Code of Best Practices for Corporate Governance

February 2003

Committee on Corporate Governance
INTRODUCTION

The Code of Best Practices for Corporate Governance (hereinafter referred to as "the Code"), which was published in September 1999, has made a significant contribution to the enhancement of governance of listed corporations. The relevant laws and regulations have been amended in accordance with the standard practices recommended by the Code. The transparency of corporate management and public confidence in the securities market have been improved significantly by the voluntary efforts of the listed corporations, which have been guided by the Code, as well as the initiatives of all social spheres. Subsequently, market participants have shown growing interest in corporate governance.

During the past several years, the corporate governance environment has changed substantially, thus prompting global discussions on corporate governance systems and hastening the movement for structural reform in various countries. The revision of the Code, which has made such a significant contribution, stemmed from this background. In this context, it should be noted that at the time of publishing the Code in 1999, the Committee on Corporate Governance stressed that the Code should be used as a guide for the development of forward-looking corporate governance practices. The Committee also pointed out that the Code should be further improved and continuously reinforced to maintain its appropriateness and impartiality, consistent with the circumstance of the time.

Over the years, various regulatory changes have been introduced, and the corporations voluntarily introduced changes in their corporate governance structures. Consequently, the original Code was viewed as somewhat inadequate in outlining the course of action for improved corporate governance. Although foreign investors' concerns over the risks involved in investing in Korea have been reduced significantly, it is generally recognized that the investment risks associated with poor corporate governance remains as one of the main causes that keeps the Korean stocks undervalued. More importantly, the large scale accounting frauds revealed in the United States and other countries during the past couple of years have deepened investors’ suspicion about the transparency of corporate management and have, once again, highlighted the critical need for the reform of corporate governance. As a result, those incidences served as the necessary justifications to many countries for the introduction of new regulations concerning the reform of corporate accounting and governance systems and to the securities markets for strengthening the listing regulations pertaining to corporate governance. Furthermore, in-depth studies and intensifying discussions on corporate governance, both from the national and international perspectives, and the growing demands of market participants for management transparency have underscored the urgency for promoting awareness on the best practices for corporate governance and global standard.

Amid these circumstances, the Korea Stock Exchange, the Korea Securities Dealers Association, the Korea Listed Companies Association, the Kosdaq, the Korea Investment Trust Companies Association and the Kosdaq Listed Companies Association newly established the
Committee on Corporate Governance (hereinafter referred to as “the Committee”) for the purpose of revising the Code. The Committee, which was comprised of twenty-three members who represented the securities industry, business sector, academia, civic organizations and other relevant research institutions, commenced its work by forming a Research Subcommittee composed of ten experts in the field of corporate governance and assigned the task of preparing a preliminary version of the revised Code.

After conducting various research and holding meetings during the four months since June 2002, the Research Subcommittee finally presented the preliminary version of the revised Code. The preliminary version was refined by incorporating various views expressed at the joint meeting of the Research Subcommittee and the Committee, as well as the issues voiced at the public hearing held on January 22, 2003. Through such processes, the preliminary version went through several revisions and was finally accepted, after incorporating further suggestions from the Committee, on February 17, 2003.

On the whole, the revised Code is an improvement over the original version. That is, much effort went in harmonizing the Code with the global standard and making it more realistic in the Korean context. In particular, to minimize the difficulties of corporations in adopting the Code, the revised Code still retains the different provisions for the large listed and other corporations, and for the areas where the immediate adoption of the Code is seen to be difficult, recommendations, rather than requests for implementation, were made. In common with the original Code, the revised Code includes the recommendations to the government and other related agencies.

It is hoped that the revised Code serves as a reference point for future improvements on corporate governance, and ultimately strengthens the corporate competitiveness. It is also hoped that the Code would accelerate the enhancement of corporate governance practices, as it may be utilized for other purposes such as development of stock indices linked to the ratings of corporate governance of individual companies. Nonetheless, in order to incorporate the changing circumstances of corporate governance and the issues emerging from the discussions of the latest practices, the Code must continually be updated and strengthened.

Lastly, I would like to express my sincere appreciation to all those who have contributed, both directly and indirectly, to the revision of the Code, particularly the members of the Committee and the Research Subcommittee, as well as the securities related organizations which provided not only the operational bases, but also the necessary support and encouragement.

February 2003
Kwang S. Chung
Chairman of the Committee on Corporate Governance
FOREWORD

Corporations now play an increasingly critical role in the national economy. A nation’s competitiveness and wealth, for that reason, depend on the competitive nature of its corporations. No doubt a transparent and reasonable governance structure bears positive impact on a company. Moreover, the issue of corporate governance structure now commands attention on the global stage.

The Committee on Corporate Governance was established as a non-government body in March 1999 to develop a code of best practices, a source to guide corporations in establishing a proper corporate governance structure. The Committee was composed of fourteen members from the fields of business, finance, accounting, law and academia, along with an Advisory Group of thirteen law, securities, and financial specialists.

The draft was initially drawn by three subcommittees of the Advisory Group, and revised through meetings based on opinions presented by each committee member. During its preparation, the committee had eight meetings and the advisory, ten. The draft was circulated on August 27th via the internet and mass media, and opinions then collected through a public hearing on September 8th. The final draft, reflecting such input, reached completion on September 22nd through a general meeting of the Committee and Advisory Group.

The Committee, by endeavoring to inform all related parties of the Code of Best Practice, has been able to gather a wide range of opinions from individuals and institutions in the related areas. With appreciation for all concerns and interest expressed, every effort has been made to accommodate such opinions in the Code.

It is the high expectation of the Committee that this Code guide corporations toward an improved governance structure and serve as a model of proper corporate governance structure. The Committee, therefore, has endeavored to focus on the practical application of the Code. At the same time, the Committee has fully attempted to take into consideration the unique managerial circumstances faced by Korean corporations, and also to include in the Code internationally accepted principles and standards governing practices for corporations. The Committee respects the demands of the present laws and decrees while simultaneously providing a direction for exemplary corporate governance systems from a future-oriented perspective.

The Committee, however, admits that this Code may have shortcomings stemming largely from the short preparatory period allotted of six months. Also, the Code of Best Practices is evolutionary in nature and should be reviewed in light of changes in circumstances.

Lastly, the Committee expresses its gratitude to all those who participated directly or indirectly
in the making of this Code. Special gratitude is extended to the dedicated efforts of the Committee members, advisors and secretariat. Similarly, much gratitude is extended to former Committee members who resigned before this Code’s completion. Financial backing of the Committee has been provided by the Korea Stock Exchange, Korea Securities Dealers Association, Korea Listed Companies Association and Korea Investment Trust Companies Association. Their support is sincerely appreciated.

September 1999

Jae-Chul Kim
TABLE OF CONTENTS

Preamble

I. Shareholders

1. Shareholder’s Rights
2. Equitable Treatment of Shareholders
3. Shareholder Responsibilities

II. Board of Directors

1. Functions of the Board of Directors
2. Composition of the Board of Directors
3. Appointment of Directors
4. Outside Directors
5. Operation of the Board
6. Committees of the Board
7. Duties of Directors
8. Responsibilities of Directors
9. Evaluation and Compensation

III. Audit Systems

1. Internal Audit Systems
2. External Auditors

IV. Stakeholders

1. Protection of Rights of Stakeholders
2. Stakeholders' Participation in Monitoring Management

V. Monitoring Management by the Market

1. Market for Corporate Control
2. Disclosure

Recommendations to the Government and Relevant Organizations
Preamble

Background

Corporations are the entities that create new economic value. Therefore, the competitiveness of businesses is crucial in determining the competitiveness of a country. As such, countries the world over are in pursuit of introducing competitive measures and practices according to international compatibility. Such measures include liberalizing capital movement and increasing the interaction between states to raise managerial efficiency, and hence, the competitiveness of corporations of their respective nationality.

With the dawning of a new millennium, Korean corporations must also take progressive and proactive measures towards meeting the global trend to survive international competition. A faultless corporate governance system is a major factor in making investment decisions in the globalized capital market. For corporations to procure long-term funds under a blanket of stability, a governance structure acknowledged internationally is a must. In response to these demands of the present era, the Committee enacts this Code to present a direction for better corporate governance that will render our companies more credible, domestically and internationally, and enhance the transparency and efficiency of management.

Purpose

The purpose of the Code is to maximize corporate value by enhancing the transparency and efficiency of corporations for the future.

To gain the trust of shareholders and interested parties, the corporation must operate a transparent and reliable management. Based on such corporate transparency and reliable management, a managerial system that promotes creative and progressive entrepreneurship must be established.

There are diverse stakeholders within a corporation. The corporation must decrease the burden of cost of mediating their interests; this must be achieved through rational and fair means to strengthen the corporation’s competitiveness. Also, for the corporation’s long-term development, its members should make every effort to become socially responsible under a strict sense of morality.

Contents and Structure of the Code

The Committee has tried, at the same time, to take into consideration the special managerial circumstances that Korean corporations face, while also trying to include internationally accepted principles and standards in the Code. Also, the Committee respects the demands of the present laws and decrees while simultaneously providing a direction for exemplary corporate governance systems from a forward-looking perspective.

The contents of the Code consist of five sections that are Shareholders, Board of Directors, Audit Systems, Stakeholders, and Management Monitoring by the Market and Recommendations to the Government and Relevant Organizations. For each section, the code is presented, along with appended notes to aid understanding.
Application of the Code

This Code applies to listed companies and other public companies. However, it is strongly advisable for non-public enterprises to also follow the Code to the extent applicable.

The circumstances surrounding each corporation are different from others and are also continuously changing; therefore, a corporate governance system should be flexible and elastic. Corporations should, with the Code as its basis, voluntarily plan and operate their own corporate governance system and continuously upgrade it with ongoing evaluations. This Code should also be reviewed regularly according to changing circumstances.

Background for the Revision of the Code

The Code published in September 1999 has served as a benchmark for the revision of laws and regulations relating to corporate governance. Through the voluntary efforts of the corporations, which used the Code as a guiding principle, and all spheres of social activities, the investor confidence and management transparency of the corporations have improved significantly, and the market participants’ interest in corporate governance has grown substantially.

The revision of the Code stemmed from the changing circumstances of corporate governance, which set off the on-going global discussions, and the reform of governance systems in many countries. Over the years, some corporations voluntarily introduced changes in their corporate governance system, and it was recognized that the original Code was somewhat inadequate in outlining the course of actions required for improving corporate governance. It has also been pointed out that the investment risks associated with poor corporate governance remain as one of the main causes that keep the Korean stocks undervalued. Then, the recently revealed large-scale accounting frauds in the United States served as an impetus for many countries to introduce new regulations concerning the reform of corporate accounting and governance systems and for the securities markets to strengthen the listing regulations pertaining to corporate governance.

Accordingly, the Committee amended the Code in order to make it more realistic, particularly in the context of the Korean situation, and compatible with global standards. In the future, the Committee will make continuous efforts to update and enhance the Code.
I. Shareholders

- Shareholder’s right should be protected, and shareholders should be able to exercise their rights through appropriate procedures.
- Shareholders should be treated equitably under the principle of shareholder equality.
- Controlling shareholders should take the corresponding responsibilities when they exercise any influence toward corporate management other than the exercise of voting rights.

1. Shareholder’s Rights

☐ Shareholders should receive all necessary information prior to exercising their rights, and should be able to exercise their rights through appropriate procedures.

1.1 Shareholders, as owners of a corporation, should have the basic rights including the following:

- the right to participate in profit sharing;
- the right both to attend and to vote at general meeting of shareholders; and
- the right to obtain relevant corporate information in a timely and regular manner.

As owners of a corporation, the basic rights of shareholders should not be taken away or restricted even through the articles of incorporation or the resolutions of the general shareholders’ meetings or the board of directors. Shareholders may participate in the corporation’s profit sharing and hold residual claims, and also hold the right to attend the general meetings of shareholders and exercise their voting rights. Also, shareholders hold the right to receive sufficient corporate information, which are necessary to exercise their rights; and the corporation must faithfully provide, barring any justifiable reason, any information requested by shareholders.

1.2 The following matters, which bring about fundamental changes in the existence of a corporation and the shareholder’s rights, should be determined at the general meeting of shareholders in a way that would result in the maximum protection of the shareholder’s right:

- Amendments to the articles of incorporation;
- M&A, business transfer and split-off;
- Dissolution;
- Capital reduction;
- All-inclusive exchange and transfer of shares, and others.

When making decision concerning corporate governance, such as M&A, business transfer, corporate split-off, all-inclusive exchange and transfer of shares, etc., it is necessary to reinforce practical measures that protect the minority shareholders and the shareholders who oppose the proposals,

In addition to the matters that require resolutions at the general meetings of shareholders under the existing laws and regulations, it is highly desirable that shareholders be allowed to make
independent decisions on issues which carry weighty influence on the corporation’s very existence and the rights of shareholders.

1.3 Resolutions at the general meeting of shareholders should be made through transparent and fair proceedings. Also, shareholders should receive sufficient prior notice including the time, location and agenda of the meeting; such time and location should be set so as to allow maximum number of shareholder participation.

Information should be provided to shareholders so that sufficient review of the agenda may be made prior to the general shareholders’ meeting. Previously, the amount and distribution of information provided to shareholders was limited due to the burden placed on the corporation. It is, however, now possible for corporations to provide large amounts of information at minimal cost through the internet and other electronic communication means; therefore, sufficient information on the meeting’s agenda should be provided to the shareholders. Also, the time and location of the meeting should be set such that shareholder attendance can be facilitated. Most notably, the number of minority shareholders holding shares of several different corporations has recently been on the rise; therefore, holding general shareholders meetings at different times would be judicious to maximize minority shareholder attendance.

1.4 Shareholders may submit items for the meeting agenda to the board of directors; they may question and demand explanation on the agenda items at the meetings. The corporation should ensure that shareholders’ opinions are sufficiently reflected at the general meeting of shareholders.

With the exception of cases where there is an intent to disrupt the meeting, where the same question is repeatedly asked or an unreasonable question is asked, the shareholders should be given sufficient opportunities for question and explanation before voting on an agenda item at the general meeting of shareholders.

1.5 Shareholders should be able to exercise their voting rights, either directly or indirectly, in the most convenient manner possible.

The exercise of voting rights, either through direct or indirect means, has the following two implications: First, with regard to the person who exercises the voting right, a shareholder may exercise his/her voting right by participating, in person, in the general meeting of shareholders or by indirect means of a proxy. Second, with regard to the method of exercising the voting right, a shareholder may exercise his/her voting right directly by participating and voting in the general meeting of shareholders or by written ballot.

In light of the rapid advancement in electronic communications and the growing number of foreign and minority shareholders, it is highly desirable that listed corporations make available the agenda and relevant information of the general meeting of shareholders through electronic means or ensure availability of the agenda and relevant information required for exercising the voting rights by posting such information on the Internet. Furthermore, listed corporations should make it easy for shareholders to exercise their voting rights by actively encouraging the use of ballot through such electronic means.

2. Equitable Treatment of Shareholders

☐ Shareholders should hold fair voting rights according to the type and number of shares owned, and all shareholders should have the equal right to corporate information.
2.1 Shareholders should hold the right to one vote per share, and there should be no infringement on shareholders’ basic rights. However, restriction on the voting rights of specified shareholders should be accomplished in accordance with the law.

The current Commercial Code recognizes one vote for each share for all shareholders, and the voting right of shareholders is an inherent right, which, in principle, no person can restrict.

However, the Commercial Code and certain statutes recognize, as an exception, placement of restrictions on the voting rights of specified shareholders. Such restriction is necessary and justifiable as a preventative measure against the occurrences of adverse effects that may result from unrestricted exercise of voting rights by controlling shareholders.

With large corporations expanding into the financial industry, including investment trust business, and with the scale of investment by financial institutions in stocks and corporate bonds on the rise, the large corporation’s grip on power on other corporations is similarly on the increase. To prevent any adverse effect from this development, therefore, a new form of voting right restriction should be introduced, if considered justified.

2.2 Shareholders should be able to obtain all necessary and timely information from the listed corporations, both in sufficient quantity and without partiality. and even with regard to information whose disclosure is not required by the regulations, the listed corporation should make such information available to all shareholders equally, without preference.

Shareholders need to be informed continually---aside from those matters disclosed regularly---of corporate matters which may have influence on its stock value. The corporation, therefore, should make every effort to provide as much information to all shareholders impartially. In particular, the corporation should disclose such information presented at its investor relations conference to those absent shareholders and other retail investors.

2.3 Shareholders should be protected from unfair conducts of insider trading and self-dealing.

The management or shareholders must not engage in insider trading or self-dealing with the intent of personal gains. Particularly, self-dealing must be dealt within reasonable bounds keeping moral obligation by the management. The corporation should be equipped with an internal control mechanism to handle insider trading and self-dealing, and the details of such transactions should be disclosed through fair means.

3. Shareholder Responsibilities

☐ Shareholders should make every effort to exercise their voting rights. Controlling shareholders, aside from exercising their voting rights accorded to the shares owned, should take the corresponding responsibility when they exercise influence over corporate management.

3.1 Shareholders, understanding that the exercise of their voting rights has influence on corporate management, should make every effort to exercise their voting rights for the corporation’s best interests.
The shareholders’ exercise of voting rights is a freedom of choice. For the sound and transparent management of the corporation, however, a general shareholder must take serious interest in the management of the corporation and make every effort to exercise his/her given rights, such as exercising the voting rights.

3.2 Controlling shareholders wielding influence on corporate management must act in the best interests of the corporation and all its shareholders. For any action running counter to such, the controlling shareholders must bear all corresponding responsibility.

The controlling shareholder is one, regardless of his shareholding ratio, who exercises *de facto* influence over major matters involving corporate management, such as appointment and dismissal of management.

The responsibility of running the corporation lies with its directors and management. In truth, however, it is difficult for such directors to completely reject the unequal power yielded by the controlling shareholder so long as he possesses influence over the selection of directors. Therefore, controlling shareholders---aside from exercising their voting rights on shares possessed or from directly participating in the corporate management as directors---should accept responsibilities for their power yielded, corresponding to the influence exercised on the corporate management using their vantage position.

Any unjustified intervention in management by the controlling shareholder, contrary to the interests of the corporation, may be controlled through strengthening managerial accountability of directors and/or effective utilization of the outside director system. However, in cases where a controlling shareholder exerts influence on the management through means other than the exercise of voting rights or participation in management as a director, the said controlling shareholder must take the corresponding responsibility. Moreover, listed corporations must safeguard the exercise of rights by minority shareholders in order to prevent abuse of power by a controlling shareholder.
II. Board of Directors

- The Board of Directors (hereinafter the “Board”) should establish the business objectives and strategies and supervise the activities of the directors and management.

- The directors and the Board should perform their duties faithfully in the best interests of the corporation and its shareholders; they should also fulfill their social responsibilities and take into account the interests of various stakeholders.

- The Board should observe the related statutes and the articles of incorporation when executing its responsibilities and ensure that all members of the corporation also observe them.

1. Functions of the Board of Directors

☐ The Board must establish the business objectives and strategies in the best interests of the corporation and its shareholders, and effectively supervise the activities of the directors and management.

1.1 The Board should have the overall authority over corporate management and perform the following decision-making and supervisory functions:

<Major Functions>
- Establishment of business goals and strategies;
- Appointment and dismissal of management and supervision thereof; and
- Assessment of management performance and determination of remuneration level.

<Specific Functions>
- Approval of business plans and budgets;
- Approval of large capital expenditure;
- Approval of large borrowing and payment guarantee;
- Approval of provision of large collateral and lending;
- Approval of material matters relating to acquisition and merger of business;
- Approval of establishment, relocation or close of business office;
- Supervision of compliance with laws, regulations and codes of conduct and ethics;
- Supervision of accounting and financial reporting system;
- Supervision of risk management and financial control;
- Supervision of disclosure of corporate information; and
- Evaluation of effectiveness of the corporate governance system and others and improvement thereof.

Under the current corporate structure, the Board is central to the management and operation of a corporation. Accordingly, a Board, which functions effectively and efficiently, is essential for the containment and monitoring of self-serving management practices by the executives or controlling shareholder, as well as for the protection of the interested parties such as minority shareholders by averting corporate insolvency. For this reason, it is necessary to clearly state the Board’s functions and responsibilities, particularly with regard to corporate decision-making and management supervision, and remind the Board of its role within the corporate governance system.
1.2 The Board may delegate its authority to the committees within the Board (hereinafter referred to as “the Board’s committees”) or the representative director. Excluded, however, are key matters as stated in the articles of incorporation and the regulation on operation of board of directors.

In recent years, management of many corporations, particularly the large-sized corporations, has become highly specialized and task-oriented. Thus, it is no longer practical to conduct all corporate affairs through occasional meetings of all board members. Furthermore, as the number of outside directors increases rapidly, it has become rather difficult to hold Board meetings frequently.

Therefore, in order to reinforce its functions and to effectively execute its responsibilities within the corporate governance system, the Board should be able to delegate part of its functions to the representative director or the Board’s committees, provided that such delegation does not violate the laws and regulations. For instance, it is advisable that the Board engage itself mainly with making important policy decisions and delegate most minor or routine matters to the representative director or management, or that the Board establish internal committees and delegate part of its authority to them.

The Board’s committees should be composed of directors with expertise and interest in the area concerned, and partake in accomplishing the work of the Board. Such division of labor contributes to the improved effectiveness and professionalism in carrying out the Board’s responsibility, while effectively overseeing the management.

2. Composition of the Board of Directors

☐ The Board should be composed so as to facilitate effective decision-making and supervision of management.

2.1 The number of directors should be sufficient enough to facilitate meaningful discussions and appropriate, swift and prudent decision-making. For large listed corporations, it is highly advisable that the number of directors on the Board be large enough to effectively utilize several committees.

The appropriate number of directors varies according to the different circumstances of corporations. Many different factors may influence the Board’s size, including the corporation’s size and the business environment and characteristics. Nevertheless, the Board’s size should be such that it allows the discussions to be fruitful and the decisions to be appropriate, swift and prudent. A large-scale listed corporation is one having a total asset value of more than one trillion Korean won.

2.2 The Board should include outside directors who are in a position to carry out their responsibilities independently from the management, controlling shareholders and the corporation. The number of outside directors should be a minimum of two, so that the Board is able to maintain practical independence. Particularly, in the case of large listed corporations, it is recommended that half of its directors be composed of outside directors (minimum of three outside directors). However, a large listed controlled company of which more than 50% of the voting power is held by an individual, a group or another company (refers to a company of which more than 50% of voting power is held by individuals or a group.), does not need to have a majority of its board composed of outside directors.
The most important role of the outside directors is to enable the Board to perform its management supervisory functions effectively. When compared with inside directors, outside directors hold an independent position from the management and controlling shareholders. Therefore, they can be more effective in monitoring management actions and providing impartial counsel.

In order for outside directors to effectively carry out their responsibilities, it is important to establish a Board comprised of a sufficient number of outside directors, so that they would be able to exert meaningful influence on the decision-making process of the Board. Therefore, the proportion of outside directors should be at the level where the Board would be able to maintain actual independence from the management and the controlling shareholders while exercising authority over management decisions.

In case of a controlled listed company, which does not need to have a majority of outside directors on its board, the fact that it is a controlled company and the basis for that determination must be clearly stated in its annual report. Furthermore, the reason for excluding the controlled companies within a business group by limiting the companies specified in the above paragraph to those of which more than 50% of the voting power is held by individuals or a group, is that even if they are controlled by another company, the governance transparency of the controlled companies within a business group needs to be assured as does the case of other uncontrolled listed companies.

2.3 For a large listed corporation, it is advisable to appoint a person who is not a representative of management (i.e., chief executive officer) as chair of the board of directors (hereinafter referred to as “the chair of the board”). In the case where this recommendation cannot be accepted, it is desirable to elect an outside director who is in a position to act as a representative for other outsider directors.

In view of the board’s supervisory role in overseeing management, separation of the chair of the board from the representative of management could bring useful effects. An independent appointment is also recommended because the checks and balance between the board and the management often contributes to the enhanced corporate performance. In cases where both positions are held by a single individual, a lead director who is able to play a central role in accomplishing responsibilities of outside directors should be appointed, and the name of the lead director disclosed. Among others, the lead director should preside over the meetings of outsider directors, and should consolidate and coordinate the different positions of outside directors.

3. Appointment of Directors

- Directors should be appointed through a transparent process, which reflects the diverse opinions of shareholders.

3.1 It is advised that a committee be established and managed to ensure the fairness and independence of the nomination process.

Directors appointed by the controlling shareholders or the chief executive officer are greatly influenced by those who appointed them, thereby raising concerns that their obligation of fairly executing duties as the managing agent of all the shareholders may be compromised. Therefore, to maintain the independence of directors, there should be an established procedure for
appointing directors that broadly reflects the diverse opinions of shareholders.

For this purpose, there is a need to thoroughly examine the adoption of a nomination committee system that facilitates impartial nomination of candidates for positions of director. This committee would be comprised of a majority of outside directors who would nominate the candidates.

3.2 The opinions of shareholders other than the controlling shareholder should also be reflected when appointing directors. For this purpose, it is recommended that a cumulative voting system be adopted and the status of the adoption disclosed.

In the process of nominating and appointing directors, the opinions of general shareholders should also be reflected. If such a process is not improved, it would be difficult to expect directors---not just standing but also outside directors---to retain actual independence regardless of how much the requirements and qualification for outside directors are strengthened.

It would therefore be best to adopt the cumulative voting system, not just to ensure the independence of directors or to reflect the shareholder’s diverse opinions when appointing directors, but also to restrict the significant influence that controlling shareholders exert on the management. To encourage adoption of this system, disclosure of whether such has been adopted by the corporation should be made compulsory.

3.3 The Board should make concrete contribution to corporate management by appointing competent individuals with professional expertise as directors, and the appointed directors’ term of office should be respected.

In order to perform its functions dutifully and to make concrete contribution to the corporate management, the board must be composed of the directors who are competent and knowledgeable in their fields. Such directors refer to those possessing the following qualities: a vision for and a strategic perception of corporate management; a level-headed and sound managerial judgment; an ability for managing and supervising the organization; a knowledge of law and finance; and some experience appropriate for the corporation concerned.

On the other hand, the term of office for the director---appointed through due process at a general shareholders’ meeting---should be respected so that his functions as managing agent for all shareholders may be performed dutifully. The exceptions are the following: the director is found liable for any illegal act; gross violation is made of the statutes or the articles of incorporation; or the director is deemed inept for office.

3.4 The corporation should disclose information about the nominees for directors prior to the general meeting of shareholders, and ensure that the shareholders are able to exercise their voting rights on the basis of appropriate information.

If the nominated directors, following the Board’s decision, are not disclosed prior to the general shareholders’ meeting, shareholders will not have sufficient prior information on the nominees, rendering the meeting a mere formality. Therefore, any such information (e.g., personal profile) should be disclosed beforehand, as it may aid the exercise of the shareholders’ voting rights and contribute to selecting competent directors.

In terms of the disclosure method, with the utilization of the timely disclosure media, it is necessary to facilitate easy access to information for shareholders, and to alleviate the corporation’s difficulties in having to finalize the nominees at the time of calling the general
meeting of shareholders.

The information on the nominees should be disclosed at least two weeks before convening the general meeting of shareholders, thus affording shareholders a minimum amount of time to assess the information. Furthermore, when intending to make an appointment upon receiving nominations by minority shareholders, it is recommended, by stating clearly such intention in the notification and agenda of the general meeting of shareholders, to receive the minority shareholders’ nomination and to disclose the information about the minority shareholders’ nominees before the general meeting.

4. Outside Directors

Outside directors should be able to independently participate in important corporate management decision-making, and to supervise and support the management as a Board member.

4.1 An outside director should be a person who is in a position to make decisions independently from the management, controlling shareholders and corporation.

An outside director should not have material relationship with the concerned corporation. A person with material relationship refers to a person who is under a contractual agreement and/or is doing business with the concerned companies, including a controlling shareholder and related parties of the concerned company. Examples of material relationships that present difficulties in appointing an individual as an outside director are:

- A former officer or staff of the concerned corporation who has retired from or left the corporation less than 5 years ago;
- A former or current employee and associate of an external audit company or its affiliates, who has audited or performed the work relating to auditing of the concerned corporation within the past 5 years;
- An employee or officer of a company to which an employee or officer of the concerned corporation serves as an outside director; and
- Related parties of the persons specified above.

4.2 Upon accepting the offer of appointment as a board member, an outside director must submit a written confirmation to the concerned corporation that he/she is not involved in any material relationship with the corporation, and the corporation must disclose the fact that the newly appointed outside director has no material relationship with it.

The outside director system has been introduced to strengthen the supervisory and advisory functions of the board. Therefore, outside directors should be independent from the management or controlling shareholders.

To ensure independence of outside directors, disclosures must be made concerning any interest held by the candidate at the appointment stage. For this purpose, accepting the offer, the outside director should submit a letter of confirmation, which the corporation should disclose, stating that he holds no interests that might impair him/her from performing duties impartially and independently from the corporation, management, and the controlling shareholder.

Even if there is no cause for concern in the likelihood of the outside director’s impartiality being
impaired, if there exists other interests he should state such information in a letter of confirmation and disclose it. Also, should there be any change in the information stated in the letter following inauguration into office, the outside director should immediately submit a corrected letter, which the corporation should disclose.

4.3 The corporation should provide outside directors with information necessary to perform duties as early as possible and without delay to allow accurate assessment of the corporation’s managerial situation. Particularly, when a Board meeting is to be convened, information should be provided beforehand so that the director may sufficiently review the agenda. Also, the outside director may request information necessary for performing duties to be provided promptly. Concerning confidential information of the corporation, however, it should be provided only at the request of the majority of outside directors, to which the management, barring any justifiable reason, should comply.

For the outside director to perform his role effectively, he must receive sufficient information concerning business plans or the corporation’s managerial situation. Therefore, management, including its head, must provide to outside directors any necessary information, sufficiently and timely, so that they may accurately assess the corporation’s managerial situation. Particularly, when a Board meeting is to be convened, the related information on the pending agenda should be provided to the outside directors to allow prior review.

An outside director should be given easy access to necessary information in order to make suggestions on the management’s objectives or the corporation’s strategic decisions. For this purpose, the outside director should be able to request information from anyone in the corporation. But to prevent leakage and abuse of confidential information, information should be provided at the request of the majority of outside directors, of which the chief executive officer and the management should comply, barring any justifiable reason. Also, it is desirable for the corporation to designate a division to oversee such matters and to effectively respond to any request for information by outside directors.

4.4 Outside directors should allot sufficient time towards performing their duties, and should review all related information before attending a Board meeting. Outside directors should listen to the opinions of shareholders and should make every effort to acquire information from various sources within and outside the corporation.

Outside directors should, in performing their duties, collect and review sufficient information on the agenda up for decision-making and make every effort to make the best decision in the interests of the corporation. For this, the outside director should allot sufficient time towards performing his duties, attending all Board meetings, and reviewing the material provided carefully. If the material proves insufficient, the outside director should collect the necessary material himself/herself and review them, e.g., reading the account books or related documents.

Also, in order to minimize the risk of management failure through compiling diverse opinions concerning the corporate management, outside directors should make every effort to obtain necessary information from diverse sources within and outside the corporation, including shareholders.

4.5 When necessary, outside directors may seek the assistance of executives, employees of the corporation or outside experts through due processes, and the corporation should cover the expenses involved in securing such assistance.

An outside director should, if necessary, be able to seek through due process the assistance or
advice of the executives and employees of the corporation or the outside professionals such as external auditors, legal advisors and others. In such cases, the corporation should cover any expenses incurred in obtaining such assistance or advice, provided that the expenses are justifiable and reasonable.

4.6 To reinforce the outside director’s management supervision and supporting functions, it is recommended that a regular meeting of outside directors be held separately from the board meetings. However, care should be taken so that such separate outside directors’ meetings are not abused as meetings where no records are maintained at Board. Moreover, outside directors and the management should make every effort to arrange opportunities for regular discussions on managerial issues.

In order to ensure that the outside director system, which has been introduced to increase the transparency of corporate management, is firmly rooted in the Korean business culture and achieves its intended goals, it is necessary to employ practical and specific implementation methods.

For this purpose, a system of cooperation among outside directors must first be established. Meetings for only outside directors should be held regularly; and a representative among the outside directors should be elected to convene the meetings and/or to take care of important matters that are delegated by the outside directors. It should be noted that the outside directors must disclose the name of their representative who convenes the meeting of outside directors and the election method of a representative outside director.

Outside directors and the management should make every effort to have opportunities for regular discussions on matters concerning management. Through regular contacts with management, outside directors would be better able to manage the Board by clearly grasping the managerial situation; management, on the other hand, would be able to gain the understanding and cooperation of outside directors on matters concerning corporate management.

5. Operation of the Board

☐ The Board should be operated efficiently and rationally to ensure that the management decisions are made in the best interests of the corporation and shareholders.

5.1 The Board meetings should, in principle, be held regularly, at least once every quarter.

To convene a Board meeting, prior notification of its date and time should be made to each director. The meeting, however, can be held at any time without effecting such a procedure, given the unanimous consent of the directors and auditors. Their unanimous consent is not required each time a meeting is held: the schedule of the Board meetings can be stated in the Board Operating Regulations, or the date and time for next meeting can be decided with the consent of the full Board, thereby allowing meetings to be held without notification.

If the majority of directors are outside directors having other principal occupation, then the Board meeting could be run more efficiently if the management provided reports on important matters to the outside directors in advance and set beforehand the venue for the meeting where directors would be able to present their opinions.

There are significant differences in the issues and the actual role that the Board meeting plays in each corporation; therefore, it is difficult to decide on a uniform standard for the frequency of
such meetings. But since the Board itself must vote on important matters concerning corporate management, Board meetings should be held regularly, a minimum once every quarter, and special meetings held whenever necessary.

5.2 To efficiently operate the Board, the regulation on operation of board of directors should be established so that the Board’s rights and responsibilities, along with the operational procedures are specifically stated.

Because the Board is composed of various standing and outside directors, without clearly established principles and procedures, conflicts and misunderstandings could occur in the processes of Board operation. To avoid such occurrence and to ensure effective operation of the Board, each corporation should have the established the regulation on operation of board of directors that comprehensively stipulates all matters related to the operation of the Board. The regulations should state the rights and authority, composition and operational procedures of the Board, and the Board must operate in accordance with such regulations.

5.3 The Board should prepare the minutes or record on tape the proceedings of its meeting each time. The minutes should state important discussion topics and resolutions as detailedly and clearly as possible. The minutes and audio recordings of the Board should be maintained and stored.

To put reasonable pressure on the Board maintaining accountability, it is important that detailed and exact records of the Board’s discussions and resolutions, along with the voting records and statements of individual directors, be kept.

Therefore, it is necessary for the corporation to keep the independent detailed minutes of the proceedings or audio recordings of the entire meeting. The minutes or audio recordings should be kept for every Board meeting, along with clear and detailed records of important discussions and voting by each speaker, and the minute must be signed by each director. Also, these records should be maintained and stored, thus serving as important pieces of evidence should problems concerning directors’ accountability arise at a later date.

5.4 It is recommended that the scope of disclosure relating to the individual director’s conduct within the board activities be expanded. The specifics of disclosure to be expanded include the attendance and voting records of each director.

It is anticipated that the disclosure of specific conducts of individual directors would greatly contribute to the activation of the Board. Additionally, the disclosed information can effectively be used as resource materials for external assessment of the board members. By disclosing the conduct of directors, they are more likely to make decisions and vote after taking into account the consequences of their decision on their reputation.

6. Committees of the Board

☐ For the Board to function effectively, it is recommended that the Board establish committees comprised of select members of the directors.

6.1 It is advised that internal committees be established to accomplish specific functions and responsibilities of the Board.

It is unreasonable for the full Board to convene on all occasions for handling corporate matters.
Particularly with the sharp increase in the number of outside directors, it has become more difficult to convene a Board meeting frequently. Also, considering the size of the Board or the limited length of the meetings, it is not easy to achieve sufficient discussion and to arrive at a satisfactory resolution during meetings.

Therefore, it is necessary to have a system where matters that arise periodically or require in depth discussions can be referred to the relevant thematic committees of the board, which are comprised of the board members who have relevant expertise and interests, so that such matters can be reviewed and examined thoroughly. Through operation of such board committees, the board would be able to enhance the effectiveness and specialization in executing its responsibilities.

6.2 It is advised that the Board establish an audit committee, nomination committee and compensation committee. In the case of large listed corporations, they are required to establish these committees. Although this recommendation is not applied to the large controlled listed corporations specified in 2.2, such listed corporations must establish an independent audit committee.

The audit committee oversees and ensures that the management performs its responsibilities in an appropriate manner and in accordance with the laws and regulations.

The nomination committee recommends the candidates for the positions of CEO and the director nominees for the general meetings of shareholders, and upon the request of the board, it also makes nominations for the members of the board committees. Accordingly, the nomination committee replaces the existing nomination committee of outside directors. Furthermore, the nomination committee should take a lead role in guiding the corporation to adopt the Code of Best Practices for Corporate Governance

The compensation committee reviews and evaluates the management performance against the management goals, and sets the appropriate compensation level for the management on the basis of such evaluation.

6.3 A majority of the nomination committee must be comprised of outside directors and the compensation committee must be comprised entirely of outside directors.

The most important function of the nomination committee is to recognize and recommend an inside director who is most qualified and to identify a potential outside director who is independent and has appropriate expertise. Accordingly, joint efforts of the inside directors, who have in-depth knowledge about the business circumstances of the corporation, and the independent outside director would maximize the effectiveness of the nomination committee. Here, in order to maintain independence, the number of outside directors on the committee should be of a size that allows outside directors to take a lead role. Therefore, the nomination committee should be comprised of a majority outside director, and an outside director should be appointed as the chair of the committee.

One of the requirements that is essential for the compensation committee in making an impartial evaluation of the management and setting an appropriate compensation level thereof is independence from the management that is being evaluated. Therefore, the compensation committee should be comprised entirely of outside directors.

An outside director may, if it is unavoidable, serve more than one committee, but it is highly recommended that such a case be avoided if possible.
6.4 The committee’s resolution on a matter that was delegated by the Board should hold the same effect as the Board’s resolution, and the committee must report such resolution to the Board and submit to the Board an annual report of the committee’s activities. Furthermore, all matters relating to the structure, operation and rights of the committee must be stipulated as a regulation.

In the case where the Board establishes committees, it is general practice that the Board carries out those tasks that mandate its direct attention in accordance with the laws and regulations, and delegates other matters to its committees. Accordingly, in the cases where the Board has delegated parts of its rights to its committees, which undertake the tasks on behalf of the Board, the committees should be given full authority to carry out their functions by recognizing the resolutions of the committee as having the same effect as that of the Board.

The board committees must establish the regulations that clearly articulate their structures, operation and powers, and among others, such regulations must stipulate the following matters:

- Purpose of the committee;
- Objectives and responsibilities of the committee;
- Annual assessment of accomplishment of the committee; and
- Qualifications of the committee members, appointment and dismissal of the committee members, structure of the committee and reporting to the board.

7. Duties of Directors

 Directors should perform their duties fairly, with prudence and faithfulness, while being impartial to all shareholders, in the best interests of the corporation and its shareholders.  

7.1 Directors should, in performing their duties, do their utmost to observe the duties of prudence and faithfulness expected of a proper manager. Directors, as heads of corporate management, should at all times seek results that would be in the best interests of the corporation and its shareholders.

Directors, according to the main purpose of entrustment as stewards, should perform their duties with prudence of a proper manager. Directors should review various materials with care and should attend all Board meetings, and if needed, receive the advice of specialists before attending.

A director may pose necessary questions and present opinions to the management on corporate operations. Also, if required, he/she may request advice from external auditors and outside specialists. In performing the duties, the director should always be careful to ensure that no laws are violated by the corporation or himself/herself.

7.2 Directors should faithfully perform their duty of loyalty toward the corporation and shareholders. Directors shall not exercise their authority for their own benefit or that of a third party, and shall place the interests of the corporation and shareholders before themselves.

The duty of loyalty particularly applies when a conflict of interest arises between the corporation and the director, or when a certain opportunity may be used by both. When the
director---as a party of the corporation, directly or indirectly---has any economic or personal gain in a contract or other transaction, or when he/she plans to engage in a transaction which is in competition with the corporation, then such director is considered as having an interest.

In such cases, the director should act with the interests of the corporation before himself/herself. When a conflict arises for the director having interests in a transaction or contract, he/she should clearly disclose such interests and related important information to the Board, and also should receive the approval of a director having no such interests.

7.3 Directors, in accordance with performing their duties, should not divulge or use, for their own or third parties’ benefit, any corporate secret obtained.

A director must keep confidentiality of important matters of the corporation that he/she has acquired in the process of performing his/her duties. He/She shall not openly discuss confidential matters, and he/she shall ensure that a third party does not reveal such information. Also, the director should not use corporate secrets for his/her own gain or that of a third party. The use of corporate secrets by a director, even if it bears no financial harm to the corporation, may erode confidence in the corporation or may incur losses on the part of shareholders and creditors; therefore, it should be prohibited.

8. Responsibilities of Directors

☐ When a director has violated the law or the articles of incorporation, or has neglected his/her duties, he/she should be liable for damages to the corporation or a third party. But managerial decisions of the director which were made following due processes and on the basis of faithful and rational judgments, must be respected.

8.1 When a director has violated the law or the articles of incorporation, or has neglected his/her duties, he/she may be liable for damages to the corporation. If there was malicious intent or gross negligence on the part of the director, he/she may also be liable for damages to a third party.

A director shall observe the law and the articles of incorporation in performing his/her duties, and shall not be negligent in his/her duties. If a director does not perform his/her duties properly, he/she may not be reappointed or may even be dismissed. These measures alone, however, do not ensure effectively the proper performance of duties by the director, and also do not make up for losses already incurred to the corporation and third party. An effective means of securing proper performance of duties by the director is to hold him/her materially accountable, that is, in proportional terms.

8.2 If the director, in the process of making a managerial decision, has collected and sufficiently reviewed with care a significant amount of reliable material and information, and has then performed his/her duties---according to his/her faithful and reasonable judgment---using means deemed to be in the best interests of the corporation, then such decision shall be respected.

Managing a corporation is very complicated, requiring technical knowledge. Therefore, it is almost impossible, and inappropriate, to hold one accountable for damages by determining any existence of negligence based on examination of ex post results. Directors may perform their duty with conviction only if actions made within their capacity, based on reasonable judgment, are respected.
The United States recognizes the business judgment rule in relation to limiting responsibilities. There are two major reasons why this principle was applied to directors. First, if the director has committed an act, although considered wrong, with all due faithfulness and prudence, he/she shall be exempted from any responsibility, thereby enabling him/her to maintain his/her adventurous yet entrepreneurial spirit. Second, it is not appropriate for the court of law, as a non-professional in the field of management, to directly intervene in business judgments of directors.

Generally, the business judgment rule is only applied with respect to the following cases: The director shall make active business judgments concerning operations of the corporation, and he/she shall not have any interests on matters needing business judgment. He/She shall, in the process of making a business judgment, make decisions only after collecting and reviewing---sufficiently and carefully---a significant amount of reasonably reliable data and information. Also, the director shall rationally believe that such business judgment is of benefit to the corporation.

Considering that an environment would be created whereby directors could act with conviction and that competent managers could be protected, the business judgment rule shall be adopted. It is difficult to predict results of a corporation’s managerial activities due to changing circumstances. Therefore, the court of law in Korea shall uphold caution when ruling on the question of negligence in the directors’ business judgment.

8.3 The corporation, to effectively hold the directors accountable and to attract competent persons as directors, may purchase, at its own expense, the liability insurances on behalf of directors.

As the size of corporations grows, the amount involved in liability claims on directors is expanding. Therefore, the effectiveness of filing a suit for accountability would decrease if the director lacks sufficient funds. To ensure such effectiveness, liability insurance shall be purchased with a portion of the directors’ remuneration so that compensation can be adequately made for damages to the corporation or third party. Also, to actively recruit those who are competent but reluctant due to the possibility of lawsuits on outside directors, it is recommended that corporations seriously consider purchasing liability insurance for directors.

However, controversy could arise concerning the question of legitimacy in purchasing liability insurance at the corporation’s expense to pay for the director’s liabilities towards the corporation or third party. Therefore, it would be best if the corporation pay for the insurance premiums for liability insurance to supplement for any losses by directors to the extent that no irresponsible business judgment is encouraged.

8.4 The directors must periodically participate in internal and external training programs that are organized to enhance their roles as director. Especially, it is highly recommendable that the newly appointed directors attend an orientation program offered by an independent, external institution that specializes in corporate governance.

The directors must invest sufficient time and efforts in acquiring thorough understanding of their duties and in performing their duties thereafter. Specifically, it is advised that the newly appointed directors attend an orientation program offered by an external institution.

9. Evaluation and Compensation
To promote active performance of duties by the management, outside directors and the Board, their activities should undergo fair evaluation; and the decisions on their remuneration and reappointment should be made on the basis of the outcomes of such evaluation.

9.1 Business activities of the management should be evaluated fairly, and the evaluation results should be reflected appropriately in the remuneration. Specifically, the compensation committee (in case where there is no compensation committee, the Board) should determine the directors’ remuneration, which is within the amount that was approved by the general meeting of shareholders.

The ultimate goal of evaluating the management’s activities lies in increasing the corporation’s business outputs by improving their contribution to the corporation. Therefore, the details of management actions, must be assessed on the basis of impartial evaluation criteria including the business performance and rate of stock price increase, achievement of long-term business goals, compensation levels of other industries in the same industry group, etc. The evaluation results should be used as the basis for determining remuneration and reappointment of the management.

Since remuneration is a compensation for performance, there should be a justifiable and proportional correlation between the remuneration and the position responsibilities. Furthermore, an appropriate level of compensation should be determined while taking into consideration the financial status of the corporation. Especially, the remuneration of the individual director should be determined, in principle, within the amount approved at the general meeting of shareholders by the compensation committee (the Board in case where no compensation committee exists). The compensation committee must submit to the Board a report on the evaluation of the management performance, which was carried out in accordance with the impartial evaluation criteria established in advance.

9.2 Stock options should be granted restrictively to the officers and employees who contribute or are able to contribute to the management performance, and the calculation standard thereof should be rational and impartial. Moreover, to protect the interests of shareholders, it is desirable that the decision on stock options is approved by the general meeting of shareholders, and the details of stock options be disclosed.

It is recommended that stock options be granted selectively to the officers and employees who make contributions or are able to make contributions to the technology development and business performance, and particularly, in the case of the stock options granted to the management, it is desirable to establish a linkage between the granting and exercise schemes and the business performance.

9.3 The activities of an outside director should be evaluated fairly, and the results of the evaluation should be used as the basis for determining remuneration and reappointment of the director. It is advisable to disclose the activities of outside directors.

Outside directors should be evaluated on the basis of their contributions, and the evaluation results should be used as a basis for deciding their remuneration and reappointment. An appropriate level of remuneration for outside directors should be determined by taking into consideration their responsibilities and the risks associated with fulfilling their duties, as well as the efforts and time required for accomplishing them.
Additionally, in order to reinforce the proactive role and supervisory functions of the Board, it is highly desirable for all members of the Board to own the shares of the corporation. Thus, it is recommended that a portion of the directors’ remuneration be paid in a form of stocks or stock options.

It is desirable, through disclosure of the details of the activities and the results of performance evaluation of outside directors, to enhance the shareholders’ ability to make informed decisions and to provide input to the executive search market.

**9.4 Activities of the Board should be evaluated fairly, and it is desirable to disclose the activities and the evaluation results of the Board.**

Regarding the activities of the Board, an internal committee may evaluate the Board and the outcome of the evaluation is presented to the Board for their review. Other methods of assessing performance of the Board include an evaluation by the general meeting of shareholders or through the executive search market. In recent years, it is generally recognized that an assessment through the executive/human resource market is more effective.

Therefore, it is advisable to enhance the ability of shareholders’ to make informed decisions and to provide input to the executive market, by disclosing the activities and the evaluation results of the Board. Disclosure of such information in the annual report is also advisable.
III. Audit Systems

- Audits should be performed by individuals who are independent from the management and controlling shareholders of the corporate being audited and are knowledgeable in auditing.
- Auditors should undertake auditing with sufficient information and devote sufficient time and effort to the task.
- Auditors must not reveal, unless required by law, any confidential corporate information learned while auditing.

1. Internal Audit Systems

- Internal auditing bodies, such as the audit committee and auditors, should perform auditing operations faithfully by maintaining independence from the management and controlling shareholders, and the details of key activities of internal auditing bodies should be disclosed.

1.1 It is desirable that the Board of listed corporations, government-invested institutions and financial institutions establish an audit committee as a board committee. A corporation, which has established an audit committee, should not employ auditors.

An audit committee is expected, through checks and balances, to bring positive results in supervising and supporting the management of large corporations, whose business operations have become complex, and financial institutions whose stakeholders are diverse, so that they may ultimately maximize the corporation’s value. Therefore, it is highly desirable for such corporations as the listed corporations, government-invested institutions, financial institutions and other corporations, which put a greater emphasis on the public nature of the management, to establish an audit committee in the Board.

A corporation that establishes an audit committee should not retain the existing auditor, which is required under the Commercial Code. This is because the dual systems of an auditor and audit committee would place an added burden on the corporation, and considerable inefficiency might result from the overlapping authorities of the two systems.

1.2 An audit committee must be comprised of at least three board members, who preferably are outside directors, or two thirds, including the chair, of the committee must be outside directors. All members of the committee should have basic knowledge in auditing and at least one member must have a professional knowledge in auditing. A corporation without an audit committee should employ at least one standing auditor.

Audit committee should be comprised of at least three persons to perform flexible functions as a meeting. It is desirable that all members of the committee consists of outside directors to maintain the objectivity and independence. However, if it is difficult, two thirds, including the chair, of the committee should be outside directors.

In order for the audit committee to effectively fulfill its functions, the appropriate authority and status must be vested in the committee, so that the committee’s independence would not be
weakened to the level lower than that of an auditor.

Auditing requires expertise. It is not essential for a person who undertakes auditing to have professional knowledge in auditing. However, it is necessary that such person has good understanding of accounting standards, financial report and internal control system, and has sufficient knowledge and experiences to appraise such matters. Therefore, at least one member of the audit committee should have professional knowledge of auditing. Also member of the committee should attend audit-related education program provided by professional institution periodically.

1.3 The audit committee or auditor should, among others, perform the following basic functions:

- To audit the legitimacy of business conducts of the directors and management;
- To audit the soundness and reasonableness of financial transactions of the corporation;
- To examine appropriateness of financial reporting processes and accuracy of financial reports;
- To review the adequacy of major accounting standards as well as the changes in accounting estimates;
- To evaluate the internal control systems;
- To approve the appointment or dismissal of a person in charge of the internal auditing unit;
- To appraise the appropriateness of the functions, structures and budget of the internal audit unit;
- To appraise the performance of the internal audit unit;
- To report on such matters as approval of the appointment and dismissal of an external auditor and report to the general meeting of shareholders thereof;
- To evaluate the auditing activities of external auditors;
- To appraise the independence and appropriateness of non-auditing activities of an external auditor;
- To confirm the follow-up actions taken on the matters to be corrected, which have been recommended by both the internal and external audits;
- To establish audit committee’s statute or audit statute and disclose them; and
- To disclose periodically the details on the committee’s activities and the matters relating to the committee’s independence.

The most important authority and responsibility of the audit committee or auditor are to audit the business conduct of the directors and management. The audit committee or auditor must audit the legitimacy of the conducts of the directors and management. Moreover, in the case where the conducts of the directors and management are clearly improper, the pertinence of the conducts must be audited.

The audit committee or auditor must confirm the quality and reliability of the financial reports. Accurate reporting of financial matters to all interest parties, including the ordinary shareholders as well as the potential shareholders, creditors, employees, government, consumer, etc., is one of the essential responsibilities of a corporation. As inaccurate reporting of financial matters can damage the foundation of a national economic system, the audit committee or auditor, in collaboration with the management, must report the financial matters accurately and faithfully.

Adequacy of the accounting standards adopted by a corporation is the keystone of accurate financial report. Therefore, the audit committee or auditor must assess whether or not the
corporation followed acceptable accounting standards.

Moreover, since accounting changes hinder the continuity of corporate accounting and give rise to confusion to readers of the accounting information, it should be discouraged. The audit committee or auditor, therefore, should examine the appropriateness of the accounting changes, even if such changes are permitted under the accounting standards, and accounting changes should be deterred, unless it is justifiable.

Designing and operating an internal control system is the responsibility of the management, but evaluating its appropriateness and exploring ways for improvement is the duty of the audit committee or auditors. To assess the suitability of the internal control system, the audit committee or auditor must appraise the existence and efficacy of a management system for protecting corporate assets, and should also evaluate whether appropriate safeguards are in place between various internal system units. The audit committee and auditor should, on the basis of such evaluations, seek means of maintaining the appropriateness of the internal control systems.

Since it is not practical for the audit committee or auditor to supervise the entire processes of corporate businesses by itself, it is necessary to establish a special affiliate unit or to receive support of the internal audit unit. In such case, the independence of the employees who perform the task of internal auditing is a prerequisite to securing the effectiveness of an audit operation. It is also desirable to safeguard the independence of the audit committee or auditor by granting the authority to approve the appointment and dismissal of the person in charge of the internal audit unit. In addition, the audit committee or auditor must oversee the capacity of the internal audit unit to efficiently accomplish its objectives, and assess the suitability of the functions, structure and budgets of the unit, as well as the performance of the units, on an ongoing basis. It is advisable to fully conclude the assessment of the internal audit unit by reporting the assessment results to the board of directors.

The audit committee or auditor must also oversee that the staff and the person in charge of the internal audit unit have the necessary independence and expertise. Particularly, it is advised that the audit committee or auditor make a request to the corporation to establish a procedure, which would prevent situations where the staff and the person in charge of the internal audit unit are put under personal disadvantage during the course of their work.

The audit committee or auditor selection committee should approve the appointment or dismissal of external auditor and report such facts to the general meeting of shareholders. Considering the fact that the existing auditor selection committees include major interested parties, the audit committees of corporations with a high debt ratio need to take into consideration the creditors’ opinions when nominating the candidates for external auditor.

The audit committee or auditor must assess whether the external auditor performs his/her duties adequately by dedicating sufficient time and efforts, and determine the remuneration that is sufficient and justifiable for the audit duties. Additionally, a decision on reappointment of an external auditor should be made at a regular interval, on the basis of the outcome of appraisal on his/her independence, etc.

In the case of dismissal or replacement of an external auditor, an opportunity should be given to the concerned external auditor to present his/her opinions to the audit committee or auditor.

Additionally, an external auditor should be deterred from providing non-audit related services, which could undermine his/her independence. If provision of non-audit related service by an
external auditor is required, a prior approval of the audit committee or auditor should be obtained, and it is desirable for the audit committee or auditor to disclose the details of such approvals regularly.

The audit committee and auditor, in the case of material difference of opinion between the management and external auditors, should propose a solution and check if the proposed solution was implemented. Furthermore, the audit committee or auditor should confirm whether major corrective measures indicated by external auditors have been incorporated in the execution of operations.

1.4 The board of directors must clearly stipulate the purpose, structure, authority and responsibility, and tasks of the audit committee and auditor as corporate regulations. Furthermore, the audit committee and auditor must examine the suitability of such regulations annually, and disclose the details of the examination.

Upon establishment of an audit committee, matters relating to the missions, purposes and structure of the committee and the specifications on the qualifications, authority, duties, responsibilities and conduct of the audit committee members must be stipulated in the regulation on operation of the audit committee, thus establishing the normative basis for business of the audit committee. The corporations, which have only an auditor (that is, no audit committee), should also establish the internal regulations covering the detailed guidelines and procedures for the audit tasks. The audit committee and auditor must examine the suitability of such regulations annually, and disclose the details of the examination.

1.5 The audit committee should hold meetings at least once each quarter, and if need arises, may allow the attendance of management, financial officers, head of an internal audit unit or external auditor.

To ensure the effectiveness of quarterly reporting, the audit committee should review the quarterly reporting process. Therefore, the audit committee should hold a meeting at least once every quarter.

The chair of the audit committee may demand the attendance of management, financial officers, head of an internal auditing unit or external auditor at a meeting of the audit committee. He/She may also allow the attendance of outsiders depending on the slated issue. If the agenda of the audit committee meeting includes the performance evaluation of management, then management should not be allowed to attend. Also, members of the audit committee should try to collect information and exchange opinions through individual contact---separate from official meetings---with the management, employees of internal auditing divisions, and external auditor.

1.6 For each committee meeting, the audit committee must prepare the minutes, which contains clear and detailed records of all important discussions and decisions made. The audit committee and auditors should maintain the audit records that give detailed results of audits.

The minutes of meetings and audit records should be written clearly and in detail, and, in accordance with the laws, they should be made available to shareholders for their perusal.

1.7 Members of the audit committee or auditor should be able to have full access to information necessary for auditing, and, if need arises, should be able to seek advice from external experts.
Full access to necessary information is a prerequisite for audit committees or the auditor to perform their duties faithfully. For this, it is necessary that the internal regulations stipulate a clause that permits an investigation into the responsibility of persons who, without just cause, do not comply with the request for information by the audit committee or the auditor.

During the course of its work, the audit committee or auditor may need the counsel of the external experts such as accountants, lawyer, etc., in addition to the cooperation of management, employees or external auditor of the corporation. Therefore, it is necessary to establish the basis for enabling the audit committee or auditor to seek advice from external experts in the related internal regulations, such as Regulation on Operation of Board of Directors Regulation on Operation of Audit Committee Steering Rules. In particular, when the audit committee utilizes external experts, the chair of the audit committee should be required to report to the Board the background and contents of the counsel, the expenses involved, and the actions taken and the effects thereafter.

1.8 The audit committee should report at the general meeting of shareholders the details on the outcome of the evaluation on the independence and main activities of the committee, and the representative director of the corporation should disclose such information in the annual report. The corporations, which do not have an audit committee, should report the details on the outcome on the independence and main activities of the auditor to the general meeting of shareholders and the representative director of the corporation should disclose such information in the annual report.

The career summary of each audit committee members, important transactions that members carried out with the corporation, if any, other interests in the corporation that may influence their independence, the fulfillment of the duties as a member of the audit committee in accordance with the related laws, regulations and the regulation on operation of audit committee, and any other important activities should be separately grouped and disclosed in the annual report.

1.9 The members of the audit committee must be independent from management and controlling shareholders of the corporation. Therefore, the members of the audit committee are entitled only to the compensation as a director, and must not accept any other recompense.

Since the members of the audit committee devote considerable time and efforts in fulfilling their duties, they may receive a higher compensation than other directors do. However, they must not accept any recompense other than that of a director. This is because other recompenses may harm the independence of the audit committee. However, if other recompense is not for the services provided in the future, but for the services already rendered, it is possible to receive a pension or deferred payment. In this case, an audit committee member may receive his/her payment in stocks, stock options or other kinds, in addition to cash, if they are available to all other directors.

2. External Auditors

☐ In order to make certain that the shareholders and other users have confidence in the corporate financial information, an external auditor must perform his/her auditing tasks fairly and independently from the corporation audited, including its management and controlling shareholders.
2.1 External auditors should maintain independence in reality and in appearance from the corporation subject to audit, its management, and controlling shareholders.

Statutes related to external auditors stipulate matters concerning the independence of external auditors. But it is, above all, most important that external auditors themselves do not enter into an audit contract if according to the judgments based on the professional ethics, it is deemed that they have common interests, in reality or in appearance, with management or the controlling shareholders of the corporation.

In cases where an external auditor performs bookkeeping services for the corporation or provides management-consulting services, such external auditor is, in principle, deemed not to be independent. However, when approval of the audit committee or auditor is obtained, an external auditor can provide such services.

Also, in cases where, for a specific purpose, an external auditor enters into a contractual agreement for a success fee in relation to auditing of the financial statements, such external auditor is deemed not to be independent. However, to prevent the risk of frequent replacement of an external auditor, the corporations are required to have their financial reports audited by the same auditor for a period of three consecutive fiscal years, while the lead auditor cannot provide the auditing services to the same corporation for more than four consecutive years.

2.2 External auditors should attend the general meeting of shareholders and answer any shareholders’ question on audit reports.

To promote the business supervisory role of shareholders, external auditors should attend the general meeting of shareholders and answer any shareholders’ question related to the submitted audit reports.

2.3 External auditors are liable to pay for damages, which were incurred from a negligent audit, to the corporation concerned and to other information users. External auditors should check whether any fact in the information disclosed regularly with the audited financial statements conflicts with the audit results.

If external auditors have been negligent in their duties, incurred losses on the corporation, omitted important matters from the audit reports, or incurred losses to information users due to false records, then they are liable for damages toward the audited corporation and any third party. Therefore, external auditors should be aware of this liability and heed special care when auditing.

Also, external auditors should demand correction of corporate information included in regularly disclosed business reports with audit reports and audited financial statements if they include information that conflicts with audit results or that may cause misunderstanding on audited financial statements.

2.4 External auditors should make every effort to verify any existence of wrongdoing or law violation by the corporation during audits.

External auditors are not obligated to check for any wrongdoing or illegal acts committed by the corporation being audited. However, checking for any such misdeed by the corporation while performing audits may increase confidence of those readers in the audit results. It is highly significant especially for auditors to, during the course of auditing consolidated and combined financial statements, unmask any wrongdoing or violation of the law that occurred.
among the corporations under subordinate relationship and the affiliated corporations within a large corporate group. It is recommended that external auditors officially notify the relevant agencies of any wrongdoing or illegality that was confirmed or any case of suspicious wrongdoing detected while auditing.

2.5 **External auditors should consider the viability of the audited corporation as required by the statutes related to external auditors.**

The fact that external auditors are required to express their opinion on the viability of an audited corporation implies the seriousness of their responsibility. Therefore, there are concerns that external auditors may evade audits on insolvent corporations or may give excessively conservative audit opinions to evade their responsibilities.

However, the opinions of external auditors on the viability of the audited corporation help to assess the actual state of the corporation and enhance the quality of accounting audits, thus positive effects outweighing the potential adverse consequences. Hence, remuneration for external auditors must be adjusted accordingly to these extra responsibilities; and the external auditors should be able to easily access information required for assessing the viability of the corporation.

2.6 **It is advised that an external auditor report the material matters that have been confirmed during the course of auditing to the audit committee or auditor.**

It is advised that an external auditor report and consult the material matters that have been confirmed during the course of auditing to the audit committee or auditor. Material matters, for example, include important accounting policy, accounting and accounting estimates that have been influenced by management’s decisions, significant audit revisions, matters on which the auditor and management have differing views and any difficulty in performing external auditing.
IV. Stakeholders

- The rights and authority of interested parties stipulated in the laws and contracts should be protected.
- Participation of interested parties in corporate governance should be determined autonomously, considering the level of interests of the parties and the rights protection systems.
- Corporations and interested parties should cooperate for mutual benefit.

1. Protection of Rights of Stakeholders

☐ Rights of stakeholders stipulated in the laws and contracts should be protected, and stakeholders should hold appropriate means of redressing infringement of rights.

1.1 Corporations should observe creditor protection procedures concerning matters, such as mergers, capital decrease and split mergers, which greatly affect the position of creditors. The corporations should notify beforehand the creditors concerned of matters that may bring changes in the creditors’ priority, or may have material influence on the possibility of collecting credit.

Creditors, including those who have extended credit to the corporation or the holders of the bonds issued by the corporation, assume the risks associated with collecting invested capitals. Therefore, they must be protected through appropriate procedures.

Mergers, capital decrease, and split mergers are matters that materially influence changes in the structural and/or financial status of the corporation and that influence the creditors’ position also. Therefore, the corporation should ensure that the creditors’ rights are protected sufficiently and appropriately beforehand in the event of mergers, capital decrease or split mergers—matters which pose great influence on the creditors’ position. Also, the corporation should notify the creditors concerned beforehand when there is an issuance of preferred bonds which changes the existing order of credit, or when it is interpreted generally that the possibility of collecting credit is worsened.

1.2 The corporation should make every effort to maintain and improve the labor conditions by faithfully observing labor-related statutes such as the Labor Standard Act.

At present, the rights of employees are stated in labor-related statutes, including the Labor Standards Act. According to such Act, the employer must determine the labor conditions from a perspective of the employees who are, in fact, the direct contributors to the creation of corporate value. He should also make every effort to observe the labor conditions decided and to stabilize employment; employees bear the same responsibility. Trade Union and Labor Relations Adjustment Act state the three labor rights, that is, the right of organization, the right to collective bargaining, and the right to collective action.

The corporation should make every effort to maintain and improve labor conditions, faithfully observing labor-related statutes such as the Labor Standards Act, and Trade Union and Labor Relations Adjustment Act.
1.3 The corporation should not be negligent in its social responsibilities, such as consumer protection and environmental protection.

With the significant rise of corporate influence on the economy and society, the public awareness on the social responsibilities of corporations has been growing. Also, consumers and local communities have been playing an increasingly important role as interested parties in the continuance of the corporation.

In particular, if the corporation neglects its social responsibilities, such as protecting consumer rights or the environment using its advantageous position, unlike in the past, it not only damages the corporate image, but also brings about devastating effects on the long-term development of corporation. Therefore, each corporation should enable its managers to faithfully perform its social responsibilities through an appropriate governance system.

1.4 When a stakeholder holds the dual position of a shareholder, each of the rights pertaining to stakeholder and shareholder is protected and can be exercised.

If a certain person has the dual positions of shareholder and stakeholder, in other words, is a supplier as well as shareholder, or is an employee as well as shareholder, the rights pertaining to each position are protected independent of each other.

Rights as a shareholder must not be unduly restricted due to the person’s position as a stakeholder, and a stakeholder must not pursue undue profit using his position as a shareholder.

1.5 If the corporation infringes upon the rights of stakeholders, the corporation should take appropriate measures for redress, and the stakeholders should retain means to efficient redress if their rights have been infringed upon.

The corporation holds diverse relations with stakeholders, those being employees, creditors, suppliers, consumers and community. Also, the roles played by the stakeholders are very important to the continuance of the corporation. Therefore, the corporation should realize that mutual cooperation with stakeholders is, in the long term, to its own benefit, and should respect and protect rights of stakeholders, as determined by statutes and contracts.

Also, when the corporation infringes upon the rights of stakeholders stated in statutes or contracts, appropriate and swift measures must be taken to redress the situation; the interested parties should retain means through which they may receive compensation efficiently if their rights are violated.

2. Stakeholders’ Participation in Monitoring Management

☐ The form and level of monitoring management by stakeholders should be determined, for each corporation, while taking into consideration the nature of stakeholders and the motivation for management monitoring. Stakeholders should have access to relevant information to protect their rights.

2.1 The form and level of management monitoring by creditors should be determined through discussions among the related parties, according to the distinct circumstances of the corporation.

Creditors assume the corporation’s risk depending on the possibility of collecting their credit,
and therefore have a strong motive for monitoring corporate management.

Due to the popularization of non-guaranteed corporate bonds and credit extensions, creditors, in common with shareholders, are exposed to the corporation’s risks. Therefore, there is a growing need for the creditors to play a suitable role in monitoring and controlling business operations. In spite of such a growing need, because of the diverse interests of the creditors, defining a uniform role for all creditors in monitoring and controlling business operations is inappropriate. Therefore, the form and level of creditors’ participation in corporate governance should be determined according to the circumstances of the corporation through a discussion or contract among the related parties.

2.2 The form and level of employee participation in corporate governance should be determined in accordance with the degree of contribution that the employee participation makes to sound corporate development.

The existing Act on Worker Participation and Promotion of Cooperation enforces the establishment of a joint labor-management council, and stipulates the matters that the employers are required to report and explain such council, including the business plans and performance thereof, quarterly production plans and performances thereof, personnel matters and the corporation’s financial and economic status, matters that must be discussed and voted by the council, as well as the matters on which the council must receive a report.

Such a consultation system has been devised to enhance the corporation’s productivity and to strengthen its competitiveness through active cooperation and participation of its employees. At the same time, this system has been introduced to enable the employees to monitor management in a constructive way. Thus, the employees’ participatory role in management as stipulated in laws should be promoted and for this purpose, it is advised that every corporation willingly adopt and implement the provisions stated in the Act on Worker Participation and Promotion of Cooperation.

Regarding employee participation in management, there is a need to give consideration to utilization of profit sharing mechanisms such as employee share ownership or incentive system, and a payment method where a fixed ratio of bonuses or incentives is paid by stocks. This is because the participation in the corporation’s capital through the employee’s stock ownership facilitates to strengthen the labor-management relationship and to accomplish indirect monitoring of the management, and contributes to the improvement of labor conditions.

2.3 The corporation must, within the legal boundaries, make available to stakeholders information necessary for protecting their rights; and the stakeholders should be able to have access to relevant information.

Creditors must have access to information necessary to assess their risks and to manage their credits. For this purpose, in dealing with corporate information, it is advised that the creditors specify, in loan agreements or corporate bond subscription entrustment agreements, the following matters: matters for which the corporation as a borrower must obtain prior consent of creditors; matters for which the corporation must notify the creditors; matters concerning financial restrictions; and others. The corporation must faithfully implement the agreements with the creditors as stated in the contracts, and must inform the concerned creditors of the matters that have a bearing on the positions of the existing creditors, such as preferential treatment contracts for specific creditors.

Employees must also have access to corporate information to protect their rights. Currently, the
Act on Worker Participation and Promotion of Cooperation requires that the employer notify and explain to the joint labor-management council the business plans, quarterly production plans and performance, personnel matters and overall corporate financial situation.

However, in the case where access to corporate information by stakeholders, including employees and creditors, is not regulated, there might be adverse effects, such as the leakage of corporate secrets and the misuse of undisclosed information. Therefore, the corporation should provide, within the legal boundaries, information relevant to the interested parties. Also, the stakeholders who have acquired corporate information must not use them for unjust purposes.
V. Monitoring Management by the Market

- Formation and function of related markets should be assured so that corporate takeovers may be used as a means of enhancing the efficiency of corporate management, thereby further increasing corporate value.

- Corporations should actively disclose the matters of material importance to the decision-making of shareholder, creditors and other stakeholders.

- In order to install better corporate governance, the corporations should willingly disclose their corporate governance system, and let the shareholders and stakeholders appraise their governance system.

1. Market for Corporate Control

☐ Corporate takeovers should be carried out in a manner that does not impair the corporate value.

1.1 Any undertaking that may lead to change in corporate control, such as takeovers, mergers, acquisitions, splits and transfers of business, must be conducted through a transparent and fair procedure.

Corporate takeovers and other such undertaking greatly affect stakeholders, such as shareholders and creditors; therefore, such undertaking must begin with an appropriate disclosure and be accomplished through a transparent and fair means.

1.2 Defense for the corporate control must not be carried out in a manner that the benefits of the corporation and shareholders are sacrificed for the protection of interests of few special shareholders or for the managerial control.

When using the corporate assets as a means of defense against a takeover, the interests of the management may conflict with those of shareholders or there may exist conflicting interests within the management. The Board may fight against the hostile takeovers through legal procedures; but even in such cases, it may not use the corporate assets for the purpose of maintaining their positions, if such defense undermines the interests of the corporation and shareholders.

When acquiring treasury stocks to defend corporate control, it is desirable to disclose the purpose for such acquisition in detail, so that all stakeholders may be able to understand the underlying reason and foresee its consequences.

As a means of defending corporate control, new shares and potential shares, such as convertible bonds and bonds with warrants, are issued to a third party. But, since such undertaking results in restriction of the rights of shareholders, it must be carried out in accordance with fair pricing and procedures.

1.3 In case of significant structural change such as merger or transfer of business, etc., a corporation must make it possible for the shareholders, who oppose such change, to exercise their claim for stock purchase at a fair price which reflects the real share value in
accordance with the laws.

In case where a change in corporate control occurs as a result of corporate takeover, merger, etc., there is a limit for minority shareholders to realize their positions and to protect their interests. Therefore, it is important to put in place a system of claim for stock purchase at a fair price.

It is most desirable that the stock purchase price be decided by an agreement between the corporation and opposing shareholders. However, for listed corporations with a large number of shareholders, it is practically difficult to determine the stock purchase price through an agreement between the corporation and the shareholders, particularly in view of the fact that the shareholders, who oppose the corporate takeover, can sell their shares on the market. Thus, in case of a listed corporation, it is recommended to determine the stock purchase prices by taking into account the market prices.

2. Disclosure

☐ The corporation should faithfully disclose material information in a timely and honest manner.

2.1 In addition to the legal disclosure obligation, the corporations must disclose any material information about business that have or may have a serious implication on the decision-making of the shareholders and stakeholders.

Active and appropriate disclosure, as the corporation’s obligation to shareholders and other stakeholders, of corporate information contributes to building confidence in the corporation and provides an equal opportunity to market participants, thus contributing to prevention of unfair practices using undisclosed information.

Therefore, in addition to the legal disclosure obligation, the corporation should disclose information that may have material influence on the stakeholders’ decision-making, provided that such information is not industrial secret, without delay through the means which investors have an easy access to.

2.2 The annual report, which is a comprehensive report and disclosure on the business status and financial details, should include information on the following matters:

- Business goals and strategies;
- Financial condition and business performance;
- Status of shareholders and the exercise of shareholder rights;
- Cross-shareholdings and cross-debt guarantees;
- Details of capital raising and capital expenditure for the fiscal year;
- Business climate and risk factors;
- Important information on executives, employees and others who perform work of the corporation;
- Details of transactions with the largest shareholders, etc. as well as the contents of transactions with the executives, employees and other stakeholders;
- Audit opinions of the external auditors and appraisals of credit rating agencies and others;
- Accounting standards or accounting estimates that have significant effect on investment decisions; and
- Details of unfaithful disclosures and sanctions thereof.
In accordance with the relevant laws and regulations, the listed corporations must periodically make a detailed and accurate disclosure on the facts about corporate businesses, including the overall conditions of the business, financial status and business performance, through the annual report.

Nonetheless, there is a need to relieve the corporation’s burden associated with the disclosure by eliminating the overlapping disclosure of the matters such as summary financial statements and explanatory notes, etc., in the annual report, which are covered by both the business report and the audit report.

2.3 In the annual report, a public corporation shall explain the differences between its corporate governance and this Code, and the reasons for such; any plans to make future changes shall also be explained.

Listed corporations must describe the differences between the existing corporate governance and this Code and the reasons thereof, as well as the planned enhancements and changes, if there are any, in their annual reports.

The corporation designs the governance structure reflecting its own distinct circumstances; therefore, each corporation’s governance structure may differ. However, the corporation shall explain to the parties of interest, including shareholders, the reasons why it is operated differently from this Code.

Since the corporate governance system is developed by taking into account the unique circumstances under which a corporation operates, each corporation may have somewhat different governance practices. However, in case where there are material divergences between the governance practices in place and this Code, it is necessary to disclose the reasons for such divergences. Here, the material divergences refer to the cases where the existing practices concerning the following major governance matters differ from the recommendations in the Code.

Major corporate governance practices subject to disclosure are: 1) the adoption of cumulative voting system; 2) information on the composition of the Board, along with outside directors and their independence; 3) the composition, rights, and activities of the Board’s internal committees; and 4) the activities of directors and the Board.

2.4 The corporations should prepare and disclose the annual report, semi-annual report and quarterly report. In cases where a corporation is, in practice, under a controlling or subsidiary relationship with another corporation, such corporation should also disclose the consolidated or combined financial statements, as required by laws.

Corporations must make periodic disclosures of the annual report, semi-annual report and quarterly report, and it is desirable to make available other information relating to the profit and loss (for example, a report on monthly profit and loss) to the market participants.

The range of items to be included in the consolidated financial statements should, in addition to the ratio of share ownership basis, be determined considering the existence of a controlling and subsidiary relationship that may actually govern the business operations, investments and financial activities. For Korean corporations, the governing relationships are linked with not only the controlling and subsidiary relationships between corporations, but also the controlling shareholders and persons with a special relationship; therefore, it is difficult to understand the
true nature of a corporate group as a whole simply by the ratio of share ownership among the corporations. Thus, it is desirable for the representative corporation of the group to also disclose a combined financial statement, so that the organization of corporate group as a whole may be understood.

2.5 In addition to the periodic disclosure, the corporations must make timely and accurate disclosures when a decision is made on material matters listed below. In the case where a decision is made through a resolution of the Board, it is advised to disclose the information on the attendance of the directors and voting results, along with the contents of resolution.

- Matters that may have material influence on the financial structure or business operation of the corporation;
- Matters concerning the issuance of shares;
- Matters entailing material changes in the assets, operations, and business environment of the corporation;
- Matters entailing major changes in debt and credit relations;
- Matters concerning important investments and financing;
- Matters entailing material changes in the profit and loss structure;
- Matters that might bring changes to the corporate control and management structure;
- Matters concerning the size and method of dividend;
- Matters relating to the accounting standards and the changes in accounting estimates that could have significant effect on investment decisions;
- Matters relating to the appointment and dismissal of an external auditor; and
- Matters relating to the granting and cancellation of the stock options.

In addition to the matters stipulated by the relevant laws and regulations such as the Securities and Exchange Act, it is desirable for the corporations to disclose any matter, which is deemed to be important from the perspectives of the users of the disclosed information, in detail without delay.

Corporations must make a disclosure in such way that all users of disclosed information can have access to the same disclosure simultaneously, thus providing an equal opportunity to all users.

2.6 Corporations must make an appropriate disclosure of the forecast on future business performance and financial standing.

The disclosure of corporate information is not limited to facts that have already occurred, but also include forecasts on future business performances and financial conditions. The financial forecasts should be comprised of the estimates for minimum of 3 years. In case of disclosing the forecasts, it should include the fact that it is forecasted information, the hypothesis and assumptions used for the forecasts and a note of caution explaining that the forecasted information could differ from the real facts. While disclosing the forecasts, the corporations should not exclude or postpone the disclosure of information that is disadvantageous to the corporations, and should not make available only the information favorable to the corporation. However, disclosure of the matters, whose confidentiality is required for the public benefits, such as the national secrets, or for the industrial secrets, such as the research results, may be postponed for a fixed period. Even so, in cases where such confidential information is leaked due to the failure on the part of a corporation in maintaining the confidentiality, such
information must be disclosed immediately.

2.7 The corporations must prepare the disclosures in such a way that their contents are easily understood and help in making disclosed information available to the users at minimal cost.

Due to diversification, high-technology, and specialization of industries, corporate information written in technical language is not always easily understandable to the information users. Therefore, corporate information should be written using common language that is easily understandable to the users, and in cases where special technical terminology is used, an explanatory note should be included. Furthermore, use of ambiguous terms should be avoided.

Corporations should make their annual reports, semi-annual reports, quarterly reports, timely disclosure and the information distributed at the investor relations seminars available on their websites on Internet, thus making them available to the public at no cost. Additionally, corporations should make available the matters relating to the corporate governance, such as the regulations for the operations of Board’s committees (including the audit committee, compensation committee and nomination committee) and the business ethics, on their websites on Internet. For the listed or registered corporations, the corporate disclosures should be made through the Data Analysis, Retrieval and Transfer System (DART) of the Financial Supervisory Commission.

2.8 It is desirable for the corporations with a large number of shares, which makes possible the participation of foreign investors in their corporate governance, to make the disclosures, particularly the audit reports and other matters of important timely disclosures, in both Korean and English.

Due to the liberalization of capital movement, there has been an increase in the number of foreign shareholders and in their shareholding ratio of Korean corporations. Therefore, any disclosure concerning the corporation shall consider these foreign shareholders. Furthermore, the need for disclosures in English has been increasing more and more for corporations to better do capital raising.

With the liberalization of capital movement, the number of foreign shareholders and the foreign investors’ share of the market capitalization of Korean corporations have been steadily increasing. In disclosing its corporate information, a corporation must take into account the foreign shareholders. Furthermore, in order for corporations to raise capital efficiently, there is a growing need for disclosure in English.

It is desirable for listed corporations to make disclosures using Korean and English side by side. However, considering the burden on the corporation, it is recommended that corporations having many foreign shareholders make disclosures in English. For example, it is desirable for a corporation, of which foreign investors own a minimum of twenty percent of the total outstanding shares, to make disclosures in English, from the perspective of protecting the shareholders

2.9 Corporations must designate a person in charge of corporate disclosure, and establish an internal information network that ensures speedy delivery of important corporate information to the person in charge.

Determination of information that must be disclosed and making an effective disclosure of such information are an important corporate activity that requires specialization. Therefore, to
promote specialization, corporations must designate a person in charge of corporate disclosure and have him/her take an education course on corporate disclosure.

Also, to disclose corporate information in a timely and accurate manner, the person in charge of corporate disclosure should be given the right to have speedy access to major corporate decisions, and an information delivery system, which facilitates notification of any disclosure information to such person as it comes up, should be established.

2.10 Corporations must disclose in detail the shareholding status of controlling shareholder and the persons in special relationship.

A genuine controlling shareholder is the one who shapes the foundation of corporate governance, thus, a detailed disclosure should be made about the controlling shareholder, including his/her equity holding status and any changes thereof, his/her position within the corporation and his/her transactions with the corporation.

2.11 The Chief Executive Officer and Chief Financial Officer of a listed or registered corporation must certify the accuracy and completeness of the financial report.

The Chief Executive Officer and Chief Financial Officer must certify the facts that the financial report states all important information required to be covered and all statements are accurate. Additionally, the Chief Executive Officer and Chief Financial Officer must certify that the material used for the financial statement have been reviewed by the audit committee of the corporation.

2.12 Corporations must formulate business ethics and disclose thereof.

Corporations may formulate their own business ethics, but must include the following important matters:

- Prohibiting the activities of the executives and employees of the corporation, which are taken for personal benefits (for example, personal borrowing through the corporation), opposed to benefits of the corporation;
- Prohibiting misuse of corporate assets by the executives and employees of the corporation, which should be used for just purposes;
- Maintenance of confidentiality of corporate information and customer information;
- Prohibiting unfair activities using the undisclosed inside information; and
- In cases where an illegal or unethical activity has occurred, reporting such activities to the person in charge.
Recommendations to the Government and Relevant Organizations

1. The government should amend the relevant laws so that this Code may be widely adopted as a standard for corporate governance of listed companies. And the related institutions are advised to reinforce their regulations in such way that the corporations practicing this Code could receive a preferential treatment.

2. To firmly establish a sound corporate governance system, the financial institutions and credit rating agencies are recommended to include the quality and efficiency of corporate governance as the items to be assessed when appraising the credit rating of corporations.

3. A regulatory system, for instance, a mediation agency, should be instituted for speedy settlement of adequate compensation for or rectification of the situation by way of simpler and less costly procedures than the legal proceedings, in cases where the rights of shareholders or creditors are infringed on,

Presently, in cases where it is deemed that the rights of shareholders or creditors are violated, the only ways to remedy such cases are for the shareholders and creditors either to exercise the rights of claim or to file the lawsuits against the concerned corporation or its directors. However, such existing methods are not practical remedies because they involve the complicated procedures and high expenses. Thus, it is necessary to establish a system through which disputes about the infringement of the right of shareholders and creditors can be settled by means of the low cost and speedy procedures, without undergoing the legal proceedings.

4. It is recommended that steps be taken to facilitate easy exercise of the rights of minority shareholders, and it is also recommended that the measures preventing abuse of the rights of minority shareholders be reinforced.

With the development of the securities market in Korea, stock diversification has been accelerating, and the number of minority shareholders and the percentage of their shareholding have been increasing steadily. Therefore, to protect the rights of minority shareholders, it is necessary to ease the conditions for the minority shareholders in exercising their rights. At the same time, considering the economic consequences resulting from the exercise of rights by minority shareholder, it is necessary to take measures to prevent filing of excessive claims.

It is necessary to improve the regulations in such a way that the views of the largest majority is conveyed at the general meetings of shareholders, where the shareholders directly exercise their rights. Especially, in view of the advances in telecommunication methods, the relevant laws and regulations need to be amended to make possible the electronic voting or voting through other communication means.

5. Institutional investors that manage the trust assets should fully exercise their rights as shareholders of the corporations in which they have made investments and should monitor corporate management thereof.

Trust assets here refer to the assets that pension, fund and investment trust companies, the trust accounts of banks and insurance companies take care of and operate on behalf of their customers.
5.1 Institutional investors must establish the internal regulations with regard to the exercise of the shareholder’s rights against the corporations in which they have made investments and disclose such regulations. They must also exercise the shareholder’s rights fully and prudently in accordance with the principle of good faith.

For the proper exercising of shareholder’s rights, institutional investors, first, should establish appropriate internal regulations on exercising shareholder’s rights. Establishment of the guiding principles for approval or disapproval of the agenda items of a general meeting of shareholders could work as an important guideline for the decision-making and course of actions of the corporations in which the investments are made.

Furthermore, institutional investors must disclose the details of activities such as the institutional policies with regard to corporate governance and exercise of voting rights, thus facilitating the trust investors to make an informed decision in selecting their institutional investors.

Second, to protect the trust assets, institutional investors should establish the principle of good faith individually or jointly and disclose it, and should exercise the shareholder’s rights fully and prudently in accordance with such principle. This is because each institutional investor, such as banks, investment trust companies and insurance companies, has different ownership and governance structures, as well as diverse business relationships with the customers and corporations. Moreover, the motivations of shareholders vary according to their investment purposes.

Third, in addition to the exercise of voting rights at the general meeting of shareholders, institutional investors should make contributions to the enhancement of corporate governance of the portfolio through the effective exercise of shareholder’s rights such as monitoring of and making shareholder’s proposal on the composition of the board and its operational methods.

Fourth, in view of the fact that effective exercise of shareholder’s rights requires an analysis of the impacts of specific agenda item on the trust investors, institutional investors should seek out the advices of external experts, including associations of institutional investors, in cases where it is difficult to undertake an independent impact analysis.

5.2 In conducting any business deals with the portfolio corporations, institutional investors must not undertake insider trading, where their positions are used wrongly or valuable undisclosed information is exploited.

Compared with individual investors, institutional investors, using their position of vantage, may acquire with relative ease information on the portfolio corporations, and may request the corporate managers to efficiently supply the business information. The corporations, from their perspective, also have reasons to provide each institutional investor with special corporate information as a means of securing friendly shareholders for business stability. Therefore, stronger measures are needed against institutional investors in order to restrain them from acquiring and using corporate information through their vantage positions.

5.3 To promote full exercise of shareholder's right by the institutional investors, associations of institutional investors and other relevant organizations should establish their own guiding principles of corporate governance and perform advisory functions.

Associations of institutional investors and other related organizations must formulate their own guiding principles relating to corporate governance and encourage the institutional investors to
integrate such guiding principles into their internal regulations, and should provide support to
the institutional investors with regard to the review of governance practices of the portfolio
companies.

5.4 Both the investments in a related corporation by an institutional investor and the
exercise of shareholder rights regarding such a corporation should be restricted by the
relevant laws and regulations, and the concerned institutional investor must disclose the
details of the relationship and the details of exercise of shareholder's rights.

A corporation, a business group, or an individual affiliated with an institutional investor should
not be allowed to acquire control of another corporation by making use of shares owned by the
affiliated institution or to exercise shareholder rights for the benefits of related parties. A
regulation in this regard will have the effect of protecting other shareholders of the corporation
and beneficiaries of the institution. For this, the exercise of voting rights by an institutional
investor should be restricted with respect to corporations affiliated with the same business group.
In addition, legal rules on equity investments in affiliated corporations should be strengthened,
for example, by introducing a tightened ceiling on such investments. An external control
mechanism and the institutional investor's internal control system to monitor implementation of
such rules are needed to be first set in place.

5.5. Institutional investors must put in place an internal control system to ensure that the
exercise of shareholder’s rights be fair and consistent with the benefits of the investors and
be based on its inhouse rules.

It is recommended that institutional investors holding assets above a certain level set up an
internal unit taking care of only the matters concerning the exercise of shareholder’s right.

5.6 it is advised to create the corporate governance funds that aim to invest in stocks of
the corporations with a high potential for the improvement of corporate governance.

The corporate governance funds refer to the funds that seek out the profits brought about by the
increased corporate value resulting from the introduction of proactive measures for improved
corporate governance, such as enhancing corporate governance of the target investment
corporation, through capital investments. In case of the large institutional investors such as
public pension funds, the corporate governance funds may be offered to the investors
independently, and in case of small institutional investors, such funds may be set up jointly.

5.7 In view of the vast power of influence that institutional investors can exercise in the
area of corporate governance, it is necessary for institutional investors to establish an
institutional mechanism to make their own corporate governance efficient.

In case of institutional investors such as the pension funds, the investment trust companies, and
the trust accounts of banks, etc., their governance structures are relatively weak because they
either have no largest shareholder or are under the influence of an organization with special
relationship, such as the government. Thus, to redress the situation, such institutional investors
must devise ways to improve their corporate governance systems (for example, establishment of
a consultation body comprised chiefly of the experts and trust investors), which could maximize
the profits of the trust investors, and faithfully implement them.

6. Outside directors have the same rights and responsibilities as the standing
directors. However, considering the limitations on the actual performance of
duties due to time constraint and the limitations in acquiring information as a non-
standing director, responsibilities of outside directors should be allocated proportionately within the range of operations that may practically be performed.

6.1 In view of the fact that it is desirable for an outside director, who oversees the executives, to own the stocks of the corporation, it should be made possible for all shareholders, except those who are in special relationships, such as the executive or the largest shareholder, to become an outside director.

7. Securities-related disclosure institutions are advised to maintain disclosure systems that are compatible with the advancement of information/communication technology, so that corporations and information users would be able to use corporate information in a fair, easy and economical manner.

8. An appropriate monitoring of the management must be carried out to prevent the infringement of interests of corporate bondholders by the unilateral decisions of the management. In relation to this, it is advised to improve the regulations and practices so that the managing underwriter and trustee corporation would be able to fulfill their roles to the fullest extent.

The Korean corporate bond market has recently been reorganizing into a market centered on non-guaranteed bonds from guaranteed bonds. However, because the regulations and practices of the corporate bond market have not yet fully incorporated the changing circumstances, the investment risk of creditors is growing. For instance, it is difficult for the creditors to monitor and regulate the situations, even in the cases where a bond issuing company undertakes the economic activities that would result in the conditions that are much unfavorable than at the time of bond issuance, such as the use of fund raised for the purposes other than originally intended or weakening the ability to repay the principal by additionally issuing a large amount of bonds.

Therefore, by openly providing the creditors with the details of investment activities and information necessary to assess the corporate value from the time when liability incurred to the date of repayment, the corporations must enable the creditors to fully understand the corporate value and the associated investment risks. For this purpose, the bond-issuing corporation must actively cooperate with the managing underwriter and the trustee corporation and allow them to perform their functions in substance, not in mere formality as it has been.

At the time of bond issuance, the managing underwriter and commissioned corporation must make available the evaluation materials on the issuing corporation and bonds, and provide the analysis of the situations for contract fulfillment and major business activities of the issuing corporation at appropriate times. They must also exercise rights that are adequate for protecting the interests of creditors. In order to ensure that such activities are firmly established as new business practices, standard forms for all documents, including the trust contract, should be prepared, and it is necessary to examine the method of modifying the issuance conditions in accordance with addition and removal of specific items on the standard forms at the time of signing the contract between the concerned parties.

9. This code should continuously be revised and strengthened as the circumstances change. Thus, it is advised that the related organizations continue to maintain close cooperation and collaboration with each other.
Appendix 1

Members of the Committee on Corporate Governance

Mr. Kwang S. Chung (Chairman of the Committee)
President of KCGS

Mr. Myoung-Hoon Song
Vice-president of KCGS

Mr. Hi-Bock Kang
Standing Executive Director, Market Economy Research Institute

Mr. Kon Sik Kim
Professor, Seoul National University College of Law

Mr. Seok-Joong Kim
Executive Director, The Federation of Korean Industries (FKI)

Mr. Yong-Duk Kim
Vice President, KEB Kommerz Investment Trust Management

Mr. Sang-Yong Park
Professor, Yonsei University Department of Business Administration

Mr. Jin Won Park
Senior Foreign Legal Consultant, Law Firm Shin&Kim

Mr. Byung Hyu Bae
CEO, The Econo Talking

Mr. Sang Ho Bae
Executive Director, KOSDAQ

Mr. Maing Kee Lee
Executive Vice President, Korea Stock Exchange (KSE)

Mr. Eui-Young Lee
Chairman, Committee of Small and Medium Enterprise, Citizens’ Coalition for Economic Justice

Mr. Chul Song Lee
Professor, Hanyang University Department of Law

Mr. Hyun Seok Lee
Executive Director, Korea Chamber of Commerce & Industry

Mr. Hyeong-Kyu Lee
Professor, Hanyang University Department of Law

Mr. Jong-Nok Im
Managing Director, The Korea Securities Dealers Association
Mr. Dong Yoon Chung
   Dean of Law School, Korea University
Mr. Young Tae Joung
   Senior Executive Director, Korea Listed Company Association
Mr. Hong Yul Jeon
   Advisor, Law Firm Kim&Chang
Mr. Dosoung Choi
   Professor, Seoul National University Department of Business Administration
Mr. Woon-Youl Choi
   Professor, Sogang University Department of Business Administration
Mr. HeungSik Choe
   Vice President, Korea Institute of Finance
Mr. Il-Sup Kim
   Vice President of the School of Business Administration, Ewha Women’s University
Appendix 2

Members of the Research Committee on Corporate Governance

Mr. DoSoung Choi, Chairman
    Professor, Seoul National University Department of Business Administration
Mr. Beomsu Kim
    Attorney at Law, Law Firm Shin&Kim
Mr. Se-jin Kim
    CEO, Korea Bond Pricing & KR Co.
Mr. Kyung Suh Park
    Professor, Korea University Department of Business Administration
Mr. Young S. Park
    Professor, Sogang University Department of Business Administration
Mr. Chungwoo Suh
    Professor, Kookmin University Department of Business Administration
Mr. Suk-Ho Sonu
    Professor, Hongik University School of Business Administration
Mr. Jinho Jang
    Professor, Yonsei University Department of Business Administration
Mr. Myeong-Hyeon Cho
    Professor, Korea University Department of Business Administration
Mr. Sung Wook Joh
    Professor, Korea University Department of Business Administration
Mr. Kwang-woo Park
    Professor of Finance, Chung-Ang University College of Business Administration
Mr. Chan-hee Park
    Professor, Chung-Ang University College of Business Administration