

**Arab Republic of Egypt**  
**Ministry of Investment**

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*The Code of Corporate Governance  
for the Public Enterprise Sector*

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**Egyptian Institute of Directors**

**July 2006**

*This Code was prepared in light of the Guidelines on Corporate Governance of State-Owned Enterprises issued by the Organization for Economic Co-operation and Development (OECD) in January 2005.*

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## A. Foreword

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During the last few years, Egypt has succeeded in realizing more progress in the area of economic reform, improving investment climate and attracting more local, Arab and foreign investments. Towards this end, the government has issued numerous procedures and undertaken actions to accelerate the rate of economic growth and to strengthen investors' confidence in Egypt's investment climate. Perhaps one of the important steps taken in this direction has been the effort made to apply the principles of corporate governance in the private sector, the public enterprise sector and the public sector. Thus, the Egyptian Institute of Directors of the Ministry of Investment issued in October 2005 a Code of Corporate Governance for enterprises listed in the stock market. These guidelines included many provisions the objectives of which were to enhance the effectiveness of the boards of directors and guarantee the rights of all shareholders as well as various stakeholders who deal with these enterprises. This code represents the general framework for corporate governance of Egyptian enterprises.

Because of the special nature of the public enterprise sector and as a result of their importance and influence on most of the country's economic sectors, it was necessary to produce a guidebook on corporate governance for these companies. In preparing this Code, the special nature of Egyptian companies and the lessons learned from the experience of other countries have also been taken into account. The preparation process started with a review of the Guidelines on Corporate Governance of State-Owned Enterprises in the OECD. Subsequently, a team of Egyptian experts drafted the initial Code, which was then subjected to in-depth examination and extended discussions on the part of the leadership of the holding companies of the public enterprise sector, the heads of administrative and legal departments in these enterprises, and also the leadership of some private sector companies. At the end, the Code was reviewed by experts from the OECD, the IFC and also the World Bank.

The guidelines delineated in the Code are considered instructive and complementary to the provisions of the Public Sector Enterprise Law No. 203/1991. Both share the same objective; namely, to liberalize the public enterprise sector from any constraints that would hold them back from competing with the private sector; for as long as they stay in the public sector, they should be successful in the long term.

It is hopeful that the public enterprise sector would strive to adopt this Code owing to its positive effects that go beyond the boundaries of these companies and because of its impact on all economic aspects of the society.

I wish to emphasize in this context that what is required is not only for the public enterprise sector to apply the corporate governance guidelines but also to adopt the philosophy and the foundations of corporate governance; which would in turn realize the

basic target of the asset management program of government investments, namely, to protect public assets and oversee workers' rights. I hope this Code will achieve its targets.

May God help us to reward our efforts with success for the purpose of achieving progress and prosperity for the good citizens of Egypt.

Dr. Mahmoud Mohie-Eldin

Minister of Investment

Chairman, the Egyptian Institute of Directors, Board of Trustees

## **B. Introduction**

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In spite of the fact that private sector transformation programs reflect an economic phenomenon in most countries of the world, the public enterprise sector remains an influential player in the level of economic activity in many countries including OECD countries. In Egypt, the Ministry of Investment is responsible for the application of an asset management program that covers the public enterprise sector and companies with equity participation from public sector.

The application of the guidelines of good corporate governance by the public enterprise sector constitutes one of the basic elements in the public sector's asset management program since it will improve these companies' performance, enhance their capacity to compete with the private sector and prepare them for their transfer to the private sector.

Besides, improving the ability of the public enterprise sector to practice good corporate governance will contribute to the growth of these companies through better economic performance and increased productivity in many sectors of the economy. In order to guarantee practices of good corporate governance by these companies, this "Code of Corporate Governance" was prepared for the benefit of the holding and affiliated companies and as a complementary framework to the "Code of Corporate Governance" that was issued in October 2005 by the Egyptian Institute of Directors.

## **C. Corporate Governance Guidelines for the Public Enterprise Sector**

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Corporate governance provisions for the public enterprise sector are complementary to the rules and provisions that govern these companies under existing laws and regulations. OECD's "Guidelines on Corporate Governance for State Owned Enterprises (SOEs)" were taken as a reference point in preparing this Code of Corporate Governance for the Public Enterprise Sector in Egypt. These principles are divided into six groups:

1. Ensuring the existence of an effective regulatory and legal framework for the public enterprise sector
2. The State acting as the owner
3. Equitable treatment of shareholders (owners)
4. Relationships with stakeholders
5. Transparency and disclosure
6. Responsibilities of the board of directors of public enterprises

## **1. Ensuring the existence of an effective regulatory and legal framework for the public enterprise sector**

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This group of guidelines focuses on the importance of creating the proper environment in the form of the legal and organizational framework needed for the public enterprise sector to run their economic activities in a manner similar to that of the private sector and to enable them to compete with them. In this context, any burden carried by public enterprises to achieve non-economic objectives must be clearly specified in explicit bylaws and regulatory procedures. They also must be known by everybody. Moreover, appropriations for costs associated with such non-economic objectives must be set aside with a high degree of transparency.

Thus, it is critically important that these companies are subject to the same rules and regulations that govern private sector companies without according them any protective preferences. And this was one of the principal reasons that led to the issuance of the Public Enterprise Sector Law No. 203/1991, which delegates the power of application to the Companies Law No. 159/1981, unless stated otherwise. In what follows, we present in some detail the most important corporate governance provisions that govern the legal and regulatory framework of the public enterprise sector:

1-1 The legal and organizational framework for the public enterprises should be developed to support fair competition with the private sector.

1-2 Without affecting the activities of the public enterprises, a clear differentiation must be drawn between the ownership function of the State and the other state functions such as monitoring and control, especially as they apply to state industrial policies.

1-3 Related to the above, no conflict ought to exist between the ownership function and industrial policies. This means that industrial policies that are not in tune with the ownership function, represented by asset maximization, should be avoided. Accordingly, it is necessary to separate the two functions to allow these companies to operate on the basis of maximizing shareholders' equity.

1-4 Sometime, the State plays the role of the owner and the regulator of a specific economic activity in competition with the private sector. Thus, there must be a clear separation between the roles of the State as the regulator and as the owner. By so doing, the conditions of fair competition can be realized between private sector companies and the public enterprises in the areas in which they compete with each other.

1-5 The Holding Companies set the procedures and regulations that govern public enterprises in a way that corresponds with and stimulates the procedures and regulations that govern private companies.

1-6 Stakeholders should have the appropriate instruments to claim their rights when they cannot obtain them from the public enterprises.

1-7 In case of a dispute with creditors or vendors, public enterprises should be subjected to the same treatment accorded to private sector companies.

1-8 The bylaws and regulations that organize the work of public enterprises should clearly determine the liabilities imposed on them to bear the burdens of some public service or to carry out certain social obligation. In consequence, the financial burdens attendant upon public enterprises carrying out these responsibilities should be transparently revealed and their necessary appropriations set aside by the State.

## **2. The State acting as the Owner**

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By this, it is meant that the State should act as the owner, just as in the private sector. The State should have an integrated, clear and a homogenous vision with regard to its ownership of public enterprises. The State, furthermore, should ensure the adoption of good practices of corporate governance in a manner that is grounded in transparency, responsibility and accountability, including the ways in which the boards of directors of these companies are formed. Because there are often overlaps between the State acting as the owner and its actions within its given responsibilities as a State, this results in its intervention in the companies' businesses and in its restricting their decision making process, which should belong to the elected or appointed board of directors under the supervision of their respective general assemblies. Consequently, there is an urgent need to separate the role of the State as the owner and its role as the regulator and administrator, whose principles of corporate governance are delineated below:

2-1 Within the framework of its role as the owner, the State should determine its objectives and priorities clearly. Not only should the objectives not be limited to making profits and avoiding price distortions, they should also take into account some social aspects. The State should determine clearly how the social targets will be achieved without hurting the economic value of the company.

2-2 The State should build up a vision and adopt a balanced and stable policy that will familiarize the local community with the role of the State as the owner as well as its objectives in an unambiguous manner.

2-3 The State should play its role as the owner without interfering in the daily management of the companies in order to allow them to independently manage their activities to achieve their pre-set objectives.

### **Ownership Unit – The Holding Companies:**

2-4 It is necessary to specifically clarify the concept of applying ownership rights within the government administration. This can be accomplished through the establishment of a Coordination Unit, or, more precisely, through one Central Unit for the Ownership Function whose line of custodianship to one ministry (or more) should be clearly determined. According to the provisions of the executive decision that organized the Ministry of Investment and in line with the Public Enterprise Sector Law No. 203/1991, the holding companies assume the role of the ownership unit under the supervision of the Ministry of Investment. Holding companies represent the State in its role as the owner and should operate within their rights through the legal framework of their affiliated companies.

2-5 To the extent that holding companies represent the owner in all dealings, in government and non-government forums, clear relations with other government agencies and organizations should be maintained. In this framework, the head of the holding company represents it vis-à-vis all stakeholders.

2-6 The holding company should unify and harmonize policies and positions, bear the responsibility of determining the general policies of its companies, develop specific principles and directives for them, and unify procedural systems between different ministries and the management of the State's ownership portfolio in the public enterprise sector.

2-7 In order for the holding company to carry out its responsibilities, it should have a high degree of flexibility and independence to enable it to assemble a team of experts, including some from the private sector, and to make available the financial resources needed to attract renowned individual talents - within its own means.

2-8 Thus, it is possible for the holding company to seek the services of some experts and consultants to assist in carrying out its responsibilities towards its companies; e.g. performance evaluation or organizational restructuring.

2-9 It is necessary for the holding company to have a degree of flexibility in the management of financial structures of public enterprises. This can be accomplished through cooperating with the companies' board of directors to enable it to streamline financing transactions by, as an example, transferring some capital from one company to another or by raising capital through private sector participation, all of which comes under the framework of the restructuring program and the management of the State's assets. However, such actions should be undertaken in a fully transparent manner.

2-10 The holding company's directives to any of the board of directors of its affiliated companies should be kept to a minimum. Such directives should be limited to strategic decisions and basic policies; moreover, they should be specific in regard to timing and implementation procedures.

### **The Structure of the Board of Directors:**

2-11 The holding company must have a clear and transparent system to nominate members of the board of directors of public enterprises or companies in which the State owns the majority stake. It should actively participate in the nomination process of the board of directors' membership of all public enterprises. The holding company ought to take the responsibility of ensuring the existence of a highly efficient board of directors for these companies.

2-12 The general assembly of the holding company should evaluate the nominees for the boards of directors in accordance with specific objective criteria.

2-13 Names of board of directors' nominees should be disclosed at least 15 days prior to the date set for the general assembly meeting. The disclosure should include some detailed information on the education and work experience of each candidate. It is also preferred that the holding company prepares a data base that includes names of qualified experts that boards of directors of public enterprises could benefit from.

2-14 The State should minimize its role in management affairs by delegating the responsibility completely to the boards of directors of public enterprises.

2-15 The holding company may nominate any of its board members to the board of directors of its affiliated companies provided that they carry the same burden as the other board members. In all cases, however, it is better if this is done when it is only necessary and with a limited number of board members. It is, however, preferred that no member of the holding company is either nominated or elected to the membership of its affiliated companies to minimize the potential impact of conflict of interest. As specified in the law, the board should also include a number of experts from the private sector with relevant experience.

2-16 The salary and incentive structure should allow the company to attract human skills that are commensurate with private sector skills and to retain the distinguished human talents already working in the company. It is also important that members of the boards of directors of public enterprises are from amongst specialized technical cadre.

### **Control and Monitoring of Performance:**

2-17 The role of the holding company is confined to performing all of its rights to protect its interest without interfering in the affairs of the board of directors. This can be accomplished through participating and voting in general assembly meetings, obtaining sufficient information on the companies' performance in a timely manner, electing and dismissing members of the board of directors, and approvals of extraordinary transactions carried by these companies.

2-18 The holding company should set specific terms of reference on which basis the board of directors can be held accountable. For example, the performance of public enterprises can be compared with the performance of its private sector counterparts or with state-owned enterprises in other countries.

2-19 The holding company should also put in place a good reporting system that allows for periodical follow up on the companies' performance, to determine the effectiveness of the management and to monitor the extent to which they are meeting their pre-set objectives.

2-20 The Central Auditing Organization should review the companies' financial statements, act as the external auditor and prepare reports on the companies' performance evaluation. Companies, especially those in which the private sector participates, may

appoint an additional auditor from the private sector provided that this will not obviate the responsibilities of the Central Auditing Organization.

2-21 The holding company should endeavor to obtain sufficient information on the affiliated companies' performance on a regular basis and according to a specific pre-set schedule; participate in the election in the general assemblies of its affiliates; exercise its right to elect and to dismiss members of the board of directors of its affiliated companies; and approve any extraordinary transactions carried out by the companies within the framework of the Public Enterprise Sector Law No. 203/1991, which stipulates that members of the holding company's board of directors are the same members of the general assembly of its affiliated companies.

2-22 An effective monitoring system must be put in place to gauge the performance of public enterprises, holding companies and their affiliates. This can be done by having a review and audit system within the ministry and the holding companies. The system must communicate on a continuous basis with stakeholders whether inside the public enterprise sector or with external auditors or with other government oversight bodies such as the Central Auditing Organization.

### **3. Equitable Treatment of Shareholders (Owners)**

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In the situation where a part of a public enterprise is offered to the private sector, the rights of the new shareholders must be maintained; the articles of association must be modified to reflect the entry of new shareholders; and the rights of the new shareholders must be protected in accordance with the law. Here, the holding company should ensure the availability of all the information and financial reports to private sector shareholders in a timely manner and on a regular basis, coinciding with their dates of issuance. The financial statements and their explanatory notes, the financial auditor's report, and the board of directors' report should be issued at least 15 days prior to the date set for the general assembly meeting. By so doing, a suitable environment is created to allow for serious discussions to evaluate the company's performance. Some corporate governance principles that are related to this subject are given below:

3-1 The State and the public enterprise should respect the rights of all shareholders, treat them equally, and furnish all shareholders with the means to obtain the required information.

3-2 As soon as a part of a public enterprise is sold to individuals or to institutions, the holding company should change the articles of association and the internal bylaws to reflect the entry of private sector shareholders, and effect the principle of equal treatment of all shareholders, especially when the State controls the majority of the company's shares, part of which was sold to the private sector.

3-3 In general, the State, represented by the holding company, should protect its interests in the companies in which the private sector is a minority shareholder, while according equal treatment to the minority shareholders. In this context, it is important to view minority shareholders as true partners in the company, listen to their suggestions, and have them properly represented in the general assembly. The respect given to the minority's rights will have a positive impact on the company's value and on the country's ability to sell additional state shares in the future. Therefore, it is incumbent on the State to act in an appropriate manner when dealing with the rights of the minority, especially that such action may become the model to be emulated elsewhere.

3-4 The holding company and its affiliated companies should provide sufficient safeguards against the majority (be it the State or others) abusing the minority. Such safeguards should instill greater transparency and disclosure, should lead to better practices by members of the board of directors, and should necessitate sufficient majority to protect the company's interests in the important decisions such as restructuring the company's capital, or changing its business plan or other similar activities.

3-5 The holding company should develop the principles and guidelines that govern the relation between the majority and the minority. It should ensure that each company in

the public enterprise sector – and especially their boards of directors – is fully and completely aware of the importance of this relation. Also, it should play an effective role in maintaining the relationship and improving it.

3-6 Holding companies should minimize the use of preferred shares or any other similar practices such as giving larger voting rights to some shares against others; thereby distorting the relation between ownership and control.

3-7 Minority owners as well as other shareholders should be able to obtain all necessary information that will help them in making their investment decisions.

3-8 Majority owners – including the holding company – ought not to use inside information to serve their interests without considering the interests of others. Therefore, they should follow rules, regulations and systems in accordance with the companies' law, commercial law, and the stock market law in case the company was listed in the stock market.

3-9 Public enterprises must develop active and effective communication systems for consultation with shareholders.

3-10 Public enterprises – including those in which the State is a minority owner – should determine the shares of minorities, whether at their disposal or with others. They should inform them at the appropriate times as specified in the Companies' Law and on a regular basis about any future meetings including general assembly meetings. Here, the responsibility of the boards of directors of public enterprises is to ensure that shareholders with a limited number of shares are well informed, are provided with relevant and sufficient information and that they are consulted on a continuous basis. This will surely help in avoiding any distortions that may arise in the decision making process on the part of the majority.

3-11 The participation of minority shareholders in the decision making process should be facilitated by instituting specific mechanisms regarding the election of the members of the board of directors, or by facilitating their participation in general assembly meetings. Therefore, the minority may be given a relative advantage in their rights of representation inside the board of directors through the institution of certain election systems (e.g. pro-ratio representation in the board of directors based on share ownership) or giving them a veto power on some strategic decisions taken by the board.

## 4. Relationships with Stakeholders

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The State, represented by the holding companies, asserts that public enterprises bear their responsibilities towards stakeholders that have interests in their companies and recognizes their rights as specified in the relevant rules and laws. They seek to promote an active cooperation between the companies and those who have claims on them for the purpose of strengthening their values, job opportunities, and protect their financial structure. It is imperative that holding companies build up their relation with their stakeholders (e.g. employees, creditors, banks, etc.), and provide them with the means to contact the board of directors and the companies' managers to discuss any concern or issue that they may have with the company. Some corporate governance provisions that are related to this subject are spelled out below:

4-1 In order to build strong companies, holding companies must be cognizant of the importance of maintaining strong and good relations with stakeholders. This is a particularly important matter for some sectors, such as infrastructure, where public enterprises play a vital and principal role in the process of economic development. Consequently, holding companies as well as their affiliates should adopt proactive policies in dealing with stakeholders and include them in setting their strategic objectives. Specific and clear policies that comprehensively govern relations with stakeholders should be instituted.

4-2 The State should not use the public enterprise sector to achieve targets that are incongruent with those ordinarily prevalent in the private sector, unless necessary compensations are made to bring them into fruition. Also, any rights given to stakeholders that could influence the decision making process must be made clear in a complete and specific manner.

4-3 Holding companies and their affiliates ought to protect and respect the rights of stakeholders as specified in the law through exchanging mutual agreements that protect the rights of all parties. It is important in this context to encourage stakeholders to play a positive and active role towards maximizing the long term value of public enterprises.

4-4 It should be made possible for the employees – to the extent to which they represent the most important segment of the stakeholders as well as according to their role in the production system – to have free access to the board of directors to report any illegal practices against them or that infringe on their rights, ensuring all the while that this is not at the expense of other activities, especially work flow.

4-5 Companies should be allowed to introduce an employee incentive system to improve their performance and to institutionalize a link between performance levels and

bonuses. It is possible to give them incentives in the form of company shares, as an example\*.

4-6 Holding companies should be mindful of the rights of employees and the entities that represent them; employees should have a voice in general assembly meetings by having one or more representative attending them.

4-7 Public enterprises– especially those listed in the stock market – should submit a report on their policies with regard to dealings with stakeholders. This report should include, as an example, information on the company’s social and environmental policies. By so doing, it would indicate that these companies operate within a framework of transparency and that they are committed to cooperating with stakeholders and to respecting their rights. This will result in raising confidence in these companies and improving their image and in turn their place in the society.

4-8 It is preferable for the holding companies to request independent reports from their stakeholders regarding their dealings with their affiliates in order to strengthen the credibility of the companies’ reports on their relationships with stakeholders. This will provide useful information on how policies set for dealing with stakeholders are implemented and how to improve them through their suggested recommendations.

4-9 Public enterprises and their employees must be committed to existing professional values and principles; they should practice them with the utmost exactitude and dedication in order to project a praiseworthy image of the companies. These principles should be followed as a company standard and, hence, should be clearly delineated so that they can be easily followed by the employees. In fact, it is preferable to develop the rules and principles in consultation and collaboration with stakeholders, especially the employees. Moreover, top management and the board of directors should strongly support these principles (it is best if they are documented in the form of a code of honor).

4-10 The set of professional and ethical rules, principles and practices in public enterprises should include a specific system to enforce due process and to introduce mechanisms needed to protect stakeholders and encourage them – especially employees – to report any unethical or illegal transactions carried out by executive managers.

4-11 The holding company should ensure that its affiliated enterprises have unambiguous systems to receive employees’ complaints or those from stakeholders from outside the companies. This should take place either on a personal basis or through entities that represent the parties. It is preferable here to have the board of directors grant the employees or their representatives a direct and confidential access to an independent member of the board who receives the complaints and presents them to the board for resolution.

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\* It is important to refer to the modification made in the Companies’ Law No. 159/1981, which instituted a framework and a set of regulations regarding the provision of incentives to employees and managers through owning a part of the company’s shares.

4-12 When public enterprises seek to secure their financing needs, they should be subject to the prevailing competitive market conditions.

4-13 The role of the State as the owner must be separated from the public enterprise sector' responsibilities towards creditors and bond holders.

4-14 There should be a mechanism through which creditors – including public and private banks – are able to have public enterprises subject to the laws that would enable them to obtain their rights.

4-15 The holding company should encourage its affiliated enterprises to enter the capital market in order to obtain the financing required for their projects through the issuance of bonds. Consequently, the companies will be monitored by the market and their performance will be continuously followed up, thereby reducing conflict of interests between the role of the State as the owner of these companies and its role as the finance source of last resort.

## **5. Transparency and Disclosure**

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The availability of information plays a significant role in decision making, performance evaluation, knowledge about the companies' conditions and assessing the credibility of the companies with those that deal with them. Therefore, transparency and disclosure are considered basic pillars in corporate governance. This necessitates that public enterprises are committed to the principles of transparency and disclosure. Holding companies should likewise be committed to the same principles that suit the nature of their activities as companies that do not carry out the activities by themselves. This can be done, as an example, by preparing consolidated budgets for submission to the general assembly.

Some corporate governance provisions that are related to this subject are given below:

### **Components of Disclosure:**

5-1 Each of the public enterprises should determine the key objectives that it intends to achieve and to disclose them to the society at large. These companies should submit a report disclosing the extent to which the objectives have been realized.

5-2 Holding companies should ensure the annual publication of its companies' financial statements, their complementary explanatory notes, the audit report, and the board of directors' report. Moreover, the companies' performance evaluation should be discussed in their general assembly meetings. Disclosure should be simplified so that any individual would be able to review the companies' performance.

5-3 The performance report should include several financial indicators that reveal the company's financial status; e.g. ratios of profitability, liquidity, turnover rate, temporal development from one period to another and against other companies.

5-4 Public enterprises should prepare quarterly financial statements that would include financial status, income statement, cash flow statement, and their complementary clarifications along with a limited audited report from the financial auditor. The disclosure of such a report periodically and without waiting until the end of the fiscal year enables the board to follow up and evaluate performance constantly and continuously, thereby enabling remedial interventions to straighten out errors as they happen.

5-5 Public enterprises should disclose in an accurate and correct manner and in a timely fashion all conditions that they are facing that will impact their activities or affect their financial status. Moreover, they should release information on extraordinary events that will impact their financial situation immediately. The holding company should follow up to ensure its companies' commitment to this.

5-6 When faced with some risks, public enterprises should disclose in a sufficient manner in its complementary explanatory notes the nature of the risk, how the company will handle it, and the extent to which the risk will influence the company's economic and financial performance. The absence of a clear identification of such risks and their attendant costs, may not give a true picture of the companies' economic and financial status.

5-7 Full disclosure should be made of the involvement of any private sector participation in the projects of public enterprises. To the degree to which such participation would affect risk diversification and the subsequent division of resources and returns between the public and private sectors, it ought to be clearly disclosed.

5-8 In order to show a true picture of the economic and financial conditions of public enterprises, any financial support received from the State or from other parties should be clearly disclosed.

5-9 Public enterprises should disclose the value of incentives, salaries and honorariums received by executive managers and directors.

5-10 The election process in general assembly meetings should be fully disclosed. Consequently, the ownership structure and the basis on which votes are apportioned should be determined well in advance and should be known to all prior to the general assembly meeting.

### **Disclosure Methods:**

5-11 Regardless of whether or not public enterprises are listed in the stock market; they should disclose their financial and non-financial information in the same manner as the private sector. They should also adhere to the accepted international accounting standards; and their financial auditors should perform their duties in accordance with international auditing standards<sup>†</sup>.

5-12 It is also useful for the holding companies to request their affiliated companies to establish electronic websites where their periodical reports and all the information that requires disclosure can be posted to facilitate their review by individuals and institutions alike.

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<sup>†</sup> The Unified Accounting System has been modified to ensure compatibility with international accounting standards. Auditors at the Central Auditing Organization do follow the international auditing standards.

### **Monitoring of Companies:**

5-13 The holding company should ensure that an internal audit (IA) department is available in each of its companies. The IA department should report directly to the board of directors. This would help the development of an organized and streamlined system that enhances risk management, financial audit and other procedures related to work flow. The importance of the IA department stems from its role in strengthening and ensuring the existence of an efficient follow up and disclosure system. This is made possible by instituting rules and regulations that govern the work flow inside the company and by ensuring that they are strictly followed and also by ensuring the flow of information in the required manner for the purpose of disclosure.

5-14 To increase the authority and independence of the internal auditors, they should report directly to the Chairman of the board of directors and to the Audit Committee, formed by the board.

5-15 The IA department should enjoy all the authorities to obtain the data it requires; and it should have direct access to the Chairman and members of the board of directors. It is also preferable that a strong link exists between IA staff and the external auditor to ensure further coordination.

5-16 Besides being subject to review by the Central Auditing Organization (CAO) in accordance with the law, public enterprises should not be precluded from employing external auditors side by side with CAO auditors. This is particularly relevant to those companies that offered some of its shares in the stock market, provided that all of this will not obviate the responsibilities of the CAO.

## **6. Responsibilities of the Board of Directors of Public Enterprises**

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The board of directors (“the board”) of any firm plays an important and decisive role in setting the company’s strategic goals and in selecting the strategies and general policies that govern the work flow inside the firm. Therefore, the financial and economic performance of an enterprise is greatly affected by the decisions taken by the board. Based on this, principles of rational management and corporate governance have greatly emphasized a number of issues related to the formation of the board and the manner, in which it directs the enterprise, maintains its assets and maximizes them. Some corporate governance principles that are related to this subject are given below:

6-1 The board must strive to help the company achieve its targets. Thus, the board should be formed in a way that enables it to carry out its functions effectively, monitors executive managers and play an effective role in drawing up the company’s strategies. Furthermore, the board should be protected from influences and obstacles that disrupt its performance or divert its attention from focusing on achieving the company’s objectives to achieving other objectives that have no links to the company.

6-2 The board should have adequate authority to enable it to take the strategic decisions and to put in place policies required to manage public enterprises. Consequently, it is necessary that the board should have the human competencies and skills needed to fulfill these roles.

6-3 The size of the board should not be large enough to negatively impact its performance. Experience has shown that the smallness of the board contributes to the creation of a more dynamic team and impacts the company’s performance positively.

6-4 The board is totally responsible before members of the general assembly (since they represent the owners) for the company’s performance. It should work towards realizing their interests in the best way possible and to treat all shareholders equally, including private sector shareholders in companies that offered a segment of its shares in the market place.

6-5 The role of the holding company should be limited to setting the strategic objectives within which the board will operate without interfering in the companies’ daily operations. Hence, the executive manager should not send reports directly to the holding company without going through the board.

6-6 The board should have the authority to appoint and evaluate the executive managers, including the CEO whose salary should be set by the board and where the board should ensure that it is linked to the performance of the company.

6-7 To determine the authority and accountability of the board, the board's report should be accompanied by the financial statements and should be forwarded to the financial auditors for their review and evaluation. The report should contain enough information on the company, its financial performance, the risks that it encountered, any extraordinary events that occurred and relations with stakeholders. Clarifications should be provided concerning the extent to which these factors have contributed or have not contributed to the company's objectives.

6-8 It is necessary to emphasize that all members of the board have the same responsibility towards shareholders. Irrespective of whether a member represents the State or another entity, he should work towards the realization of the company's objectives and the shareholders' interests as a whole and not those of a certain group of shareholders at the expense of others.

6-9 In situations where the company employees are represented on the board, appropriate mechanisms are to be established to ensure that their voice will be heard inside the board, that their participation is effective and that their interventions strengthen the capabilities and skills of the board and bolster the flow of more useful information about the company as a whole.

6-10 Employees' representatives should perform their duties and bear their responsibilities just as the other board members do. Their behavior should be directed towards the purpose of fulfilling the company's objectives; and they should treat all shareholders equally.

6-11 The nomination and election process of members of the board should be based on clear principles and should be completely transparent. Members of the board should possess experience relevant to the company's line of work. The majority should be from independent members who are not from the executive manager cadre, and preferably they should be from the private sector.

6-12 The board should include only a limited number of executive managers.

6-13 The Chairman of the board should preferably be neither from the public enterprise sector, nor from amongst the executive managers. Preferably, he should possess financial or technical expertise and should be from the private sector so that he can bring in with him the direction and thinking that rely on the free market mechanism.

6-14 The Chairman should have the skills and abilities needed to carry out his responsibilities, which are represented in basically steering the board towards directing the company in an effective and efficient manner.

6-15 The two functions of the Chairman of the board and the CEO should be separated in as much as possible to attain a sort of balance of power, expand the span of accountability and improve the decision making process. This separation is considered a means through which a strong and effective board can evolve.

6-16 In case members of the parliament (the People Assembly) or the Shura Council are members of the board, this should be done in accordance with the laws that regulate such an occurrence.

6-17 The board should exercise its functions by setting the company's work strategies, oversee the executive managers, follow up their performance and obtain all the reports on a regular basis.

6-18 The board may form specialized committees from amongst its members to assist it in carrying out its functions. It is preferable that such committees are established so that the board can better perform its functions; with an audit committee being one of them<sup>‡</sup>.

6-19 The Chairmen of these committees should not be from the executive members of the board. They should also include a large number of independent members. The percent of independent members and the degree of independence depend on the type of committee and the degree of sensitivity of the issues to potential conflicts of interest. For instance, the audit committee should be made up entirely of independent members.

6-20 The existence of board committees does not free the board from its responsibilities concerning all matters related to the company. For the committees, there must be clear and detailed instructions on the expected functions and tasks, their authority limits, and how their memberships are determined. The committees should submit their reports to the board in its entirety and should also distribute minutes of their meetings to all board members.

6-21 The boards of public enterprises may, in collaboration with their holding companies, establish nomination committees for their board. This is due to the importance of having the board participate in and give its views on the way it is formed and its structure. It is important that the board take the responsibility of searching for suitable nominees. It may also submit specific recommendations regarding this matter to the holding company.

6-22 Appropriate mechanisms must be instituted to evaluate the performance of the board<sup>§</sup>. As an example, it is possible to suggest as part of the evaluation to limit nomination to the board membership to a specific number of terms.

6-23 The board of public enterprises should prepare an annual evaluation of its achievements. This represents a strong incentive for each member in the board to devote the time and effort to carry out his membership responsibilities.

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<sup>‡</sup> The functions and areas of specialization of the audit committee are detailed in the Corporate Governance Code for Listed Companies issued by the Egyptian Institute of Directors in October 2005.

<sup>§</sup> The board of directors of the holding company carries out this function in respect of its affiliated companies. The results are presented at the general assembly meeting of the concerned company. The evaluation of the board of directors of the holding companies is done by the Ministry of Investment and the results are reported to the general assembly meeting of the concerned holding company.

6-24 The board may seek technical assistance from experts outside the board and from the holding company when it prepares its self-assessment. It is preferable that the evaluation be made on the board as a whole and on each member separately.

6-25 According to accepted best practices, the responsibility of evaluating each board member lies with the board Chairman. Based on the overall evaluation of the board as a whole and on the evaluation of each member separately, it will be possible to examine many issues related to the size of the board, its structure, and its paid honorariums. This evaluation may be employed as a basic tool to develop suitable and effective programs for either the old or the new board members.