ICL., Law, Article 108, paragraph (1)

B. The Independent External Auditor

An independent audit conducted by an External Auditor is an important element of the company's control framework. The objective of an audit is to enable the External Auditor to express an opinion on whether or not the financial statements of the company are prepared, in all material respects, in accordance with an identified financial reporting framework and whether they are reliable. It gives shareholders, managers, employees and market participants an independent opinion about the company's financial position and, if performed properly, should attest to the accuracy of the statements. An independent audit conducted by a publicly recognized and accredited accounting firm normally enhances the company's credibility, and accordingly, its prospects for attracting investment.

Three key points about the independent audit are:

1. Management remains responsible for preparing and presenting the company's financial statements
2. The External Auditor is responsible for forming and expressing an opinion on the financial statements prepared by management
3. The audit of the financial statements does not relieve management of any of its responsibilities.

1. When an Annual Audit is Required?

The annual financial statements of all public and listed companies must be audited by an independent and eligible public accountant. Furthermore, the annual financial statement of a public listed company must be audited by an independent public accountant that has been registered with OJK.

2. The Rights and Duties of the External Auditor

In relation to the external audit of a company, the External Auditor (or Auditing Company) has rights to:

- Receive fees for services provided to clients
- Request the company to supply fully and promptly accounting documents and

other necessary documents and information related to the performance of the audit under the contract

- Request, inspect and confirm economic and financial information related to the companies being audited from relevant sources of information inside and outside such entities.

In relation to the external audit of a company, it is recommended to appoint an External Auditor who has the following ethics:

- Allocate adequate and professional human resources to ensure the quality of the audit service delivery. Pay compensation for damages caused by its audit team members to their clients when providing auditing and other relevant services
- During the course of auditing, if it detects signs of financial and accounting legislation violations, violation to the Capital Market law (including its implementing regulation) and any other issue that may endanger the company's financial condition and the interest of its client it is obliged to notify such to the audited companies or write appropriate comments in the audit reports
- To provide information about operating licensed auditors and audited clients to the audited companies in accordance with legal provisions to be held responsible before law, clients and partly responsible before users of audit results and provided services
- To refuse providing services if it finds out that the Audit Company is not able to ensure independence and professional auditing conditions or if the client violates the Law on Auditing or other related regulations

The auditor or Auditing Company representative may be permitted to attend all GMS meetings and be entitled to receive other notices and information which shareholders are entitled to receive relating to the GMS and may be entitled to express his/her opinions about issues relating to the audit.



Best Practices

The External Auditor will often submit, and companies seeking to implement good corporate governance should demand, what is referred to as a 'management letter' in addition to the audit report. This management letter typically covers all material weaknesses in the company's internal control,

accounting and operating procedures. The purpose of the letter is to provide constructive suggestions to management concerning improvements for such procedures.

The findings contained in the management letter are considered to be “non-reportable” to third parties, yet require corrective action by management. Companies wishing to attract external finance should be aware that investors would typically request a copy of the management letter.

3. The Rights and Duties of the Company

The audited company has the right to:

- Select an External Auditor or Auditing Company fully satisfying the conditions for lawful professional practice in Indonesia to sign contracts on the provision of auditing services, except otherwise provided for by law
- Request the External Auditor provide relevant information in its registered business license file, an audit opinion or other information about the Auditing Company’s practicing auditors
- Refuse to provide information that is not for the purpose of the audit and request the change of the practicing auditors if they violate the independent principle of auditing
- Discuss or demand written explanations relating to unclear issues stated in the draft audit report
- Complain about practicing auditors if they commit illegal acts during the audit
- Request the External Auditor compensate for damages caused by the audit

The audited company is obligated to:

- Provide accurate, sufficient and timely information/documents according to the External Auditor’s requests and be responsible for the accuracy, integrity and objectivity of the information provided
- Coordinate with and facilitate the auditors during the audit
- Not block or hinder the scope of the audit

- Implement all recommendations made by the External Auditor in a complete and timely manner
- Inform, in a sufficient and timely manner, all violations by the practicing auditors to the State authorized agency and the professional auditing body
- Pay audit fees in accordance with terms provided in the audit contract
- In case of an audit contract signed by an individual accountant for more than three consecutive years and not more than six consecutive years by a public accountant office, the company must request the External Auditor change the practicing auditors who sign the audit report
- Refuse the Auditing Company's services if the Auditing Company is deemed not to be qualified to perform the audit services
- Other obligations in accordance with legal provisions.

4. The Appointment of the External Auditor

Under the ICL, there is no provision on the authority to appoint and dismiss the External Auditor. Indonesia CG Code stipulated that for a company with an Audit Committee, the appointment of an external auditor shall consider opinion of the committee rendered to the Board of Commissioners before approved by the GMS.⁴



Best Practices

It is increasingly common for external auditors to be recommended by an independent audit committee of the board or an equivalent body and to be appointed either by that committee/body or by shareholders directly. Moreover, the IOSCO Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence states that, "standards of auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, that addresses at least the following threats to independence: self-interest, self-review, advocacy, familiarity and intimidation" (see *OECD Principles of Corporate Governance*, pages 55).

⁴ CG Code Part IV.1.3

1. Who Can Be an External Auditor

Any legal entity with a license to perform auditing services can be appointed an External Auditor. However, as mentioned above, the External Auditor of public companies must be an independent and eligible Auditing Company which is registered with OJK.

An external audit is served by a public accountant office. A public accountant office is a business entity who obtains a permit from the Minister of Finance as a platform for the public accountants to deliver their service.⁵ A public accountant office may form as a civil association or a firm or individual. In the event where the public accountant office is formed as civil association or firm, it may only be established by at least 2 (two) public accountant which one of them appointed as managing partner. In the event where the civil association or firm has a non public accountant associate, it may be established at least with composition of 75% of partners are public accountants.⁶ Furthermore, to obtain the permit for the public accountant service from Minister of Finance, several requirements are set out in Article 18 of the Minister of Finance Regulation No. 17/PMK.01/2008 on Public Accountant Service (“**MOF Reg. 17/2008**”).

In delivering its service, a public accountant and public accountant office must comply with⁷:

- Public Accountant Professional Standard which stipulates by the Indonesia Accountant Public Association (“**IAPA**”);
- Code of Ethics of Public Accountant Profession which stipulates by IAPA;
- Applicable laws and regulations in public accountant service.

Pursuant to Article 46 of MOF Reg. 78/2008, a public accountant cannot be a partner in more than one public accountant offices. Public accountants are also prohibited to occupy a double position as follows:

- a. government officials;
- b. chairman, member, or officer in a government agency, government institution, or any other agencies which are formed with laws;
- c. chairman, manager, or officer in a state-owned enterprise, regional-owned enterprise, private entity, or partner in other business entity;

5 Ministry of Finance Regulation No. 17/PMK.01/2008 on Public Accountant Service, Article 1 point 3

6 Ministry of Finance Regulation No. 17/PMK.01/2008 on Public Accountant Service, Article 16

7 Ministry of Finance Regulation No. 17/PMK.01/2008 on Public Accountant Service, Article 40

- d. chairman, manager, or officer in other legal entities;
- e. chairman or manager of a political party; chairman, manager, or officer in an education institution; or
- f. commissioners, committee which reports to commissioners, or other position executing the same function as commissioners or the said committee in more than 2 (two) state-owned enterprise, regional-owned enterprise, private entity, or partner in other business entity.

Exception may apply to certain positions as stated in Article 46 paragraph (3) on Ministry of Finance Regulation No. 17/PMK.01/2008 on Public Accountant Service:

- a. lecturer in an higher education institution whose not occupy position as chancellor, chancellor assistant, dean, dean assistant, headmaster, director, or any equivalent positions;
- b. commissioner, committee which reports to commissioners, or other position executing the same function as commissioners or the said committee in not more than 2 (two) state-owned enterprise, regional-owned enterprise, private entity, or partner in other business entity;
- c. chairman, manager, or officer in Indonesia Accountant Association, IAPA, religious foundation, or any other business entities for social purposes only.

For public accountants who occupy the abovementioned positions, must report to the Secretary General of the Finance Department of the Republic of Indonesia.⁸



Best Practices

In the U.S., the 2002 Sarbanes-Oxley Act prohibits public accounting firms from providing non-audit service to their audit clients including, (1) bookkeeping or other services related to the accounting records or financial statements of the audit client, (2) financial information systems design and implementation, (3) appraisal or valuation services, fairness opinions, or contribution- in-kind reports, (4) actuarial services, (5) internal audit outsourcing services, (6) management functions or human resources, (7) broker or dealer, investment adviser, or investment banking services, (8) legal

8 Ministry of Finance Regulation No. 17/PMK.01/2008 on Public Accountant Service, Article 46 paragraph (4)

services and expert services unrelated to the audit and (9) any other service that the Board of Directors determines, by regulation, is impermissible.⁹

An exception to this rule is made should non-audit services that are not listed above be pre-approved by the Board of Directors Audit Committee. The Audit Committee should, however, disclose these services to investors in periodic reports. Another exception is made when the non-audit services constitute less than 5% of the total amount of revenues paid to its auditor, these services were not recognized to be non-audit services at the time of engagement, and the Audit Committee promptly approves these services prior to the completion of the audit.

2. The Contract with the External Auditor

The company must enter into a contract with the External Auditor once it has been approved by the GMS. The ICL does not specify who must sign the contract on behalf of the company, provided however one of the authorities of the Board of Directors is to represent the company, therefore a President Director is authorized to sign the contract on behalf of the company. The contract with the Auditing Company stipulates the rights and duties of the External Auditor and the company, and may include any additional terms that the parties agree upon.

5. Compensation

The company pays for the Auditing Company's services. The Audit Committee shall review the External Auditor fees and submit its recommendation to the Board of Commissioners. Clearly, the procedure for the payment of compensation and the amount of compensation must not be made dependent upon the audit results.

Auditing companies and audited companies may agree to apply one of the following methods of calculating the auditing service charge:

- Calculating according to working hours of practicing auditors and a charge rate per hour
- Calculating according to each auditing service with a package charge

⁹ The Sarbanes-Oxley Act of 2002, Section 201(a). See also: <http://news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf>.

- Calculating according to each auditing service at charge rates in the percentage (%) of the contract or project values
- Calculating under multi-period audit contracts with a fixed charge rate for each period.

6. Reporting

For a listed company, the External Auditor shall prepare an audit report and submit it to the Board of Directors no later than three months from the end of the financial year.

The External Auditor presents conclusions on the reliability of the company's financial statements and compliance with accounting procedures. The opinion paragraph of the auditor's report should state the auditor's opinion as to whether the financial statements give a true and fair view (in all material respects) in accordance with the financial reporting framework used by the company and, where appropriate, whether the financial statements comply with statutory requirements. The External Auditor must prepare a report on the annual audit that includes:

- Opinions on the accuracy of the company's reports and other financial documents
- Information on violations of accounting or financial reporting procedures, disclosure rules and relevant laws and regulations.



Best Practices

The External Auditor should divulge (potential) errors, misconduct, and violations of legislation or the company's internal rules during audits, and report them immediately to the Board of Directors' Audit Committee or Supervisory Board. The External Auditor should make the company aware, as soon as practical and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to the Auditor's attention. The Board of Directors' Audit Committee or the Supervisory Board should take appropriate steps to remedy these problems.

If the company plans to seek access to international capital markets, the External Auditor should prepare the report in accordance with the International Standards on Auditing (ISA) issued by the International

Federation of Accountants (IFAC). The audit report must give opinion on the financial statements prepared in accordance with the International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB).



Best Practices

The External Auditor should participate in the AGM and answer shareholder questions with respect to the audit report. Moreover, the Audit Committee or the Supervisory Board should evaluate:

- Whether the audit was made in accordance with the established procedures and whether the External Auditor omitted any matters in carrying out the audit
- The opinion of the External Auditor before it is presented at the GMS.

7. The External Auditor's Liability

Indonesia laws have not stipulated stringently and clearly the liabilities to which the licensed auditor is relevant. Since the licensed auditor or the Audit Company is liable for civil, administrative, and criminal infractions, he/she should be adequately insured by a reputable (domestic or international) insurance provider with appropriate coverage. The Audit Company has to be insured from the risks associated with the inaccurate audit opinion given by the licensed auditor, as well as non-application of the ISA, if required and code of ethics for professional accountants.

a. Civil Liability

The grounds and terms of civil liability are usually specified in the contract between the Audit Company and the audited company. The licensed auditor and Audit Company must keep company operations information confidential. If they divulge confidential information, the company may seek compensation for the resulting losses.

b. Administrative Liability

Auditing and accounting regulations state that the licensed auditor bears administrative liability if he/she provides the company with an obviously false opinion. In such cases, the best practice suggested is that the auditor's license may be revoked by the MOF.

c. Criminal Liability

The Penal Code stipulates that when the licensed auditor uses his/her authority for his/her own purposes and violates the rights of a company or related parties, the licensed auditor may be prosecuted.¹⁰

The damages caused by Auditing Company for which it is responsible to compensate for shall be agreed between the auditing companies and the audited companies or determined by the authorized agency in accordance with laws and regulations. Methods of compensation as agreed between the two companies can include:

- Cancellation of the signed auditing contract
- Not being allowed to sign an auditing contract in the following years
- Deduction of the agreed audit fee
- Maximum compensation 10 times of the year's audit fee.

¹⁰ Penal Code, Article 167263.

C. The Audit Committee of the Board of Commissioners

The Board of Commissioners is encouraged to establish an Audit Committee, as it is increasingly seen as an essential element of the corporate governance structure in many countries. Indonesia CG Code Part IV 3.7. stipulated that in carrying out its duty, the Board of Commissioners may form committees. Any proposal from the committees shall be submitted to the Board of Commissioners for approval. According to Regulation Number IX.I.5, for publicly listed companies, state-owned enterprises, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, an Audit Committee shall be established, whereas other committees are formed as required.

The following are some best practices on the functions of the Audit Committee (in case the function of the Board of Commissioners is abolished or ineffective).



Best Practices

The Audit Committee typically focuses on financial reporting, risk management, internal and external auditing (see Figure 3).

Figure 3: The Three Main Areas of Focus for the Audit Committee



```
graph TD; AC[Audit Committee] --> RM[Risk Management]; AC --> FR[Financial Reporting]; AC --> IEA[Internal & External Audit];
```


International best practices suggest that the Audit Committee develop and maintain an internal document, for example an internal regulation for the Audit Committee that addresses its purpose, duties and responsibilities. The following are suggested by the New York Stock Exchange:¹¹

- The purpose of the Audit Committee is to assist supervisory function of the Board of Commissioners to oversee the integrity of the company's financial statements, the External Auditor's qualifications and independence, and the performance of the company's internal audit function and External Auditor on the one hand and to prepare the report that OJK rules require be included in the company's annual proxy statement.
- The duties and responsibilities of the Audit Committee are to, inter alia:
 - Review company's financial information that will be released, such as financial statement, financial projection and other financial information
 - Review the company's compliance to the law and regulation regarding Capital Market and Public Companies
 - Conduct independent recommendation regarding dissenting opinion of management and accounting
 - Conduct recommendation to Board of Commissioner regarding the appointment of Accountant based on independency, scope of task, and fee
 - Review of audit implementation then supervise the Director's action regarding such audit
 - Review any risk faced by company which is conducted by Director if it is not monitored under Board of Commissioner
 - Review any complain related with Issuers or Public Company's financial report
 - Review and give opinion to the Board of Commissioners regarding any potential conflict of interest
 - To keep the confidentiality of company's document, data and the issuer's information
- Conduct an annual performance evaluation of the Audit Committee.

11 New York Stock Exchange Corporate Accountability and Listing Standards Committee, dated 6 June 2002 (see also: www.iasplus.com/resource/nysegovf.pdf).

1. Functions



Best Practices

The National Association of Corporate Directors' (NACD) is an international independent training institute for directors, which aims to improve leadership of the director on Blue Ribbon Commission on Audit Committees has identified the following indicators of risk that the Audit Committee should monitor and closely examine:¹²

- Complex business arrangements which appear to serve little practical purposes
- Large last-minute transactions that resulted in significant revenues in quarterly or annual reports
- Auditor changes over accounting or auditing disagreements
- Overly optimistic news releases in which the Chief Executive Officer (General Director) seeks to cajole investors into believing in future growth
- Widely dispersed business locations with decentralized management and a poor internal reporting system
- Inconsistencies between management's discussion and analysis, the President's letter and the underlying financial statements
- Insistence by the General Director or Chief Financial Officer that he/she be present at all meetings of the Audit Committee, Internal or External Auditor
- A consistently close or exact match between planned results and reported results, and managers who always achieve 100% of their bonus opportunities
- Hesitancy, evasiveness, and/or lack of specifics from management or auditors regarding questions about the financial statements;

¹² The Report of the NACD Blue Ribbon Commission on Audit Committees. See also: www.nacdonline.org. Reprinted with permission of the NACD, 1133 21-st Street, NW, Suite 700, Washington, DC 20031, www.nacdonline.org.

- Frequent differences of views between management and the External Auditor
- A pattern of shipping most of the month's or quarter's sales in the last week or last day
- The internal audit operating under scope restrictions, such as the Internal Auditor not having a direct line of communication to the Audit Committee
- Unusual balance sheet changes, or changes in trends or important financial statement relationships such as, for example, receivables growing faster than revenues, or accounts payable that are continually delayed
- Unusual accounting policies, particularly for revenue recognition and cost deferrals such as recognizing revenues before products have been shipped ("bill and hold"), or deferring cost items that are normally expensed as incurred
- Accounting methods that appear to favor form over substance
- Accounting principles/practices at variance with industry norms and
- Numerous and/or recurring unrecorded or "waived" adjustments rose in connection with the annual audit

2. Composition



Best Practices

Members of the Audit Committee must be financial literate. An experienced individual who is a financial expert should chair the Audit Committee. The independence, aptitude and leadership skills of the chairman are crucial for the committee's success. According to Regulation Number IX.1.5, for public listed company, the head of the Audit Committee shall be the Independent Commissioner.

Further, the member of the Audit Committee shall consist of 2 Independent Commissioner or any other external party.

3. Meetings

If a Board of Commissioners meeting considers matters pertaining to Audit Committee activities, an Audit Committee meeting should take place before the Board of Commissioners meets. This meeting should occur sufficiently in advance of the Board of Commissioners meeting to allow the Audit Committee to communicate its conclusions and allow the Board of Commissioners to thoroughly consider them.

The Audit Committee should also:

- Regularly informs the Board of Commissioners about violations of procedures and legislation by the company's officers
- Informs the Board of Commissioners about individuals who are responsible for irregularities, the circumstances under which they took place and how errors could be prevented in the future
- Analyzes and give recommendations to the Board of Commissioners regarding risks associated with transactions and operations of the company.

The Audit Committee should conduct meetings at least on a quarterly basis.



Best Practices

In some countries the Audit Committee is required to conduct meetings once a month. However, meeting once a month may be regarded as onerous and burdensome, as well as costly. The new U.K. Combined Code suggests that Audit Committee meetings be held to coincide with key dates in the financial reporting and audit cycle, with no fewer than three formal meetings per year.¹³ The Audit Committee's Chairman will likely call additional meetings to establish an on-going and informal contact with the Board of Commissioners and Board of Directors.

¹³ The U.K. Combined Code on Corporate Governance, Section 2.7. See also: www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf.

4. Access to Information and Resources

The Board of Commissioners should be provided with information on the financial and operating results of the company. Therefore, Audit Committee members will need to have unfettered access to documents and corporate information to allow them to fulfil their functions of reporting to the Board of Commissioners. The Corporate Secretary often plays a crucial role in this respect, facilitating a free flow of information to fulfil the Audit Committee’s requests.



Best Practices

It is recommended that the Audit Committee be authorized and be provided with resources to hire outside audit, financial, legal and other professional advisors, on which must be acknowledged by the Board of Commissioner.

D. Internal Control Function

Internal control in fact is a process conducted by the Board of Directors, management and the company's employees, to provide a reasonable guarantee that financial reporting is reliable and accurate, operations are efficient and effective, and the company complies with legislation, its own internal rules and guidelines.

Indonesian CG Code has stated internal control as one of the Board of Directors' role and function. It covers as follows:¹⁴

- The Board of Directors shall establish and maintain a sound internal control system to safeguard company's assets and performance and its compliance with laws and regulations;
- Publicly listed companies, state-owned enterprises, province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, shall have an internal control function or unit;
- The internal control function or unit shall to assist the Board of Directors in ensuring the attainment of objectives and business sustainability by: (i) evaluating the implementation of the company's program; (ii) providing recommendations to improve the effectiveness of the risk management process; (iii) evaluating the company's compliance with company's regulations, implementation of GCG and the laws and regulations; and (iv) facilitating sound coordination with external auditor;
- The internal control unit or the head of an internal control function shall be responsible to the President Director or to the Director in charge for the internal control function. The internal control unit has a functional relation with the Board of Commissioners through the Audit Committee.

In fact, an effective internal control structure can help the company:¹⁵

- Make better business decisions of a higher quality and more timely information
- Gain (or regain) the trust of investors
- Prevent loss of resources
- Provide security over its assets

14 CG Code Part IVD.3.3

15 Moving Forward - A Guide to Improving Corporate Governance Through Effective Internal Control: A Response to Sarbanes-Oxley, Deloitte & Touche, January 2003.

- Prevent fraud
- Comply with applicable laws and regulations
- Gain a competitive advantage through streamlined operations.

The internal control system can be defined as control over the conduct of the company's financial and business operations (including the implementation of its financial and business plan) by the company's divisions and bodies.

To have a better understanding of the internal control system, in the following section, we shall discuss the internal control principles, elements of internal control systems, bodies and persons responsible for the internal control as well as the roles of internal auditing in the internal control system.

1. Internal Control Principles

A company's internal control system should be based on the following principles:

- The internal control system should function at all times and without interruption. A system that functions on a permanent basis allows the company to identify deviations on a timely basis and helps to predict future deviations.
- Each person involved in the internal control process should be held accountable. The performance of each person carrying out control functions should consequently be managed by yet another person in the internal control system.
- The internal control system should segregate duties. Companies should prohibit duplication of control functions and should distribute functions among the employees so that one and the same person do not combine functions relating to the authorization of operations with certain assets, recording of such operations, ensuring and safe-keeping of assets and inventory of these same assets.
- The proper authorization and approval of operations. Companies should establish procedures for approving financial and business operations by authorized persons, within the scope of their authority.
- Companies should ensure the organizational separation of its subdivision responsible for internal control and ensure that this subdivision is accountable directly to the Board of Directors. This organizational separation ensures that internal controls are verified by an independent authority, in this case the Board of Commissioners, which is not involved in the implementation or maintenance of internal controls.

- All units and departments of the company should integrate and cooperate to allow the internal control system to be properly implemented.
- A culture of continuous development and improvement needs to be put in place. A company's internal control system should be structured to allow it to flexibly address new issues and be easily expanded and upgraded.
- A system for the timely reporting of any deviations should be put in place. Ensuring the timeliness of reporting on deviations with the shortest possible deadline allows authorized persons to act swiftly to correct problems.

2. Elements of the Internal Control System

The internal control system includes the following inter-related elements:¹⁶

- a. Control environment:** The control environment sets the tone of an organization and influences the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of the company's employees and officers, management's philosophy and operating style, the way management assigns authority, responsibility and organizes and develops its staff and the attention and direction provided by the Board of Directors.



Best Practices

An essential element of an effective internal control system is a strong control culture.¹⁷ It is the responsibility of the Board of Directors and senior management to emphasize the importance of internal control through their words and actions. This includes the ethical values that management displays in business dealings, both inside and outside the organization. The words, attitudes and actions of the Board of Directors and senior management affect the integrity, ethics and other aspects of the company's control culture.

¹⁶ Internal Control - Integrated Framework, COSO. See also: <http://www.coso.org/IC-Integrated-Framework-summary.htm>.

¹⁷ Framework for Internal Control Systems in Banking Organizations, Basel Committee Publications No. 40, September 1998, <http://www.bis.org/publ/bcbs40.pdf>. Note that this document is for banking organizations. However, some of its provisions are equally applicable to companies in other sectors.

b. Risk assessment: Every entity faces a variety of risks from external and internal sources. A precondition to risk assessment is setting the company's objectives. Risk assessment is the identification and analysis of relevant risks to achieve company objectives, forming a basis for determining how risks should be managed.

c. Control activities: Control activities are the policies and procedures that help guarantee that management directives are carried out. They help ensure that necessary action is taken to address risks and achieve the entity's objectives. Control activities occur throughout the organization, at all levels and functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.



Best Practices

Control activities should be as strict on the top as on the bottom of the company's operations, lending credibility to the control environment and the tone at the top.

d. Information and communication: Pertinent information must be identified and communicated in a form and within a timeframe that enables employees to carry out their responsibilities. Information systems produce reports containing operational, financial and compliance-related information that make it possible to run and control the business. They not only deal with internally generated data, but also information about external events, activities, and conditions necessary to informed business decision-making and external reporting. Effective communication must also occur in a broader sense — flowing up, down and across the organization. All personnel must receive a clear message from senior management that control responsibilities must be taken seriously. Furthermore, they must understand their own role in the internal control system, as well as how individual activities relate to the work of others. Of particular importance is that management do not limit itself to communicating on a control measure in and of itself, but properly emphasize the meaning and purpose of the particular control element. They must also have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and shareholders.

e. Monitoring the efficiency of the internal control system: Internal control systems need to be monitored over time to assess the quality of the system's performance. This is accomplished through on-going monitoring activities, separate evaluations, or a combination of the two. On-going monitoring occurs during the course of operations. It includes regular management and supervisory activities and other actions personnel take in performing their duties. The scope and frequency of separate evaluations depend primarily on an assessment of the risks and effectiveness of on-going monitoring procedures. Internal control deficiencies should be reported upstream, with the most serious matters reported directly to the Board of Commissioners. The Board of Directors and the Board of Commissioners need to clearly formulate sanctions to be imposed as a result of control violations on an ex ante basis.

3. Bodies and Persons Responsible for Internal Control

Internal control is, to some degree, the responsibility of everyone in an organization and should be an explicit or implicit part of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operations, non-compliance with an internal code of conduct or company-level corporate governance code, should such documents exist, or other policy violations or illegal actions.



Best Practices

The company's department responsible for corporate training programs should ensure that all employees and executives receive training on the company's control culture and system. Furthermore, although each company has its own specific internal control system and bodies, there are some general rules that a company should follow. Internal control always starts at the top of the company, at the level of the Board of Directors and executive bodies. In particular, the Board of Directors and executive bodies are responsible for establishing the proper internal control environment and maintaining high ethical standards at all levels of the company's operations. Furthermore, the approval of internal control procedures falls within the competence of the company's Board of Commissioners, commonly through

the Audit Committee. The Board of Commissioners' Audit Committee is also assigned to review and evaluate the efficiency of the internal control system as a whole, and prepare proposals on how to improve it. Finally, the implementation of internal control procedures is the responsibility of the executive bodies.



Best Practices

The President Director is ultimately responsible for and should assume ownership of the system.¹⁸ More than any other individual, he/she sets the 'tone at the top' that affects the integrity and ethics of a positive control environment. In a large company, the President Director fulfils this duty by providing leadership and direction to senior managers and reviewing the way they control the business. Senior managers, in turn, assign responsibility to establish more specific internal control policies and procedures to personnel responsible for the unit's functions. For example, controls for the company's IT system should fall under the responsibility of the Chief Information Officer or manager responsible for IT. Of particular significance are financial officers and their staff, whose control activities cut across, as well as up and down, the operations and other units of a company.

The executive bodies, in particular the President Director or the Finance Director should further create structures (services or departments), or assign persons to be responsible for carrying out specific control activities on a daily basis.

4. The Internal Auditor

The Internal Auditor plays a significant role in a company's governance structure to ensure good controls are in place. The Internal Auditor carries out regular internal audit. The internal audit is an integral part of a company's internal control system.

¹⁸ Internal Control - Integrated Framework, COSO. See also: www.coso.org/publications/executive_summary_integrated_framework.htm.

While internal control is wider in scope, the internal audit can be defined as an independent, objective assurance and consultation activity designed to add value and improve an organization's operations.¹⁹ It helps an organization accomplish its objectives by introducing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and corporate governance processes.

More specifically, internal auditing reviews and ensures the reliability and integrity of information, compliance with policies and regulations, the safeguarding of assets, economical and efficient use of resources and the attainment of established operational goals and objectives. Internal audits encompass financial activities and operations including systems, production, engineering, marketing and human resources.

The Head of Internal Audit is appointed and dismissed by the Board of Directors, provided that any appointment, replacement, or dismissal of the Head of Internal Audit shall be notified to OJK. The Deputy Head of Internal Audit and other positions are appointed and dismissed under requests from the Head of Internal Audit

The internal audit function shall be responsible to keep confidential documents and information in accordance with prevailing laws and regulations, the credit institution's charter and the internal regulations on internal audit of the credit institution. Based on Regulation Number IX.I.7, the internal audit unit's duty and responsibility are as follows:

- a. compiling and performing annual Internal Audit plan;
- b. reviewing and evaluating the operation of internal control and risk management in accordance to company's policy;
- c. performing audit and assessing the efficiency and effectiveness in the area of finance, accounting, operation, human resource, marketing, information technology and other activities;
- d. performing compliance audit to related regulations and laws;
- e. identifying the efficiency and effectiveness of improvement and enhancement alternative of resources and funding consumptions;
- f. giving objective improvement of advice and information regarding audited activities for all management levels;
- g. reporting the audit result and delivers the report to President Director and commissioner;

¹⁹ The Institute of Internal Auditors. See also: www.theiia.org.

- h. monitoring, analysing and reporting the progress of recommended action performance;
- i. cooperating with the Audit Committee;
- j. developing program to evaluate the quality of internal audit action which is performed by it; and
- k. performing special audit, if necessary.

The internal audit function shall be responsible before the Board of Commissioners and the Board of Directors on the results of the internal audit, the assessment and recommendations in the internal audit report. The internal audit function shall review and follow up implementation of their recommendations.



Comparative Practices

The typical internal audit tasks include:

- Appraise compliance of business activities with internal policies and procedures
- Provide advice in setting up internal policies and procedures
- Appraise controls over the safeguarding of assets
- Appraise compliance with laws and regulations
- Appraise internal controls over financial information
- Appraise internal controls over business processes
- Appraise the process for identifying, evaluating, and managing business risks
- Appraise operational efficiency
- Appraise compliance with contractual obligations
- Conduct audits of information technologies
- Investigate fraud
- Audit subsidiary companies.

In order to function properly, the Internal Auditor should enjoy a reasonable degree of independence. This can be attained by making him/her accountable to the Board of Commissioners (through the Audit Committee) rather than an executive of the company (the President Director or Finance Director).



Best Practices

In reality, it is difficult for the internal audit function to be entirely independent of management. Indeed, the internal control function is a key management tool. It would lose a great deal of its utility if it did not report to management. Cognizant of the need to maintain independence while working closely with management, the Institute of Internal Auditors suggests that the Internal Auditor report administratively to the President Director and functionally to the Board of Commissioners' Audit Committee.

Chapter **15**

**OVERVIEW OF THE
CORPORATE GOVERNANCE
FRAMEWORK OF STATE
OWNED ENTERPRISES
(SOES)**

Table of Contents

A. INTRODUCTION	512
1. The Origin of Indonesian SOEs	512
2. Turnaround	515
B. THE STRUCTURE AND CHALLENGES FOR THE GOVERNANCE OF INDONESIAN SOEs	515
1. The Legal and Regulatory Framework	515
2. The Position of the State as an Owner of SOEs	517
3. Equitable Treatment of Shareholders	520
4. Stakeholders relations	521
5. Transparency and Disclosure	523
6. The Boards of SOEs (Responsibilities and the Appointment)	526
C. SUMMARY	529
BIBLIOGRAPHY	530

A. Introduction

1. The Origin of Indonesian SOEs

The history of SOEs in Indonesia began since the Dutch colonial era. The Dutch government formed many enterprises for public use, such as railways, post office, seaports etc.¹ These SOEs were governed by two laws, namely *Indonesische Comptabiliteitswet Stb 1925 No. 448 (ICW Enterprises)* and *Indonesische Bedrijvenwet Stb 1927 No.419 as amended by Stb 1936 No. 445 (IBW Enterprise)*. Both ICW enterprises and IBW Enterprises obtained their capital entirely from the Dutch Government, provided that it was only IBW Enterprises were allowed to raise additional capital from government loans subject to interests and accordingly prudent audit was applied to ensure that these enterprises could settle their debts.

After Independence, the Indonesian Government took over most of the SOEs established by the Dutch government. Following takeover, for controlling purposes, the government turned all of the SOEs into a single form entity called State Enterprise or *Perusahaan Negara (PN)* and such transformation was governed by the Government Regulation in Lieu of Law No. 19 of 1960 concerning State Enterprise. Many believed that this initiative was unsuccessful and created repercussions.

Starting 1966 under the New Order regime (*Orde Baru*), SOEs arrangement was reformed. The New regime issued Law No.9 of 1969 concerning the forms of state business. This law changed the single form of enterprise into three categories, namely *Departmental Enterprise (Perusahaan Jawatan or “Perjan”)*, *Public Enterprise (Perusahaan Umum or “Perum”)*, and *Limited Liability Enterprise (PERSEROAN or “Persero”)*. These SOEs by law and nature had their own characteristics as shown exhibited in the following table:

1 Meidyah Indreswari, Doctoral Dissertation: ‘Corporate Governance in the Indonesian State-Owned Enterprises’, (New Zealand: Massey University,2006), 148

Table 1: Types of Indonesian SOEs

Characteristics	Types		
	Perjan	Perum	Persero
Purpose of activities	Public Services	Mixed public services and profit making	Profit making
Relevant Law	IBW	Act No 19/1960	Commercial Law
Relationship of the company to the government	Part of government agency	Autonomous organisation	Autonomous organisation
The Board of Directors appointed	By the president	By the president	By the GMS
Capital	Part of annual budget	Government participation	Share Capital
Employment status	Public servant	Based on special regulation	Similar to private employees
Scope of business	Public utility (vital and strategic)	Public utility	Similar to private enterprise

Source: Djamhari (1996:177)

During this regime era, the “state control” over SOEs was levied under the Directorate General of SOEs in the Ministry of Finance². The state control means there was no clear separation between the state’s ownership functions and state controlling functions. Accordingly the state had absolute control over SOEs. While this power could have been used to positively manage SOEs, many believed that SOEs were not managed properly³. The poor performance of SOEs was not only because of their management, but also because of the organizational structure and its unfavourable position⁴. In view of these circumstances, SOEs had reduced their contribution to the state from time to time and finally many of them were collapsed during the financial crises in the late 90s.

2 Nugroho and Wrihatnolo, Pengalaman Revitalisasi BUMN, <http://www.bappenas.go.id/pencarian/global/?keyword=pengalaman+revitalisasi+bumn&task=Cari>

3 Ibid

4 Nugroho and Wrihatnolo, op cit

2. Turnaround

The economic crises in the late 90s were the most important milestone in the history of Good Corporate Governance practise in Indonesian SOEs. The collapse of large corporations and financial scandals in several countries has brought attention on the importance of corporate governance. During the crises, the government was forced to reform the corporate governance system⁵. Accordingly, the government along with a number of stakeholders such as the Capital market Supervisory Agency (*Badan Pengawas Pasar Modal* - “Bapepam”, currently known as Financial Service Authority - OJK), the Jakarta Stock Exchange (currently known as Indonesian Stock Exchange) and the certain professionals launched several initiatives such as establishment of National Committee on Corporate Governance (NCCG), the Indonesian Institute for Corporate Governance (IICG), and the Forum for Corporate Governance in Indonesia (FCGI).⁶

5 Dudi M. Kurniawan and Nur Indriantoro, ‘Corporate Governance in Indonesia’ (2000) Paper on The Second Asian Roundtable on Corporate Governance 9 <<http://www.oecd.org/dataoecd/6/62/1931154.pdf>> at 21 March 2008

6 Meidyah Indreswari, op cit, 235

B. The Structure and Challenges for the Governance of Indonesian SOEs

1. The Legal and Regulatory Framework

As an effort to establish strong foundation of Good Corporate Governance practise in Indonesian SOEs, Government believes the importance of having a specific law regulating SOEs in a more comprehensive manner to tap the business growth. These needs were then responded by the issuance of Law No. 19 of 2003 concerning SOEs (“SOE Act”). The Law has successfully addressed regulatory framework for the SOEs, provided however it does not specifically address the good corporate governance related issues. Despite of these fact, there are number of Good Corporate Governance (GCG) codes/guidelines that could be taken as references for SOEs to implement GCG such as those issued by the National Committee on Corporate Governance (“KNKG Code”) and Organization for Economic Co-operation and Development (“OECD Guidelines”). It should be noted that while these guidelines are not mandatory, especially to the OECD guidelines where Indonesia is not an OECD states member, these guidelines set out important references that can be followed by SOEs in exercising the GCG. The legal reference concerning this respect was issued through the Regulation of SOEs Minister No. 01 of 2011 (“GCG Regulation”) concerning the Implementation Good Corporate Governance in SOEs.

The Issues:

While the Indonesian SOEs have already had legal reference to exercise GCG in their operation, they remain bound to the other prevailing legislations. One of the major challenges in this respect lies in inter-legislations consistency. As an example, the inconsistency occurs amongst rules concerning capital structure of SOEs. In reference to SOEs Law, the capital of SOEs is separated from the State assets. However, in reference to the Corruption Act the losses of SOEs are in the category of State losses. In view of this issue, the main concern here is that how to develop effective legal and regulatory framework that favours SOEs best practice in implementing GCG.



Developing effective legal and regulatory framework shall consider consistency aspects. Besides, this framework shall satisfy a number of requirements of GCG best practices and consideration of market economy where SOEs shall be granted equal access to commercial and legal certainty in carrying out its business activities as private corporations have. In doing so there has been best practice recognised. In the national context, KNKG code of GCG issued in 2006 setting out basic principles in promoting the creation of a healthy, efficient and transparent business climate. Accordingly this shall be implemented along with consistent law enforcement.

In reference to the OECD guidelines, in order to ensure effective regulatory development, the first requirement is to make sure that state functions are separated. This is aimed at preventing massive intervention from outside political interest groups thus ensuring independency of the Boards in exercising their function to grow the SOEs. However, it is thought that this could be the one and only measure exposed to great challenges. Hence, while this seems not easy, this is the utmost requirement that the state shall pay attention in managing SOEs through developing effective framework. While the intervention shall be managed, Walker states that the rule of law should take into account that some degree of governmental intervention to some extent is required⁷. He further states that this intervention requires checks and balances for necessary accountability and to prevent arbitrary and unfair actions⁸.

Simplification of operational policies and legal forms are the next important measure. These are accordingly deemed as the measure that can be directly linked to reduction of inconsistency. Accordingly, to approach this Walker indicates the core requirements for a Legal System shall clearly define the roles, rights and responsibilities of the directors, managers and shareholders. So, practically, the inconsistency can be mitigated through developing clear definitions and conducting thorough reviews to the prevailing legislations thus ensure if the more technical regulations will provide clauses that will likely be against the higher legislations, such reasons need to be clearly explained.

⁷ John L Walker, Building the Legal and Regulatory Framework pg. 64

⁸ Ibid

Apart from those two measures, some other measures from these guidelines are also applicable and important to take into considering whilst developing the regulatory framework. Besides, while there have been efforts to apply similar measures, there is a need to keep the efforts going. One of these measures is Disclosure on SOEs obligations and responsibilities. It is noted that certain public listed SOEs have disclosed their performance, obligations and responsibilities uploaded in their website which is a positive improvement. However, they shall keep ensuring that disclosure is updated. Further, SOEs shall not be exempt to get exposed over general laws and regulations. In this respect, SOEs are subject to the other legislations and thus this principle has been well done although often faced by a number of inconsistencies. When SOEs are faced with this issue, it is thought that this is the time that the state to protect the interest of SOEs without violating the rights of stakeholders and without violating the prevailing legislations.

In view of the above Issues and their suggested mitigation measures, the OECD guidelines provides that “the Legal and regulatory framework for SOE should ensure a level-playing field in markets where SOEs and private sector companies compete in order to avoid market distortions”. Hence, the effective regulatory framework shall stimulate good practice of SOEs in the efforts of GCG implementation.

2. The Position of the State as an Owner of SOEs

The position of state:

Considering the main objectives of SOEs to generate income and to serve public, the authority of the state/government over the SOEs and how this is exercised is very critical. The SOE Law clearly governs that the state is the owner of SOEs and a Line Minister shall represent the state in an SOE. In reference to the Clause 14 of the Law the Line Minister represents for and on behalf of the state as a the General Meeting of Shareholders (GMS) where the state owns all of the shares in an SOE or only as a shareholder where the state does not own the entire shares of an SOE. Hence, irrespective to degree of shares possession, the Law guarantees that the control over the SOEs is granted to the state represented by a Line Minister.

Concerns:

While the state may control the SOEs, the primary concerns lie in *the effectiveness of the Line Minister as the State representative to make sure that the SOEs can work accordingly*. In reference to the best practice as set out in the OECD guidelines, ideally “the state should act as an informed and active owner and accordingly establish a clear and consistent ownership policy, ensuring that the governance of SOE is carried out in a

transparent and accountable manner with the necessary degree of professionalism and effectiveness”.

Many believe that the ideal stage where the state can act as a good owner over an SOE is considered as a continuous homework to work on. Furthermore, there have been numerous failures found in managing the SOE although sets of necessary legislations to support positive change have been issued. The recent Pre IPO of Krakatau Steel best illustrates state failures to act as a good owner of SOEs that yielded to turbulence in their IPO launch where the initial stock price publicly offered was way too low⁹. Besides, it was estimated only 2% of the entire stocks were offered to the public. Hence, irrespective to the primary culprits determining this case, this issue shows the failure of the state to act as a good owner over SOEs.



Best Practices

Best Practices: In improving the effectiveness of the Line Ministries there have been numerous efforts taken by the state. However, many do not feel that the government is a good representative of the state to manage SOEs. Accordingly they shall re-define their practice to ensure their effectiveness and accordingly they may consider some measures from international best practice. OECD guidelines have set up some measures that the state may consider in order to be a good owner of SOE. Accordingly, the state shall:

1. develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.
2. not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
3. let SOE boards exercise their responsibilities and respect their independence.
4. define the exercise of ownership rights within the state administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralization of the ownership function.

9 Yanuar Rizki in <http://news.detik.com/read/2010/11/29/130643/1504762/159/yanuar-rizky-permainan-krakatau-steel-paling-gila-gilaan>

5. ensure that the coordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.
6. exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:
 - a. being represented at the GMS and voting the state shares.
 - b. establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards.
 - c. setting up reporting systems allowing regular monitoring and assessment of SOE performance.
 - d. when permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.
 - e. ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.

While numerous efforts have been exercised to satisfy those principles, the only measure that is unlikely to be easy to be applied is the government involvement in the day-to-day management of SOEs to allow them full operational autonomy to achieve their defined objectives. As previously already mentioned, by law they are the owner of the SOEs and have full control over the SOEs.

In order to facilitate those best practices, the only way is through developing mindset of the Line Ministers to exercise high degree of Commitment and Consistency in the inclusion of GCG to the SOEs operation and to increase the corporate performance. Besides developing trust allowing the boards to work autonomously and independently is definitely required.

3. Equitable Treatment of Shareholders

The Shareholders Treatment Arrangement:

The right of minority shareholders in PERSERO is considered an issue. In reference to the OECD guidelines, the state and the SOE should recognise the rights of all shareholders and ensure all shareholders are treated equitably and have equal access to corporate information. The equal treatment of shareholders in the Minister Regulation 01/2011 is governed in Article 10 which is provided that “the shareholders who possess the same shares classification must be treated equitably (Equal Treatment)”. Further, this regulation also reserves the right of Shareholders to attend and vote in GMS, access to SOEs material information, receive dividend and other rights stipulated in SOEs, AoA and Legislation¹⁰. Thus, these imply that the minority Shareholders have the same right with the other Shareholders as long as they have the same shares classification.

The issues:

While there are almost no substantial issues concerning the equal treatment of shareholders, it was quite common where the right of minority Shareholders triggered the right of first refusal. While the issuance of Minister Regulation 01/2011 has improved the practice, such issues in particular who should manage of minority Shareholders of SOEs still remain. It is noted that are some uncertainties in terms of a line minister managing the minority shareholders in the SOEs both as owner of minority shares in private company and inside the SOEs itself.¹¹ In this case, not only the equitable treatments of shareholder that should be considered by the State, but it should be concerned more to the minority shares ownership by SOEs in other company. For public listed company, the minority shareholders regulation is subject to the regulations issued by the Capital Market regulator. This body has issued numerous regulations that may favour the minority shareholders in both private companies and SOEs.



Best Practices

It is noted that in practice minority shareholders are sufficiently protected and further in some cases market seeks to purchase minority shares and thus it is likely that in general in terms of the shareholder treatment the practice in

¹⁰ PERMEN 01/2011, Article 5.

¹¹ <http://dunia.news.viva.co.id/news/read/174407-menkeu-bumn--berebut--saham-minoritas>

Indonesian SOEs has closely met the following best practices:

1. The coordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.
2. SOEs should observe a high degree of transparency towards all shareholders.
3. SOEs should develop an active policy of communication and consultation with all shareholders.
4. The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.

4. Equitable Treatment of Shareholders

Theoretical Framework:

In terms of stakeholder relations, Allen and Gale (2000) argue on the effectiveness of the agency theory approach based on several reasons. One of these reasons is “The agency approach to corporate governance is somewhat narrow in its focus”. In many instances, managers are responsible to other stakeholders, including employees, who may be legally entitled to exert control on the firm’s policies.¹² Further, Meidyah Indreswari also states “in SOEs where the stakeholders’ value is the main objective, the emphasis of corporate governance is to safeguard the interests of diverse groups such as employees, customers, and the community at large”.

The Rights of Stake Holders:

In reference to Clause 38 the Minister Regulation, SOEs shall consider the right of Stakeholders arising due to legislations and/or agreement entered into between SOEs and employees, customers, and creditors as well as the society around SOEs, and other Stakeholders. Hence, it is understood that SOEs have multiple stakeholders where their rights shall be respected and thus the relationship amongst them shall be maintained.

12 Meidyah Indreswari, Corporate Governance in the Indonesian State Owned Enterprises: A Thesis presented in fulfilment of the requirements for the degree of Doctor Philosophy in Development Studies at Massey University, Palmerston North, New Zealand. 2006, Page 34.

While the SOEs are mandated to consider the stakeholders rights in their operation, the implementation shows some challenges. *Managing employees in particular during privatization is case in point.* It is noted that there is no such clear governance on how to manage the industrial relationship during the privatization. Yet, there have been apparent issues whenever the privatization initiative will be launched there will be huge pros and cons and this creates anxiety to the existing employees.



Best Practices

It is to reiterate that Stakeholders are parties concerned with the State due to its legal relationship with the State.¹³ SOEs must accordingly respect the rights of the stakeholders arising under the laws and regulations and/or agreements made by SOEs with its employees, customers, suppliers, creditors and the community around the concerned SOE, and other stakeholders.¹⁴ Hence, it is thought that there should be no discriminations against the stakeholders in particular, in the context of GCG to employees based on their races, religion, class and gender.

Managing relationship with employee stakeholders is specifically governed under the Employment Law No. 13 of 2003. This Law regulates a number of important principles to favor mutual cooperation between SOEs and their employees. However, some issues arise due to numerous reasons. Accordingly, OECD guidelines and KNKG code have pointed out some measures that the state and SOEs shall consider to manage stakeholder relationship such as provide reports on SOEs relationship with stakeholders, develop stakeholders relationship ethics and respect the rights of stakeholders. These principles amongst others include:

1. Governments, the coordinating or ownership entity and SOEs themselves should recognize and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.
2. Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

13 Per-01/MBU/2011, Article 1 point 8

14 PER – 01/MBU/2011, Article 38

3. The board of SOEs should be required to develop, implement and communicate compliance programmes for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries

5. Transparency and Disclosure

General Point of View:

It is noted that Transparency and Disclosure issues are amongst the most critical points in the SOEs operation and these remain challenging issues although the Indonesian SOEs have been required to apply GCG in terms of transparency and disclosure. In the past, lack of transparency and disclosure was apparent. These days, efforts to create transparent SOEs seem to be everlasting homework for SOEs.

Governance of Transparency and Disclosures:

Information disclosure in SOEs is governed in Clause 32 of the Minister Regulation. This clause states “SOEs must disclose important information on its annual report and financial statements in accordance with the State laws and regulations not only in a timely manner but also in an accurate, clear and objective way”. While SOEs are required to be transparent they shall respect any confidential information. Unless otherwise provided by statutory provisions, AoA, and/or company rules the external auditors, internal auditors and the audit committee and other committees (if any), SOEs must keep confidential information obtained while performing their duties. Accordingly, it is the responsibility of both the BOD and BOD to maintain the confidentiality of company information.

Transparency Vs Confidentiality:

The conflict between principles of transparency and disclosures and confidential information is considered the primary issue that the Indonesian SOEs shall take into account. Meanwhile, it is understood that there are no clear measures on the extent of transparency and confidentiality. This is coupled with the fact that the Indonesian SOEs are still reluctant in disclosing their financial statement¹⁵. Hence, the number of SOEs who are listed in the stock exchange is low. Since the establishment of Indonesian Stock Exchange (previously Jakarta Stock Exchange) dating back 20 years ago, there have been only 18 SOEs listed¹⁶.

15 Firdaus Nur Iman in <http://www.indonesiainancetoday.com/read/32112/Perusahaan-BUMN-Masih-Takut-Transparansi-Laporan-Kuangan>

16 Ito Warsito, <http://investasi.kontan.co.id/news/bei-tantang-transparansi-bumn-di-bursa>

While information disclosure has been clearly regulated under SOE Act, GCG Regulation and Act No. 14 Year 2008 concerning Public Information disclosure, there are no clear reasons upon the reluctance to exercise the transparency amongst the Indonesian SOEs. Many believe that Lack of transparency seems to be an intentional agenda of political interest groups and bureaucrats¹⁷. Hence, lack of transparency is linked to inefficiencies in the SOEs¹⁸. One of the commonly noted cases is in the budgeting in procurement of Goods and Services. This is the fragile area where the lack of transparency entails to inefficiencies due to breach of integrity committed by the SOEs boards and personnel.

Breach of Integrity:

While a number of SOEs have performed well, it is noted that many of them are exposed to the alleged Breach of Integrity issue. In several SOE's, there is a resistance to commit to reforms, and often there are close ties between business and politics¹⁹. Indeed, the integrity of SOEs personnel is still questionable. As widely known, a number of officials in a number of SOEs have been committed to and processed for breach of integrity allegations such as corruption and collusion. Hence, breach of integrity issues may be considered as the top challenge in SOEs operations. In the last 3 years, the Indonesian Corruption Eradication Commission (KPK) has processed quite a few numbers of the alleged cases.

In view of Transparency and Disclosure issues, there is no quick fix to favor these in the SOE operation. Go Public can be one of the best ways where SOEs can exercise their transparency and disclosure initiative. However, the road to go there is quite stiff and there is always a need to have right measures.



Best Practices

While set principles of Transparency and Disclosures are accommodated in the GCG Regulation, this does not provide technical guidance on how SOEs shall be transparent and disclose their information vis-à-vis keeping the confidential information.

17 Miko Kamal, Journal of International Commercial Law and Technology Vol. 5, Issue 4 (2010)

18 Ibid

19 DOING BUSINESS IN INDONESIA, A Norwegian Perspective, Update as of February 2011

In managing the stakeholder relations, in reference to OECD guidelines, the state/Line Minister shall:

- a. Observe high standards of transparency;
- b. Develop consistent reporting on state-owned enterprise operation and publish it annually;
- c. Develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ;
- d. Be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.
- e. Be subject to the same high quality accounting and auditing standards as listed companies. Further, Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.
- f. Disclose material information such as:
 - A clear statement to the public of the company objectives and their fulfillment.
 - The ownership and voting structure of the company.
 - Any material risk factors and measures taken to manage such risks.
 - Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE. And
 - Any material transactions with related entities

6. The Boards of SOEs (Responsibilities and the Appointment)

The Boards of SOEs both in the form PERSERO and PERUM are found similar with those in regular companies. These mainly involve Boards of Directors (BOD) and Boards of Commissionaire (BOC).

Board of Directors (BOD) is considered the executive organ of Indonesian SOEs who runs them in daily basis. The BOD shall report to the Shareholders through a General Meeting of Shareholders (GMS) mechanism. In view of GCG perspective to the responsibilities of BOD, they shall perform their duties with good faith for the sake of corporate goals and ensure the SOE perform its social responsibilities taking into account the interest of the stakeholders²⁰. Further, the BOD is required to avoid conflict of interest²¹. So, in principles the BOD has set of duties mandated by law and this regulation that they have to perform taking into account no conflict of interest principle.

The GMS appoints the members of BOD with an initial appointment period of 5 (five) years, with the possibility of extending the tenure period by 5 more years. The appointment of BOD is considered as one of the critical aspects that entails to further dynamics in the SOE operation as the state remains in possession of powerful authority. In reference to clause 15 of the SOE Law, the GMS or a Line Minister are authorized to appoint BOD. Further there is not yet further legal reference upon clearer mechanism on the BOD appointment.

While the SOE Act and the SOE Minister Regulation state a number of criteria for the appointment of BOD and this further detailed by the SOE Minister Regulation No.4 of 2009 concerning the appointment of BOD in SOEs there is no clarity on the conditions where the BOD members shall be appointed through GMS mechanism or shall be appointed by a Line Minister. In practice where the minister appoints the member of BOD, the members of parliament may not agree. One of the noted cases is the appointment of President Director of PT. PTPN III. On this appointment, the vice chair of Commission VI of the parliament, Mr. Aria Bima requested the SOE minister to cancel this appointment²².

The Board of Commissionaire (BOC) is the organ that supervises the BOD and provides advice. In addition, the BOC is able, at anytime, to take over BOD functions in daily business activity in certain instances such as in the absence of BOD. Like BOD,

20 Claus 19 (1) of Permen 01/2011

21 Clause 23 Permen 01/2011

22 <http://www.suarapembaruan.com/home/dpr-minta-pengangkatan-direksi-bumn-dibatalkan/18471>

The appointment of BOC is also one of the critical aspects that entails to further dynamics in the SOE operation as the state remains in possession of powerful authority. In reference to clause 27 of the SOE Lawt, the GMS or a Line Minister are authorized to appoint BOC. Further, like the appointment of BOD, there is not yet further legal reference upon clearer mechanism on the BOC appointment in terms of conditions where the GMS or Line Minister is authorized to appoint the BOC.

In light of the appointment of BOD and BOC members, the dynamic can be a political process that may involve members of parliament to interfere. Besides, failures in appointing the right person to lead SOE may create repercussions that can be linked to the management failures of the SOEs. The World Bank identifies one of the chronic problems faced by SOEs elsewhere involves the ability and capability of the BOD²³. Further, the World Bank notes that members of the BODs are influenced and driven by the government because most of them are public servants. This experience shares similarities to Indonesian SOEs. This issue is coupled by various objectives amongst Boards of Directors conflicting each other thus considered as Conflict of Interest. Board members who come from labors also have their own agenda against the interests of the company as a whole and vice versa²⁴. These conflicting objectives are then brought to where the boards exercise their responsibilities, and accordingly independency from political affairs in such corporate actions is always an issue.



Best Practices

It is noted that the most intriguing dynamic in the appointment and responsibilities of the Boards of SOE (BOD and BOC) is political affair. This issue is strongly linked to the absence of clear separation amongst state functions as discussed above. While the political affair is normal and a sign of lucrative activities, the primary concern is that if this affair entails to failures in appointing the right members and assigning inappropriate tasks to wrong personnel.

23 The World Bank, 'Improving the Corporate Governance of State-Owned Enterprises: The Approach of the World Bank' <[http://www.ifc.org/ifcext/economics.nsf/AttachmentsByTitle/SOE_Brochure/\\$FILE/SOE_brochure.pdf](http://www.ifc.org/ifcext/economics.nsf/AttachmentsByTitle/SOE_Brochure/$FILE/SOE_brochure.pdf)> at 11 December 2009

24 Ibid

In respect to the appointment of the SOEs boards (BOD and BOC), it is to reiterate that the procedures are governed in the SOE Minister Regulation No 4 Year 2009. In principle, in order to reduce the political process in the appointment of the Boards, the appointment shall be made in transparent manner. This means there should be clear measures on the appointment such as developing clear criteria of the candidates' profile, clear stages of recruitment and there shall be evaluation team consisting the professionals who will appraise the competency of the candidates. In light of these matters, the procedures in the said regulation shall be exercised with high integrity.

Besides the appointment, another severe issue is found in the independency of exercising the boards' responsibilities. Accordingly, in order for the BOD to perform their duties independently, any parties other than the organs of an SOE shall not interfere with the management of the SOE.²⁵ In so doing, again OECD guidelines indicate some of the best practices and therefore the boards shall:

1. Have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management.
2. Be assigned a clear mandate and ultimate responsibility for the company's performance.
3. Carry out their functions of monitoring of management and strategic guidance.
4. Exercise objective and independent judgment.
5. Develop employee representation mechanism.
6. Set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. And
7. Carry out an annual evaluation to appraise their performance.

In addition to the above measures, to meet the requirement of accountability, transparency and administration order the boards must:

1. Make the list of shareholders, the special register, the minutes of GMS and minutes of meetings of the BOD;
2. Make annual reports and financial documents;
3. Maintain all lists, minutes, and financial documents, and other documents;
4. Keep at the company domicile, the entire list, minutes, financial documents, and other documents.

25 Law on SOEs, Article 91

C. Summary

Corporate Governance rules, norms and procedures evolve gradually time to time as SOEs grow and develop²⁶. These days as the set of legislations concerning SOEs and the implementation of GCG have been issued the SOEs have taken change initiative and thus start applying GCG idea in their operation. Along with improving economy in Indonesia and plummeting business climate occurring some of developed countries, the businesses and the investor have turned their eyes to invest in Indonesia and one of ways is to invest in the Indonesian SOEs. The government is confident that the IPO of Indonesian SOEs is highly lucrative to foreign investors²⁷. Hence, this is the right time to change and develop GCG in the SOEs operation. However, given the issues surrounding the initiatives, the GCG implementation shall be safeguarded.

The practice of SOEs during the new order era and the financial crises marked the development of GCG inclusion in SOEs. The legacy of SOE operation from the new order gave challenges and accordingly these challenges can be viewed in 6 perspectives including the Legal and Regulatory Frameworks, The Legal Standing of the State as an Owner, Equitable treatment of Shareholders, Transparency and Disclosure and the Appointment and Responsibilities of the Boards. While there numerous initiatives to improve the SOE operation through the inclusion of GCG have been taken, challenges remain and there is no quick fix to overcome these issues. Accordingly continuous improvement shall be taken to ensure that the inclusion of GCG can be safeguarded and the goals of having SOEs with high accountability, integrity and transparency can be achieved.

26 Patrick, 2001: 12 in Meidyah Indreswari: 2006 Pg 249

27 Whery Enggo Prayogi in <http://finance.detik.com/read/2012/06/08/153810/1936416/6/jadi-incaran-investor-pemerintah-yakin-ipo-bumn-laris-manis>

Bibliography

Legislations

Law No. 19 of 1960 concerning State Company

Law No. 31 of 1999 concerning Eradication of Criminal Acts of Corruption

Law No. 13 of 2003 concerning Manpower

Law No. 19 of 2003 concerning State-Owned Enterprises

Law No. 40 of 2007 concerning Limited Liability Company

Regulation of the Minister of State Owned Enterprises No. PER – 01/MBU/2011 concerning Good Corporate Governance for State Owned Enterprises

Journal/Article

DOING BUSINESS IN INDONESIA, A Norwegian Perspective, Update as of February 2011

Indreswari, Meidyah, Corporate Governance in the Indonesian State Owned Enterprises: A Thesis presented in fulfilment of the requirements for the degree of Doctor Philosophy in Development Studies at Massey University, Palmerston North, New Zealand. 2006, Page 34.

Kamal, Miko, *Journal of International Commercial Law and Technology* Vol. 5, Issue 4 (2010)

Walker, John L, Building the Legal and Regulatory Framework pg. 64

Bibliography

Websites

Bangun, Astri Kharina, Kontan.co.id, *BEI tantang transparansi BUMN di bursa*, <<http://investasi.kontan.co.id/news/bei-tantang-transparansi-bumn-di-bursa>>

Iman, Firdaus Nur, Indonesia Finance Today, *Perusahaan BUMN Masih Takut Transparansi Laporan Keuangan*, <<http://www.indonesiainancetoday.com/read/32112/Perusahaan-BUMN-Masih-Takut-Transparansi-Laporan-Keuangan>>

Kurniawan, Dudi M., and Nur Indriantoro, 'Corporate Governance in Indonesia' (2000), *Paper on The Second Asian Roundtable on Corporate Governance 9*, <<http://www.oecd.org/dataoecd/6/62/1931154.pdf>>

Nugroho and Wrihatnolo, Kementerian PPN/Bappenas, *Pengalaman Revitalisasi BUMN*, <<http://www.bappenas.go.id/pencarian/global/?keyword=pengalaman+revitalisasi+bumn&task=Cari>>

Rizal, M., Detikcom, *Yanuar Rizky: Permainan Krakatau Steel Paling Gila-gilaan*, <<http://news.detik.com/read/2010/11/29/130643/1504762/159/yanuar-rizky-permainan-krakatau-steel-paling-gila-gilaan>>

Susanto, Heri and Syahid Latif, Viva News, *Menkeu-Menneg BUMN Berebut Saham Minoritas*, <<http://dunia.news.viva.co.id/news/read/174407-menkeu-bumn--berebut--saham-minoritas>>

Suara Pembaruan, *DPR Minta Pengangkatan Direksi Dibatalkan*, <<http://www.suarapembaruan.com/home/dpr-minta-pengangkatan-direksi-bumn-dibatalkan/18471>>



**International
Finance Corporation**
World Bank Group

IFC INDONESIA

Indonesia Stock Exchange Building
Tower 2, 9th Floor
Jl. Jend. Sudirman Kav 52-53
Jakarta 12190
t. (62-21) 2994-8001
f. (62-21) 2994-8002

ifc.org

Contact:

Moez Miaoui

Project Manager

e. MMiaoui@ifc.org