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ROSC

Report on the Observance of Standards and Codes (ROSC)

CORPORATE GOVERNANCE
COUNTRY ASSESSMENT

Indonesia

APRIL 2010

About the ROSC

What is corporate governance?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The OECD Principles of Corporate Governance provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the board.

Why is corporate governance important?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research. Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

The Corporate Governance ROSC

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment benchmarks a country's legal and regulatory framework, practices and compliance of listed firms, and enforcement capacity vis-à-vis the OECD Principles.

- The assessments are standardized and systematic, and include policy recommendations and a model country action plan. In response, many countries have initiated legal, regulatory, and institutional corporate governance reforms.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the World Bank can also carry-out special policy reviews that focus on specific sectors, in particular for banks and state-owned enterprises.
- Assessments can be updated to measure progress over time.
- Country participation in the assessment process, and the publication of the final report, are voluntary.

By the end of June 2010, 75 assessments had been completed in 59 countries around the world.

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The 2010 Corporate Governance ROSC for Indonesia

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The assessment reflects technical discussions with Bapepam-LK, Bank Indonesia, the Ministry of Finance, the National Committee on Governance, the Ministry of State Owned Enterprises, the Indonesian Stock Exchange, the Chamber of Commerce (KADIN), the Indonesian Central Securities Depository (KSEI), the Company Registry (Ministry of Trade), the Indonesian Mutual Fund Association, the Indonesian Issuer Association, the Public Notary Association, and representatives of companies, banks, and market participants.

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Findings of this ROSC are based on the Detailed Country Assessment (DCA), which is presented as a separate annex. Data sources for the ROSC and DCA include the 2006, 2007, and 2008 Corporate Governance Scorecards prepared by the IICD; a survey of listed companies; and focus groups organized by IICD that included market participants and local stakeholders.

ACRONYMS

Bapepam-LK: The capital market and non-bank financial sector regulator (Badan Pengawas Pasar Modal dan Lembaga Keungan)

BAE: Share Registration Bureau (Biro Administrasi Efek)

CGCG: Code of Good Corporate Governance

CDS: Central Depository System

CEO: Chief Executive Officer

CFO: Chief Financial Officer

CL: 2007 Company Law

CSR: Corporate Social Responsibility

DSAK: Indonesian Financial Accounting Standards Board (Dewan Standar Akuntansi Keuangan)

EGM: Extraordinary General Meeting

ESOP: Employee Stock Ownership Program

GDP: Gross Domestic Product

IAPI: Indonesian Institute of Public Accountants (Institut Akuntan Publik Indonesia)

IDX: Indonesian Stock Exchange

IFRS: International Financial Reporting Standards

OSCO: International Organization of Securities Commissions

ISA: International Standards on Auditing

JSC: Joint Stock Company

KSEI: Indonesian Securities Central Depository (Kustodian Sentral Efek Indonesia)

LR: Listing Rules

NCG: National Commission Committee on Governance

RPT: Related Party Transaction

PSAK: Indonesia Financial Accounting Standards (Pernyataan Standar Akuntansi Keuangan)

SEC: Securities and Exchange Commission

SOE: State Owned Enterprise

SPAP: Standar Profesional Akuntan Publik (Indonesian Public Accountant Professional Standards)

DEFINITIONS

Cumulative voting: Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as she/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.

Pre-emptive rights: Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.

Proportional representation: Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.

Pyramid Structures: Pyramid structures are structures of holdings and sub holdings by which ownership and control are built up in layers. They enable certain shareholders to maintain control through multiple layers of ownership, while at the same time they share the investment and the risk with other shareholders at each intermediate ownership tier.

Shareholder agreement: An agreement between shareholders on the administration of the company. Shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.

Squeeze-out right: The squeeze-out right (sometimes called a "freeze-out") is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.

Withdrawal rights: Withdrawal rights (referred to in some jurisdictions as the "oppressed minority," "appraisal" or "buy-out" remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

Corporate Governance Country Assessment

Indonesia

April 2010

EXECUTIVE SUMMARY

This report assesses Indonesia's corporate governance policy framework. It highlights recent improvements in corporate governance regulation, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in Indonesia. It is an update of the 2004 Corporate Governance ROSC.

Good corporate governance enhances investor trust, helps to protect minority shareholders, and can encourage better decision making and improved relations with workers, creditors, and other stakeholders. It is an important prerequisite for attracting the patient capital needed for sustained long-term economic growth.

Achievements: Bapepam-LK, the securities regulator, has continued to introduce and amend its regulations, and has actively enforced these regulations to better protect investors. In 2006, Bank Indonesia introduced rules for corporate governance in banks, and has actively monitored and enforced their implementation. The Code of Good Corporate Governance (CGCG), first adopted in 1999, was amended in 2006, and sector specific codes issued for Banking and Insurance. In 2007 a new Company Law was adopted that introduced explicit duties for board members. The Ministry of State Owned Enterprises has also carried out significant corporate governance reform in the State Owned Enterprise (SOE) sector.

Basic shareholder rights are in place. Under recently revised Bapepam-LK regulation, non-conflicted shareholders approve certain related party transactions before they take place and the 2007 Company Law expanded shareholder rights to private redress.

Regulatory requirements and private actions have improved board professionalism and company disclosure. The authorities have declared their intention to fully adopt international accounting and auditing standards. Companies produce relatively timely and complete reports. Boards of commissioners are more professional about their responsibilities, and have independent members. Many board members have received training on their duties and other areas.

Key Obstacles: While the new Company Law has clarified the basic duties of board members, commissioners still do not carry out many key functions required by the OECD Principles of Corporate Governance, particularly the choice of CEO (presiding director). Board committees have permanent members who do not serve on either board tier, in part because commissioners are not believed to have sufficient technical skills. Minority shareholders have little influence on board member selection.

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A key aspect of the audit framework — the selction of the external auditor — is not sufficiently clear in law or regulation. External auditors do not have a clear liability to shareholders or the company. Oversight of the accounting and auditing professions is shared among the self regulatory organizations, Bapepam-LK, and a division of the Ministry of Finance (the PPAJP). The PPAJP has limited resources given the large number of public accounting firms and accountants.

A significant weakness is a lack of reporting of ultimate ownership and control, which hinders the effectiveness of rules on conflicts of interest. Shareholders also have limited rights to access other information from the company, like the article of association, and many companies post little or no relevant information on their company websites. Mandatory corporate governance statements also tend to have limited content.

While shareholder rights are generally respected, shareholders have relatively weak rights to propose agenda items or ask questions. Rules on takeovers were changed in June 2008 and now require a higher threshold before a tender offer has to be made. Market participants have noted that these changes have made it difficult for large shareholders to accumulate shares and delist their companies from the exchange.

While some of its provisions have been adopted into regulation, the CGCG is voluntary and companies do not have to "comply or explain" their adherence. This has reduced awareness of and compliance with the Code.

Shareholders have made limited use of their redress rights under the law. Courts are slow, and few suits have been filed against companies or board members.

Assessment: The Detailed Country Assessment of the OECD Principles of Corporate Governance is summarized in the tables at the end of the report. Indonesia's scores have improved since the last ROSC was carried out in 2004. The biggest increases are in shareholder rights, where average percent of observance increased from 56 to 76, and equitable treatment of shareholders, which went from 60 to 74. Nevertheless, more work remains to be done. Using a new methodology to assess compliance with the OECD Principles only four Principles were fully observed, 25 were broadly observed, 34 principles were partially observed, and two were not observed. Compared to other countries in the region, Indonesia still lags in some key areas, but is closing in on the regional pacesetters, particularly India, Thailand, and Malaysia.

Next Steps: Indonesia has undertaken important reforms in recent years. However, fully tapping the potential of capital markets and professionalizing boards and management will require that reform continues. Key reforms include:

- Better regulation of ownership disclosure and other nonfinancial disclosure;
- Requiring key shareholder rights be incorporated into company articles;
- Making more effective use of independent commissioners and audit committees;
- Amending company law to better protect shareholders;

- Incorporating and expanding board member powers in company law and the CGCG;
- Requiring that companies disclose their compliance with the CGCG;
- Giving minority shareholders a greater say on board selection;
- Increasing Bapepam-LK's capability to oversee company disclosure and other key areas;
- Encouraging board and media training.

Beyond these reforms, authorities should review: tender offer and delisting rules, and the role of the PPAJP and oversight of accounting and auditing. A more in depth analysis of state owned enterprise corporate governance should also be considered.

Landscape

The Corporate Governance ROSC assessment of Indonesia benchmarks law and practice against the OECD Principles of Corporate Governance and focuses on the companies listed on the Indonesia Stock Exchange (IDX). This report updates a previous report published in October 2004.

The Indonesian economy was hit particularly hard by the 1997–98 Asian financial crisis and subsequent political instability. The government was forced to rescue the majority of the banks in 1998–99 at an estimated cost of US$70bn. Over the past five years, the country's markets, financial institutions, and economy were well on their road to recovery, with annual growth averaging 5.2 percent since 2000.

As in other countries in Asia, the 1997-98 crisis exposed certain weaknesses in the country's corporate governance framework. Concentrated ownership by large family-controlled groups, combined with weak rules on related party transactions and other forms of self-dealing, resulted in significant minority shareholder expropriation, and a lack of transparency exacerbated investor response to the crisis. In response, the government and the private sector implemented a variety of reform measures, including the creation of a national corporate governance code, regulations on review, approval, and disclosure of related party transactions, and significant reform of the governance of state-owned enterprises.

Corporate governance has been a major policy concern in Indonesia for the past 10 years.

Capital Markets

Until recently Indonesia had two stock exchanges, the Jakarta Stock Exchange and the Surabaya Stock Exchange. The two merged in 2007, creating the Jakarta-based Indonesian Stock Exchange (IDX).

The equity market has grown rapidly in size and importance.

As in other emerging markets, the five years leading up to 2008 saw a boom in market prices and activity. From January 2005 to December 2007, the composite index of the IDX climbed by over 160 percent, and the number of listed companies grew from 330 to 383. The market then declined by over 50 percent, before recovering in 2009 and almost doubling to a record high by April 2010. However, despite its significant growth, Indonesia's equity market (and portfolio equity flows) remains relatively modest by international standards.[1]

1 *SOURCE: IDX monthly reports, World Bank Development Indicators, Global Development Finance 2009.*

TABLE 1: Equity Market: Indonesia vs. Regional and Global Emerging Markets (2009)

	Listed Co's	Market Cap percent GDP	Market Cap (Billions $US)	Turnover Ratio (%)	Market Cap percent of OECD Avg.	Market Cap ($) % of OECD Avg.	Turnover ratio % of OECD Avg.	Portfolio Equity Inflows (Billions $US)
Indonesia	398	33	178.2	83	49.9	17.3	93.9	.8
Thailand	535	52	138.2	112	78.6	13.4	126.7	1.9
Korea	1778	100	836.5	n/a	151.2	81.4		..
Malaysia	953	134	256.0	33	202.6	24.9	37.3	..
Singapore	459	171	310.8	103	258.5	30.2	116.6	..
Brazil	377	74	1,167.3	74	111.9	113.6	83.7	37.1
China	1700	100	5,007.6	230	151.2	487.2	260.3	28.2
India	4955	90	1,179.2	119	136.1	114.7	134.7	21.1
Russia	1824	19	30.3	8	28.7	3.0	9.1	.0
OECD Avg	812	66	1,027.9	88	100.0	100.0	100.0	15.3

FIGURE 1: IDX IHSG Index 2000-2009

FIGURE 2: Market capitalization as % of GDP

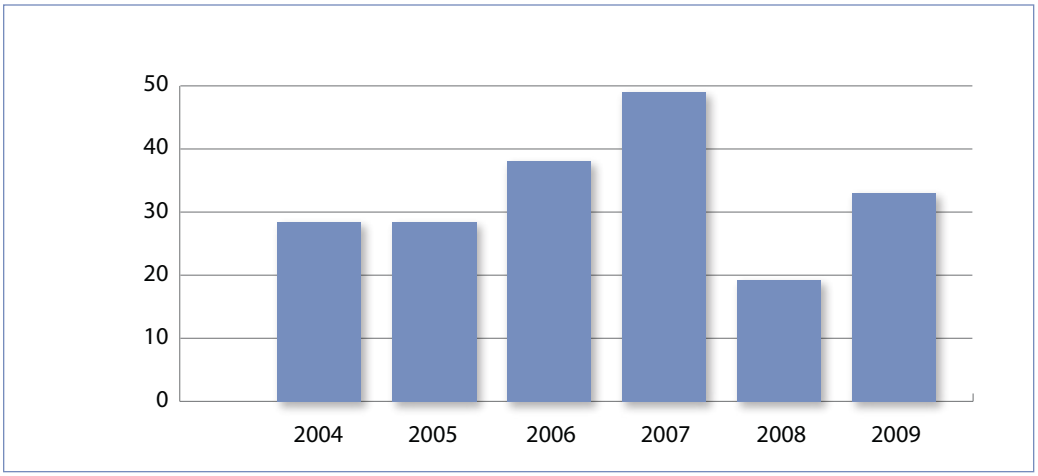
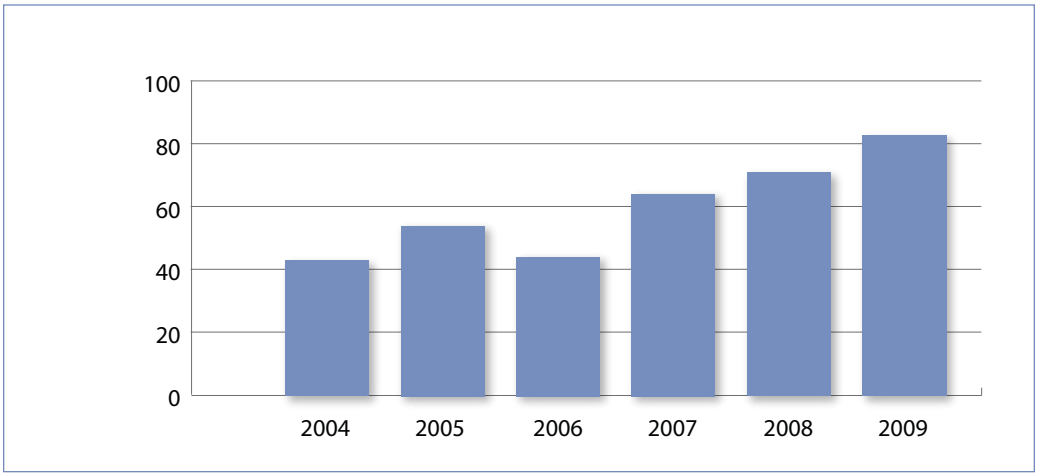


FIGURE 3: Turnover Ratio



Indonesia has a modern shareholder recordkeeping system. All shares that are traded on the IDX must first be dematerialized and deposited in KSEI.[2] Only brokers and custodians have access to the system but the KSEI has also begun keeping track of sub-accounts at the customer level. Bapepam-LK and KSEI are developing eBAE reporting facility where BAE can report shares ownership data in script form to Bapepam-LK online. Settlement is T+3.

There are about 388.957 accounts in KSEI.[3] When mutual funds are included, many estimate that there are approximately 2 million shareholders in Indonesia.

Shares traded on the IDX are held by the central depository, but many shares are still held by other registrars.

2 The great majority of issuers also use the services of an independent registrar (BAE in Bahasa Indonesia). There are 11 BAE licensed by Bapepam-LK, and 16 in-house BAE (where issuers act as BAE for their own shares).. The BAE reconcile "scrip" shares for which they keep the records directly and dematerialized "scripless" shares with KSEI. An average 70 percent of" shares are held in scripless form. There is no organized initiative to move to 100 percent scripless shares.

3 As of 31 April 2010.

Ownership

Ownership of listed companies remains highly concentrated.

Based on ownership data from scripless shares, the three largest shareholders control an average of 60.9 percent of listed companies. Listed companies can be generally broken down into five different categories (actual ownership patterns are not transparent and detailed data were not available for the report):

- **Groups.** The majority of listed companies are controlled by families or approximately 10 large family-owned company groups.
- **State owned enterprises.** The national government controls 114 companies through the Ministry of State Owned Enterprises. 16 were listed on the IDX as of January 2010.
- **Banks.** There are 123 banks, of which 24 are listed (including all the large ones). The four state-owned banks (all listed) represent 35 percent of assets. According to Bank Indonesia, on average, 48 percent of bank assets are owned by foreigners.
- Foreign controlled companies.
- Independent companies that are not part of groups.

International investors play a significant ownership role.

Of the shares held in the central depository (KSEI), over 67 percent are owned by foreign entities and individuals.[4] Most domestic shareholders are registered as corporations (indicating a group structure) or individuals. Domestic institutional investors own approximately 11 percent of the market. Custodians play an active role in the market, both for foreign investors and for local institutional investors (for whom custodians are mandated).

Ownership of Listed Companies on 31 December 2009 (Scripless Shares Only)

	Domestic	Foreign
Corporates	15.0 %	7.0 %
Individuals	7.1 %	0.2 %
Mutual Funds	4.1 %	4.2 %
Insurance companies	3.3 %	3.3 %
Pension Fund	1.4 %	1.2 %
Securities Company	1.0%	1.8 %
Financial Institution	0.8 %	23.6 %
Foundations	0.1 %	0.1 %
Others	0.1 %	28.9 %
TOTAL	**32.9 %**	**67.1 %**

SOURCE: KSEI data

4 This data should be interpreted with caution because many of these "foreign" shares are reportedly off-shore Indonesian capital coming back into the country.

Laws and Institutions

Bapepam-LK is the securities regulator and main source of redress for shareholders.

The company law framework is based on civil law. Key laws include the 2007 **Company Law** (Law 40/2007) and the 1995 **Capital Market Law** (Law 8/1995). **Bapepam-LK** is the securities and non-bank financial institutions regulator and has issued a number of corporate governance related regulations. **Bank Indonesia**, the central bank, has also issued corporate governance standards for banks. The **National Committee on Governance** (NCG) was established by Decree of the Coordinating Minister for Economy, Finance and Industry, and includes 30 representatives from the public and private sector. It works on both public and private sector governance and issued a **Code of Good Corporate Governance** (CGCG), most recently updated in 2006. A revised Capital Markets Law has been drafted and is awaiting Parliamentary approval.

Limited liability companies are incorporated according to the Company Law. A **public company** is a company that has at least 300 shareholders and a paid-in capital of at least three billion rupiah (about USD 300,000). To be listed on the stock exchange, companies must be public companies, must be registered as issuers with Bapepam-LK, and must conduct an IPO and apply to be listed on the stock exchange. There are a very small number of public companies (approximately 10) that are not listed.

Key Findings

The following sections highlight the principle-by-principle assessment of Indonesia's compliance with the OECD Principles of Corporate Governance.

COMMITMENT AND ENFORCEMENT

Legal and Regulatory Framework

Since the last corporate governance ROSC in 2004, the authorities have continued to make significant efforts to improve corporate governance and investor protection.

First issued in 1999, the Code of Good Corporate Governance was last amended in 2006.

Since it was issued in 1999, the CGCG has been revised several times (in 2001 and most recently in 2006). In addition the NCG has developed a set of sector-specific codes, including the Banking Sector Code (2004) and the Insurance Sector Code (2006). The GCG Code is considered to be voluntary, and to be "a reference point" for both regulators and "all companies in Indonesia". In contrast to codes in many other countries, companies do not have to provide a report on whether or not they comply with certain provisions, and if not why not (i.e. "comply or explain").

The CGCG has indirectly served as an important source of good practice; the regulatory authorities have adopted key provisions and thus made them mandatory. This approach does increase compliance with those provisions that have been adopted into law or regulation, but also reduces flexibility for small companies and others that may have specific and legitimate corporate governance concerns. In addition, a number of the Code's provisions have not been included in regulation,

The company law was replaced in 2007.

A new Company Law (CL) was introduced in 2007. The new law introduced explicit duties for board members and included a number of other updates.[5]

Bapepam-LK and Bank Indonesia have each issued key corporate governance regulations.

Bapepam-LK has issued a variety of regulations for public companies. These cover typical securities market matters (prospectus and disclosure requirements, and takeover regulation) but also issues that are often part of company law (for example shareholder meeting requirements). In many cases the regulations duplicate certain CL provisions, allowing Bapepam-LK to enforce these matters directly.

Bank Indonesia's (BI) 2006 corporate governance regulation applies to both listed and non-listed banks. The regulations address: the function and composition of the BOC and the BOD; risk management, audit, nomination and remuneration committees; the compliance, internal and external audit, and risk management functions; disclosure of financial and non-financial information; and introduce a requirement for a corporate governance implementation report.

Bapepam-LK consults more consistently on new regulations.

The authorities generally consult with stakeholders on regulatory changes. Bapepam-LK's rule-making process requires an adequate consultation period when seeking comments from the public, and that these comments and amendments be disclosed. Observers report that Bapepam-LK's performance in this area had significantly improved over time.

5 The new CL also contains: new regulations on corporate social responsibility for companies; removal of the possibility for companies to have authorized capital in excess of issued capital; new requirement for a "Shariah Supervisory Board" for companies organized under the principles of Islamic finance; increased capital requirements for a limited liability company, and requires all shares to be paid in full; allows companies to send electronic updates to the company registry; allows shareholder meetings to be held through electronic means.

To be responsive to the concerns of listed companies during the current global crisis, Bapepam-LK has also tried to be flexible and has adjusted some corporate governance-related rules and regulations (including those related to share buy backs and shareholder meetings).

Enforcement

Bapepam-LK plays a key role in overseeing CG of listed companies.

The power and authority of Bapepam-LK is generally consistent with international good practice. Bapepam-LK has the authority to conduct inspections and investigations against public companies if it suspects violations of the capital markets act or its own regulations. Bapepam-LK actively and creatively enforces the law and regulation over listed companies. Because Bapepam-LK regulations duplicate some aspects of company law, it can intervene in a number of areas outside the traditional purview of a securities regulator.

There have been concerns about Bapepam-LK's independence from government. According to the CML, "Bapepam-LK reports and is responsible to the Minister (of Finance)." Bapepam-LK is not financially independent; it relies on the state budget for its funding. Revenue from fees paid by market participants and fines must be paid directly to the state budget. Bapepam-LK can then withdraw it for institutional purposes.

Overall resources are considered to be sufficient. The number of Bapepam-LK employees is 875. The budget for FY 2009 is IDR 156.3 billion. However, several divisions of Bapepam-LK reported that they have insufficient skilled resources in accounting and legal issues. Bapepam-LK has a relatively good reputation in the marketplace.

Bapepam-LK can draft and propose prudential rules, regulations and statutes. It can impose fines and take action to stop or reverse a decision of GMS, board, or management if that decision violates the law. It can investigate shareholders complaints and launch formal and criminal investigations. Most penalties are administrative, with fines and other penalties determined by a Bapepam-LK sanctions committee. Bapepam-LK can also launch criminal investigations. Bapepam-LK cannot and does not intervene in disputes between shareholders (other than investigating complaints). As noted in the Table below, Bapepam-LK has sanctioned companies in a variety of areas; the preponderance of cases involve disclosure.

Bank Indonesia actively enforces its CG regulations.

BI has developed a "bank self assessment method" to monitor the implementation of its regulation, and monitors the corporate governance reports that must be produced by banks. In general, these assessments indicate that governance performance significantly improved from 2008 relative to 2007, and state-owned banks appear to be doing better at complying with corporate governance regulations than smaller banks. In general, there appears to be a much higher level of understanding, more training, and better policies and procedures relative to five years ago.

Progress has been made in sharing data between BI and Bapepam-LK, to allow them to better coordinate their enforcement functions. A Memorandum of Understanding was signed between the two authorities on April 30, 2010.

Courts are expensive to use.

Courts in Indonesia take more procedures and time than the OECD average, and are significantly more costly than both OECD and other East Asian economies. This is detriment to redress not just for shareholders, but also other stakeholders like employees and creditors, as well as the regulatory authorities. Bapepam-LK rarely refers cases for prosecution.

TABLE 2: Bapepam-LK Sanctions of Listed Companies 2005-2009

	Roupiah (billions)						USD
	2005	2006	2007	2008	2009	Total	Total
Article 107 Capital Market Law				1.0		1.0	$ 98,900
Article 93 Point B Capital Market Law			5.0			5.0	$ 494,500
IX.A.2 : Registration Procedures For a Public Offering				.0		.0	$ 20
IX.a.7: Responsibilities Of Underwriters				.0		.0	$ 10
IX.D.1: Pre-Emptive Rights	.0	.0	.0	.0	.0	.1	$ 7,121
IX.D.5: Bonus Stocks	.2				.0	.2	$ 18,395
IX.E.1: Conflicts Of Interest On Certain Transactions		.1	1.1			1.2	$ 118,680
IX.E.2: Material Transaction And Changing In Core Business		.0				.0	$ 1,879
Viii.G.11 :The Responsibility Of BOD On Fin. Statement			7.0			7.0	$ 692,300
Viii.G.2: Annual Reports	2.5	.6	2.4	2.7		8.1	$ 803,068
Viii.G.7 Guidelines For The Preparation Of Fin. Statements		.7				.7	$ 71,703
X.K.1: Information That Must Be Made Public Immediately	.1		.0	.0		.1	$ 13,787
X.K.2: Obligation To Submit Periodic Fin. Statements		3.0	.4			3.3	$ 330,623
X.K.2: Obligation To Submit Annual Fin. Statement	3.3		2.1	2.3		7.8	$ 769,976
X.K.2: Obligation To Submit Semi Annual Fin. Statement	.6	1.2	.3	1.5	.0	3.6	$ 354,191
X.K.4: Reports On Funds Received From a Public Offering	.5	.8	.3	.6	.3	2.4	$ 239,734
X.K.5 :Disclosure Of Information Re: Bankruptcy			.1			.1	$ 13,055
X.K.5: Keterbukaan Pernyataan Pailit (X.K.5).3		.3				.3	$ 27,890
X.M.1: Disclosure Requirements For Certain Shareholders	1.0	.0	.0	.3		1.3	$ 127,591
Xi.B.2: Repurchases of Shares	1.9					1.9	$ 187,910
GRAND TOTAL	**10.0**	**6.7**	**18.7**	**8.4**	**.4**	**44.2**	**$ 4,371,331**

TABLE 3: Doing Business 2010 Enforcing Contracts Indicator

Indicator	Indonesia	East Asia & Pacific	OECD Average
Procedures (number)	39	37.2	30.6
Time (days)	570	538.1	462.4
Cost (% of claim)	122.7	48.5	19.2

SHAREHOLDER RIGHTS

Shareholder Meetings

Shareholders have the right to attend and cast votes at the GMS. Shareholder meetings must be announced 28 days before the meeting. The invitation to the GSM (including the agenda) must be made at least 14 (fourteen) days before the GSM, excluding the invitation and the GSM date. Shareholders also have the right to ask questions, although under the law these should be linked to the agenda. But shareholders have relatively weak rights to add items to the agenda — they must either call a shareholder meeting (10% of capital required) or have the unanimous consent of all shareholders.

Shareholders have to the right participate at the GMS, but not to ask off-agenda questions.

The company survey conducted by IICD suggests that companies comply with the legal requirements for the GMS (i.e. 14 days), and that almost all GMS are held in Jakarta. Some focus group participants specified some technical problems (e.g., for shareholders residing outside Jakarta, and for foreign investors). Shareholders do ask questions, but (as in many countries) companies are not enthusiastic about the process.

Shareholders can vote in absentia, and such proxy voting is widely used. The proxy does not need to be notarized. Provisions supporting electronic voting at shareholder meetings were included in the 2007 reform to the company law, but adoption of this technology appears to be in its early stages.. There is no rule against proxy solicitation. Foreign investors generally rely on custodians, and in practice, market participants confirm that custodians do pass information to their clients and vote based on their instructions in the GMS. Bapepam-LK enforces its own regulations covering shareholder meetings.

Many institutional investors do vote, and the average attendance rate of institutional investors is higher than that of individual investors. Participants in the focus group discussion also noted that many investors had internal policies on voting and corporate governance. However, shareholder engagement with companies is limited. There are no recommendations or rules that specifically encourage institutional investors to vote.

Institutional investors attend and vote, but do not disclose their voting or voting policies.

Bapepam-LK has issued several rules addressing certain types of conflicts of interests for institutional investors (e.g., investment management companies, mutual funds). However, the legal and regulatory framework does not appear to require institutional investors to develop a policy for dealing with conflicts of interest that may affect their decision-making during the exercise of their ownership rights, or to disclose such a policy. During the focus group discussion, many institutional investors noted that they did have policies on conflict of interest, which are disclosed internally. Some institutional investors do vote against the recommendations of the board and management, although in most cases they vote with them.

Appointing Board Members and Setting Dividends

In general, the right to vote for board members is in place and is not violated. However there is generally no opposing slate of candidates. In practice, minority shareholders can nominate candidates, but there are no required mechanisms that allow non-controlling shareholders to appoint or elect board members (i.e. proportional representation, cumulative voting).

Minority shareholders have little influence on board appointment.

The CGCG recommends BOC nomination and remuneration committees, which should be chaired by an independent commissioner, and banks are required to have such committees. According to the company survey, just 12 percent of listed companies had remuneration committees.

The GMS sets dividends.

Company law gives shareholders the rights to dividends out of profits. In practice, directors propose interim (and final) dividends, which are then approved by the GMS. There were no reports of problems with late or non-payment of dividends, though the company survey found that 65 percent of firms pay dividends more than 30 days after they are declared.

Major Transactions and Corporate Events

Shareholders have preemptive rights in the event of a capital increase.

Any increase in capital must also be approved by shareholders in the GMS. Shareholders also have pre-emptive rights in the event of a capital increase.

The threshold for a mandatory tender recently increased from 25 to 50 percent.

Under Bapepam-LK regulation negotiations which may result in a takeover must be disclosed and if a shareholder passes the 50 percent ownership threshold, or in some other way "directly or indirectly" causes a change in control, he or she must make a tender offer for all outstanding shares.[6] The price to be offered during a tender offer of a listed company must be at least as high as the price during the 90 days prior to the announcement of the tender.

On June 30, 2008, Bapepam-LK amended the takeovers regulation, increasing the tender threshold from 25 percent to 50 percent, limiting the ability of minority shareholders to sell shares during certain *de facto* controls changes. According to market participants, the amendments also **indirectly** prevent companies from delisting from the exchange, or taking the company private, should the company wish to do so for its own corporate needs. An investor can make the mandatory offer for 100 percent of all the shares of the company, but within two years the acquirer must transfer 20 percent of its shares to the public after the tender offer is completed. This amendment was considered by some market participants to act as a deterrent to new listings and keep marginal companies on the exchange.

Shareholders approve certain large transactions, except in the core business of the issuer.

The approval and disclosure requirements for "material" transactions are summarized in table on the following page. Material transactions are those with a total value equal or greater than 20% of a company's equity. Transactions of a size greater than 50% of equity require approval from the GM; the agenda of the GMS must include a special session to explain the transaction. Companies must assign an independent appraiser to make a valuation and provide opinion about fairness of the transaction value. The board of directors and commissioners must make a statement that all material information has already been disclosed, and that the information is not misleading. Transactions that are "the core business of an Issuer or a Public Company" are excluded. In general, this rule has forced companies to be more transparent in executing material transactions.[7]

6 *The new controller must make an offer for all remaining shares, except shares owned by other bidders or other "major shareholders" or "other controllers".*

7 *The threshold for shareholder approval was increased as part of a revision of regulation IX.E.2 in November 2009.*

TABLE 4: Comparison of Rules Covering Significant Transactions

	Material Transaction	Affiliated Transaction	Conflict of Interest Transaction
Definition	Material Transaction is any: a. purchase of shares, including acquisition b. sale of shares c. investment in entities, projects, and/or certain business activities d. purchase, sale, transfer, exchange of business segment or non-share assets e. ease of assets f. fund lending and borrowing g. pledge of assets and/or h. provide corporate guarantees with a total value equal or greater than 20% of a company's equity which made in one transaction or in a series of transactions for a particular purpose or certain activity.	Transactions with an affiliated party: • a family relationship by marriage and descent to the second degree, horizontal as well as vertical; • a relationship between a Person and its employees, directors, or commissioners; • a relationship between two Companies with one or more directors or commissioners in common; • a relationship between a Company and a Person that directly or indirectly, controls or is controlled by that Company; • a relationship between two Companies that are controlled directly or indirectly by the same Person; or • a relationship between a Company and a substantial shareholder.	Any transaction where a director, commissioner and/or substantial shareholder have a conflict of Interest.
Approvals required	For material transaction with total value 20% - 50% of company's equity, issuers are not required to get prior approval from shareholders. Prior approval by shareholders in a shareholders meeting is needed for material transaction which is greater than 50% of company's equity.	None	Prior approval by non-conflicted shareholders
Independent appraisal	Yes	Yes	Yes
Disclosure timing	For material transaction with total value 20% - 50% of company's equity: the disclosure should be made no later than 2 working days after the transaction. For material transaction with total value greater than 50% of company's equity, the disclosure should be made at least 14 (fourteen) days before the invitation and the invitation shall be at least 14 (fourteen) days before the General Shareholders' Meeting.	Two days after transaction (as "material event")	Materials for shareholder approval
Ex-poste disclosure	• Date, place, agenda of shareholders meeting (if required) • Description of the Transaction • Summary of an independent appraisal report • Justification and reason for transaction	• Statement from commissioners and directors to declare that all significant information has been disclosed and such information is not misleading. • Summary of any expert or independent.	
Exemptions	• Transactions with its 99%-controlled subsidiaries • Borrowing from financial institutions • Transaction that are "the core business of an Issuer or a Public Company" • Issuing non-equity securities through public offering procedures • The information has already been disclosed in the prospectus completely and meet the regulation requirements • Share acquisitions or share sales to maintain level of ownership • Execution of pre-emptive rights • Court decisions • The transaction is intended to satisfy law and regulation.	• The use company facilities by employees directly related to their responsibilities and in accordance with a shareholder-approved company policy. • Compensation and benefits to employees (must be disclosed in aggregate in financial statements)	Same as for affiliated transactions plus: • Pre-existing transaction, fully disclosed in the prospectus. • Sales done through an open auction. • Value is less than 0.5% of paid in capital (up to 5 billion rupiah). • Transaction carried out following court order.

Independent shareholders must pre-approve certain RPTs.

Bapepam-LK upgraded its requirements for the approval of related party transactions in 2008 and 2009. There are two types of transactions under the regulation: *affiliated transactions* (defined quite broadly) must be disclosed to Bapepam-LK and announced it to public no later than 2 days after the transaction; *conflict of interest transactions* must first be approved by independent shareholders or their authorized representatives in a GMS.

A recent survey of related party transactions in Indonesia finds that while the rules are "adequate", enforcement and implementation remain a challenge.[8] The available evidence suggests that companies comply with the disclosure requirements, although it is difficult for shareholders to easily assess the extent of compliance. Detailed information on violations is not easily accessible.

In recent years, Bapepam-LK has brought charges against companies for violating rules related to conflict of interest. There have been no conflict of interest cases involving individual directors or commissioners. Shareholders can also challenge but have rarely done so in the past. The vagueness of Article 99 of the Company Law (which addresses board conflicts of interest) would appear to hinder legal challenges.

Protecting Shareholders From Illegal Insider Trading

Insider trading is prohibited, but has not been prosecuted.

The CML prohibits insiders from passing on or trading on inside information or influencing others to do the same. Insiders include commissioners, directors, employees, major shareholders, and others who acquire information from their relationship with the company. Securities companies are also prohibited from trading on inside information. Commissioners, directors, and significant shareholders are also required to disclose their changes in ownership.

As in many countries, detecting and enforcing violations of illegal insider trading rules has proven to be a significant challenge. There have been at least three cases where Bapepam-LK has charged company insiders or market intermediaries with insider trading or market manipulation. Market participants agree that Bapepam is making an effort to bring cases, but also feel that insider trading and market manipulation continue.

Shareholder Recordkeeping

KSEI is addressing brokers' unauthorized use of customer accounts.

There were no problems reported with custodians or the KSEI in terms of accurate shareholder recordkeeping. There have been some problems reported with brokers trading client shares under their control, and shareholders suffering losses as a result. To address this situation KSEI now allows clients to see their KSEI subaccounts via the internet, and a compensation/protection fund that has been set up.

It is not possible for companies to restrict the transfer of shares, and there are no reports of companies trying to block share transfers.

8 Sidharta Utama, Indonesia: National Experiences With Managing Related Party Transactions, produced for the 2008 Asian Roundtable on Corporate Governance, available at www.oecd.org.

Shareholder Redress

Shareholders can sue directly or file suit on behalf of the company…

Shareholders have significant right to private redress under the law. Company law allows shareholders to file a direct suit against the company. Shareholders with at least 10 percent of the voting rights may also file a derivative suit on behalf of the company against director or commissioners who by their fault or negligence create losses for the company. Under the capital market law, any person who suffers losses due to violation of the law may sue for compensation.

Shareholders have other powers. Under the company law, shareholders with at least 10 percent of voting rights may go to court to request an inspection of the company if it is believed the company or a member of either board "committed an illegal action which may cause adverse effect to the shareholders or a third party". Shareholders may also request the company to buy back their shares if that shareholder does not agree with a major decision (such as amendments of the articles of association, or a merger/acquisition). Shareholders with at least 10 percent of the voting rights can call a shareholder meeting.

…but rarely do so in practice.

However, very few of these legal actions are applied in practice. Some observers indicate that a combination of passive minority shareholders, expensive court actions, and lack of experience of judges in capital market matters have meant that there are very few (if any) private actions taken under the law.

Doing Business 2010 sheds some additional light on this question. The following table shows Indonesia's scores on the "protecting investors" index. Indonesia scores highly on the extent of related party transaction disclosure (see above) but less highly on the extent of directors liability, and the ease of shareholder lawsuits.

TABLE 5: DB Investor Protection Index Components (2010)

DB Investor Protection Indicator	Indonesia	East Asia & Pacific	OECD Average
Extent of disclosure index (0-10)	10	5.1	5.9
Extent of director liability index (0-10)	5	4.6	5.0
Ease of shareholder suits index (0-10)	3	6.3	6.6
Strength of investor protection index (0-10)	6.0	5.3	5.8

DISCLOSURE AND TRANSPARENCY

Company Reporting

The great majority of companies produce annual reports on a timely basis.

All listed companies are required to produce annual reports with audited financial statements that include a balance sheet, income statement, and cash flow statement. Consolidation is required if a public company controls or has majority ownership in other companies. The great majority of listed companies produce annual reports on a timely basis and Bapepam-LK regularly monitors and enforces compliance with basic disclosure requirements.

Non-financial Disclosure

Annual reports should include statements on corporate governance.

In addition to financial statements, the annual report must also include a board report with statements on corporate governance and corporate social responsibility. Recent regulation requires the disclosure of corporate governance policies and practices. However, disclosure on compliance with the CGCG is purely voluntary In practice, according to 2008 IICD data, only 28 percent of listed firms provide a comprehensive statement regarding governance policies, while 48 percent disclosed some aspects of governance policies. 24 percent do not disclose anything related to governance.

Details on board member pay are generally not disclosed.

The annual report should also include details on board members including qualifications, meeting attendance, and independence. Board member remuneration and remuneration policy is also to be disclosed. In practice, according to 2008 IICD data, most listed companies disclose aggregate remuneration, but only 2 percent of listed firms disclosed remuneration on an individual basis and only 5 percent disclosed their remunation policy.

Major shareholdings, RPTs and risks are to be disclosed; ultimate control and ownership are not.

Other mandatory elements of non-financial reporting include ownership, related party transactions (RPTs), and risks and risk management. Shareholders owning 5 percent or more of shares and the holdings of board members are to be disclosed. Disclosure of indirect or ultimate shareholdings or control is not required. Because shareholder approval is required for certain transactions, RPTs are sometimes disclosed *ex-ante.* National accounting standards also require *ex-post* disclosure in the notes to the financial statements. A limited set of RPTs, included transactions between SOEs, do not have to be disclosed.

In practice, large majorities of companies do disclose direct shareholdings and RPTs.[9] Most companies also disclose risk factors. However, many do not disclose their risk management policies. Control that relies on indirect shareholding is not disclosed, and not all companies confirm that RPTs take place on an arm's length basis.

Material information should be disclosed publicly, not selectively.

Under Bapepam-LK regulation, companies are required to publicly disclose information that could materially impact stock prices within two days, though such information is rarely posted on company websites. Material information is not to be selectively disclosed to certain investors or others, and companies generally comply with this requirement.

9 Using 2006 Annual Reports, a study by Rivano (2008) found that compliance with Bapepam-LK related party transaction disclosure requirements was 78.6%.

Financial Reporting and Auditing[10]

Standard setters plan to fully adopt IFRS in 2012…

The Financial Accounting Standard Board (DSAK), part of the Indonesian Institute of Accountants *(Ikatan Akutan Indonesia*, or IAI) is the financial accounting standard setter. In 1994 National Accounting Standards (*Pernyataan Standar Akuntansi Keuangan*, or PSAK) were introduced, largely based on old IAS. In recent years, DSAK — IAI updated the Standards to reduce the gap with current IFRS. IAI has announced its intention to converge to full IFRS in January 2012. However, previous convergence efforts have missed similar deadlines.

….and International Standards of Auditing by 2012.

In February 2008 MoF regulation authorized the Indonesian Institute of Public Accountants (*Ikatan Akuntan Publik Indonesia*, or IAPI, a member of IAI) to set auditing standards. IAPI plans to converge local auditing standards with International Standards on Auditing (ISA) by 2012.

Auditors must be rotated every six years.

IAPI also issued a Code of Ethics for public auditors in October 2008, based on the IFAC Code of Ethics, with an effective date of January 1, 2011. Bapepam-LK regulation sets additional independence requirements for the auditor and audit firm, and limits non-audit services that can be provided. Bapepam-LK requires a 6-year rotation for audit firms, and the 3-year rotation for individual partners; BI requires a 5-year rotation for auditors of banks.

MoF, IAPI, Bapepam-LK, and BI each oversee accounting and auditing.

The Center for Supervision of Accountants and Appraiser Services (PPAJP) is a division of the MOF that provides broad oversight of the accounting and auditing profession. PPAJP licenses both audit firms and auditors, who must also be certified by the IAPI. Auditors of listed companies must be registered with Bapepam-LK, and auditors of banks must be registered with BI. PPAJP has carried out on-site reviews of about 50 accounting firms.

Bapepam-LK is working to create an independent and more effective audit inspection capability.[11] However, these efforts are in their early stages, and resources are limited. IAPI also has internal procedures to review the quality of its members work and can sanction its members but is not seen as an effective source of redress for investors. PPAJ has become more active in its enforcement efforts, but must oversee a large number of public accounting firms and accountants with limited resources.

Auditor accountability to the board and shareholders is unclear.

The CL does not specify who chooses or removes the external auditor, and the Bapepam-LK regulation on the audit committee does not mention the external audit process. The voluntary CGCG recommends the GMS choose based on the recommendation of the BOC and Audit Committee, and based on available data this is the practice in most companies. While audit standards give the auditor the responsibility to ensure that statements are free from material misstatement, auditors have no explicit liability to the company, shareholders, or other investors. No accounting firm has been sued for substandard work by companies, shareholders, or third parties.

10 The 2009 Accounting and Auditing ROSC for Indonesia (forthcoming) provide a more detailed assessment of accounting and auditing issues in Indonesia.

11 This is to meet the requirements to become a member of the International Forum of Independent Audit Regulators (IFIAR).

BOARD PRACTICES AND COMPANY OVERSIGHT

The Role of the Board

Historically, the role of commissioners has been limited.

Indonesian companies have a two-tier board structure: a board of commissioners (BOC) and a board of directors (BOD). The BOC is supposed to oversee and advise the BOD, which in turn carries out the day-to-day operations of the company. Beyond these general mandates, there are few explicit responsibilities for the two boards in the law.

In the past, the BOC in many companies played a limited role, at best, with almost all power vested in the BOD (and controlling shareholders). Recently however, some BOCs have become more active in overseeing the company, thanks to training, awareness raising and recent legal and regulatory changes, including requirements to have audit committees and independent commissioners and the introduction of board member liability.

Commissioners do not choose directors...

The BOC does not choose the CEO (president director) or other top management. Under the CL, both the BOC and BOD are chosen directly by shareholders in the GMS. The BOC may suspend a director, but this decision must be confirmed by the GMS in 30 days.

In some countries with two-tier boards, only supervisory boards — the equivalent of the BOC — select directors. Electing directors by GMS can limit the ability of the BOC to oversee management and hold them accountable. It also requires the GMS to have the technical expertise to choose top managers directly.

...or have clear authority in other areas.

Descriptions of the role and responsibilities of the boards in law or regulation are limited. The voluntary CGCG does contain some explicit board responsibilities. For the BOD these include developing the company's strategy and risk policy. Objectives are set jointly with the BOC. The BOC is also to monitor major corporate actions and performance. Neither the code nor law gives the BOC explicit responsibility to develop performance indicators or approve major transactions.

Board Member Duties

Duties of loyalty and care are found in the law.

Fiduciary duties for board members were introduced in the CL in 2007. Board members are to act in the interest of the company, in a reasonable manner, and with good faith and prudence. Under the CL, board members can be held liable for losses caused to the company for violating these duties.

No board member has been found liable for a violation of duties their duties under the CL.

In practice, many board members have been informed of their duties through company or outside training, and awareness of the liability introduced in the 2007 CL is high. In addition, Bapepam-LK has imposed sanctions on boards of directors, for violations of various provisions of the Capital Markets Act.[12] However, concern remains that too many board members continue to act in the interest of the controlling shareholders, and not other shareholders or the company. No board member has been been brought to court for a violation of their duties under the CL.

12 Bapepam-LK fined the BOD of PT PGN over July 2006 - March 2007 in the amount of five billion rupiah for giving statements that were "materially not true" in accordance with Article 93 of CML. Bapepam-LK has also brought a case against PT GRI, which was found guilty of criminal conduct in the capital markets (violation of manipulating information in the financial statements).

The CGCG encourages the BOC and the BOD to consider the interest of stakeholders, like employees and customers, both for reasons of fairness and to maximize the value of the company. It also encourages companies to have codes of ethics.

Codes of ethics are voluntary.

Board Independence and Objectivity

The two tier board structure ensures that all commissioners are non-executives. They may still be major shareholders or have other connections to controlling shareholders and management. Listing rules require public companies to have 30 percent of commissioners to be "independent". Independence is defined by Bapepam-LK regulation.[13] In practice, most companies have and identify these commissioners, but do not exceed the legal requirement.

Listing rules require independent commissioners.

All public companies are required to have audit committees chaired by an independent commissioner. Audit committees must also have outside experts who are not on the BOC or BOD as members. Banks are also required to have a nomination and remuneration committee, and the CGCG encourages other companies to have this committee. Bank nomination and remuneration committees should be composed of one independent commissioner (who acts as chair), one other commissioner, and one executive officer (in charge of human resources, or an employee representative) who must possess knowledge of the remuneration and/or nomination systems and the bank's succession plan. They may also have outside experts as members, and do so in practice.

Mandatory audit committees must have outside experts as members.

In many other countries, these sorts of committees are composed exclusively of board members, with a majority of independents. They may consult outside experts, but only experts also on the board may be members. This allows for independent board members to play a leading role, while ensuring that full responsibility for key decisions remains with the board. In Indonesia, market participants were skeptical that commissioners could play an effective role on technical committees without outside assistance.

The audit committee has a mandate to review financial reporting, ensure compliance with laws and regulation, oversee the internal audit, and report on risk and risk management to the BOC. Regulation does not give the audit committee a mandate to review the work of the external auditor.[14] Nor does it have an explicit role in managing conflicts of interest.

Audit committees have a range of responsibilities, but do not oversee RPTs.

13 According to regulation IX.I.5, an independent commissioner:
- *comes from outside of Issuers or Public Companies;*
- *does not have any direct or indirect ownership in Issuers or Public Companies;*
- *is not affiliated with Issuers and Public Companies, Commissioner, Director, or majority shareholder of Issuers or Public Companies;*
- *does not have business relationship direct or indirectly which relates with business activity of Issuers or Public Companies. of both.*

14 In banks, the audit committee has a mandate to review financial reporting, ensure compliance with laws and regulation, and oversee the internal audit, compliance and risk management functions. Regulations does give bank audit committees a mandate to review the work of the external auditor, specifically compliance with auditing standards. The audit committee also reviews the implementation of follow-up actions by the Board of Directors on findings of the Internal Audit Work Unit, external auditor, and Bank Indonesia supervision findings.

Board members should disclose conflicts to the board, practice is mixed.

Legal experts interpret the CL to require board members to report potential conflicts of interest to other board members and not vote on areas in which they are conflicted.[15] The CGCG explicitly recommends disclosure and notes that board members should derive "no personal gain" from their position except through remuneration.

The company survey provides only partial evidence that board members are regularly informing the board about their other interests. 77 percent of surveyed companies reported that board members abstain from voting on items where they are conflicted, but only 59 percent stated that board members regularly report conflicts to the board. 47 percent of companies have policies on loans to board members and managers.

Internal audit and controls required.

According to Bapepam-LK regulation, the BOC and BOD are required to sign the annual report (including the financial statements) and confirm their responsibility for it. Companies are required to have an internal audit function and the BOD is responsible for internal controls. Under the CGCG the BOD is also responsible for risk management, which is overseen by the BOC.

Shareholders approve pay for both boards.

Compensation for both boards is normally set by the GMS, though BOD pay can be delegated to the BOC. In banks and other companies that have them, the nomination and remuneration committee may advise the shareholders on pay policy. Similarly, these committees may also advise on board appointment.

Neither regulation nor the code provide guidance on linking pay to long-term performance. In practice, boards in a number of companies do play a role in setting compensation and director nomination, but key decisions are made by the controlling shareholder(s).

Board training is not required, but still common.

While not encouraged by the CGCG, several institutions offer board member training, and hundreds of directors and commissioners have participated in training programs. The CGCG does encourage some board evaluation, and many companies seem to have some evaluations for the BOC, though they disclose few details on the process.

The MSOE oversees SOE board apointments and CG.

As noted above, Indonesia continues to have a significant state-owned enterprise sector (including state-owned commercial banks). The national government controls 114 companies through the Ministry of State Owned Enterprises.

A significant amount of work and reform has been carried out on the SOE sector. The Ministry of Finance (MOF) has always been the legal owner of the SOEs), but since 2001 it has delegated day-to-day oversight to the Ministry of State Owned Enterprises (MSOE). The MSOE appoints directors and commissioners in conjunction with other line ministries.

To improve SOE governance and performance, the MSOE has appointed more-professional directors/commissioners, improved the design of annual performance contracts for managers and listing minority stakes in many companies. They have also pushed through other changes, for example, requiring a major bank to appoint five new directors to support an IPO in 2003.

15 Article 99 notes that members of Boards of Directors do not have the authority to represent Companies if a. there is a case before the courts between the Company and the member of the Board of Directors concerned; or b. the member of the Board of Directors concerned has a conflict of interests with the Company.

More recently, MSOE has developed a scorecard for rating the governance of the companies in the portfolio and produces an annual report on the state of the portfolio.

FINDINGS OF THE DCA

The Detailed Country Assessment of the OECD Principles of Corporate Governance is summarized in the tables at the end of the report. These results indicate that:

Corporate governance in Indonesia is improving, but key areas are still lagging.

- **Indonesia's scores have improved since the last ROSC was carried out in 2004.** The average percent of observance in the shareholder rights chapter increased from 56 to 76, and from 60 to 74 in the chapter on equitable treatment of shareholders. Disclosure percent implementation increased from 60 to 71, and the percent implementation of board responsibilities from 60 to 66.

- **Nevertheless, more work remains to be done.** Using the new methodology to assess compliance with the OECD Principles 4 Principles were fully observed, 25 were broadly observed, 34 principles were partially observed, and 2 were not observed.

- **Indonesia lags many countries in the region, but is gaining on the regional pace-setters.** Across most of the aspects of good corporate governance as defined by the OECD Principles, Indonesia is now closing on several countries (India, Thailand, and Malaysia).

Recommendations

Bring the corporate governance framework more in line with the OECD Principles.

Indonesia has undertaken important reforms in recent years. However, fully tapping the potential of capital markets and professionalizing boards and management will require that reform continues. Good corporate governance ensures that companies use their resources more efficiently and leads to better relations with employees, creditors, and other stakeholders. It is an important prerequisite for attracting the patient capital needed for sustained long-term economic growth.

Key reforms include:

- Better regulation of ownership disclosure and other nonfinancial disclosure;
- Requiring key shareholder rights be incorporated into company articles;
- Making more effective use of independent commissioners and audit committees;
- Amending company law to better protect shareholders;
- Incorporating and expanding board member powers in company law and the CGCG;
- Requiring that companies disclose their compliance with the CGCG;

* Giving minority shareholders a greater say on board selection;

* Increasing Bapepam-LK's capability to oversee company disclosure and other key areas;

* Encouraging board and media training.

The recommendations are organized in three sections: reforms to the legal and regulatory framework (including specific recommendations to better protect investors, ensure greater transparency, and improve the effectiveness of company oversight), reforms to build regulatory capacity, and recommendations for further study in several additional areas of reform.

Reforms to the legal and regulatory framework

Improved disclosure of ownership and control is the top priority.

The disclosure of ownership is hampered by the lack of a requirement to disclose "ultimate" shareholders — most disclosure is made at the level of direct shareholders (including custodians). This prevents shareholders and regulators from understanding the true picture of ownership and makes it much more difficult to detect a variety of possible conflicts of interest (especially the various forms of related party transactions).

- Definitions of direct (nominal) ownership and ultimate (indirect / beneficial) ownership should be introduced into the law, probably in the capital markets law.
- Regulation X.M.1 should be updated to require all "ultimate" shareholders to disclose their holdings when they pass the 5 percent level. These disclosures should be made to the Bapepam-LK and the company, which should then be required to immediately make them public.

- Companies should also be required to disclose all significant (5 percent) direct and controlling owners in the annual report.

- As part of the redrafting of rules related to the disclosure of ownership and control, issuers should also be required to disclose the voting rights of all classes of shares, any special voting rights for specific shareholders, cross-shareholding, company group structures, and the identity of the ultimate controlling shareholder.

- Bapepam-LK should also review ownership disclosures and work with the private sector to publish a report on overall ownership and control of listed issuers.

Improve other areas of non-financial disclosure.

Non-financial disclosure should be more effectively regulated and complied with more generally. This includes: board member remuneration, including individual pay, pay policy, and the link to long-term performance; and policies on risk management and conflict of interest

Incorporate basic shareholder rights and good board practice into articles of association.

To increase the level of shareholder rights, companies should be required to include a variety of practices in their articles of association, via Rule IX.J.1. (Some of these requirements would ratify existing practice). This should include:

- Explicitly state that shareholders should have access to a specific list of information (including annual reports, articles of association, meeting invitations/agendas/materials, and minutes of the shareholders meeting) at the offices of the issuer.

- Require issuers to develop and place this same information on a company website.

- Require pre-invitation disclosure of the details of the amendments to the articles of association.

- Include additional requirements on information describing the candidates up for board election.

- Allow shareholders to add items to a shareholder meeting agenda (with an appropriate ownership threshold).

- Require issuers to answer questions at shareholder meetings, subject to the same restrictions as those placed under company law.

- Require the Board of Commissioners to adopt, implement, and oversee **conflict of interest** and **ethics** policies.

- Require the Board of Commissioners to participate in induction and on-going corporate governance training programs.

Regulation should also be changed to require prior approval by non-conflicted commissioners of affiliated transactions (as defined in XE1).

Audit committee regulations should be strengthened.

Bapepam-LK Rule IX.I.5 (*Guidelines on Establishment and Working Implementation of Audit Committee*) should be modified to:

- Reform the audit committee and make it a true committee of the board. Audit committees should be required to have a majority of independent commissioners, and outside experts should only serve in an advisory role.
- Explicitly require that at least one member of the audit committee should be a financial expert and all members should be financially literate.[16]
- Mandate that audit committees oversee the company's relationship with the external auditor, including: (1) discussing concerns about financial reporting; (2) recommending selection, retention and dismissal of external auditors; (3) evaluating the objectivity and independence of the external auditor; (4) reviewing the scope and results of the external audit; (5) seeking acknowledgment from the auditor that the board of commissioners and not management is the auditor's client; and (6) jointly decide with management the audit fee.
- Audit committees should also review and advise the BOC and/or the GMS on potential conflicts of interest.

Future revisions to the Company Law should clarify current requirements, empower the BOC, and consider lowering thresholds for shareholder action.

Future revisions to the company law should:

- Reduce the thresholds for shareholder action from 10 percent to 5 percent, giving concentrated ownership.
- Give shareholders the explicit right to access specific information.
- Permit electronic voting.
- Require that changes to voting rights of a class of shares need to be approved by a supermajority of the impacted shares, when there is more than one class of shares.
- Specify the role of the boards in recommending dividends to the general meeting and set a time limit within which dividends must be paid.
- Specify the role of the BOC in proposing the external auditor, subject to shareholder approval.
- Give the BOC explicit power to pre-approve major transactions and manage conflicts of interest, subject to relevant regulations for listed companies.
- Give companies the option of allowing the BOC to directly appoint the board of directors, or appoint them subject to final shareholder approval.

16 A "Financial expert" is (at a minimum) an individual who: (1) understands accounting principles and financial statements; (2) is able to assess the application of accounting principles; (3) has experience in preparing, auditing, analyzing, or evaluating financial statements with general comparable complexity or experience actively supervising those engaged in such activities; (4) understands internal controls and financial reporting; and (5) understands audit committee functions. A "financially literate" board member is able to read and understand basic financial statements.

- Give the BOC authority to set director remuneration, subject to shareholder approval.
- Define the duties of the external auditor, and liability for violating those duties.
- Conflicted commissioners should inform the BOC, and recuse themselves from relevant decisions.

Efforts should be made to revive awareness of and compliance with the CGCG. The mandatory corporate governance statement required by Bapepam-LK regulation currently does not have to mention compliance with the national code. To increase its impact, companies should be required to disclose compliance or non-compliance with the CGCG.

Companies should be required to make "comply or explain" statements on the CGCG.

The code should also be amended to provide better guidance to boards and companies:

- Companies should have websites with investor information, including the annual report;
- Detailed information should be provided in the meeting announcement on board candidates;
- Minority shareholders should be able to nominate independent commissioners that own some shares or have links to non-controlling investors (this may also require changes to regulation);
- "Independent shareholders" should also be able to hold a separate election to appoint one or more of the independent commissioners (depending on the size of the free float);
- Companies should disclose individual board member pay;
- Board member tenure and committees served on should also be disclosed;
- A reasonable limit on the number of board seats someone can serve on (e.g.. 4-7) should be included;
- Code of conduct or ethics should include board member duties, and companies should disclose if they have such a code;
- Board members should ensure equitable treatment of shareholders;
- BOC should have the right to approve business plans, budgets, major transactions, acquisitions, and divestitures;
- The BOC should also oversee communication and disclosure;
- The BOC should periodically review board practices and procedures;
- The role of the nomination & remuneration committee in choosing directors should be strengthened, and this committee should develop a succession plan for the presiding director;

Amendments to the CGCG should give minority shareholders the ability to choose some independent commissioners…

… and include greater powers for the BOC.

- The nomination & remuneration committee should also develop the remuneration policy (subject to shareholder approval) with a clear link between pay and performance;
- Audit committee should monitor reporting on and compliance with requirements on conflicts of interest
- Independence (i.e. outside member) requirements should be harmonized with those in Bapepam-LK regulation and listing rules;
- Board members should be encouraged to receive training on their duties and other relevant areas;
- Boards should be able to consults outside advisors, which should be disclosed to shareholders;
- The BOC should undertake an annual self-evaluation.

Reforms to Build Regulatory Capacity

Bapepam-LK should build its capacit:y to oversee its enforcement of corporate governance rules.

Bapepam-LK should develop a set of guidelines, an operations manual, and a training program for the oversight of disclosure and other key corporate governance topics, in order to strictly enforce existing and future regulation. The manual should include (a) a description of why disclosure is so important, (b) a description of good practice in each area, and (c) clear guidelines on what types of disclosures and behaviors are not acceptable.

Topics should include at a minimum:

- Conduct of shareholder meetings.
- The review and approval of significant/related party transactions.
- The disclosure of ownership and control.
- Interpretation of company corporate governance statements.

Bapepam-LK should also strive to improve its capacity to review financial statements. Bapepam-LK should engage additional professionally qualified and experienced accountants and train existing staff to further enhance the effectiveness of the financial statements reviewers in the Corporate Finance Bureau to detect sophisticated manipulations of accounting and financial reporting policies.

Bapepam-LK should also seek to recruit other staff from the private sector; and its policies on remuneration and training should be reviewed to facilitate this. Bapepam-LK should also create a strong deterrent to fraudulent use of customer securities by vigorously taking action against brokers and other market intermediaries in the event it takes place.

Improve oversight of accounting standard-setting and audit.

Detailed guidance on improving the regime for accounting and auditing is provided in the 2010 Accounting and Auditing ROSC. Key recommendations include:

- Reconstitute the Accounting Standards Board under Bapepam-LK, and develop and implement the IFRS convergence strategy.
- Establish an independent audit review board within Bapepam-LK, and merge it with the existing PPAJP. The functions of the new unit would include:
  - Registering the statutory auditors of public interest entities.
  - Conducting audit practice review.
  - Complaint handling.
  - Exercising disciplinary power.
  - Reporting to the public.
  - Formation of an advisory committee of key stakeholders.

Consider broader reforms.

Media training on corporate governance and related issues could be an effective way to raise awareness about corporate governance. Other actions that could improve the environment for corporate governance include greater use of alternative dispute resolution (ADR) to compensate for lengthy court procedures.

Recommendations for Further Study

Bapepam-LK should carry out several background studies to clarify future regulatory directions.

There are several aspects of the current legal and regulatory framework which appear to over-regulate or under-regulate the market, with an unclear rationale. Bapepam-LK should undertake special studies in the following areas in order to determine the appropriate next steps that should be taken to review regulatory costs and benefits:

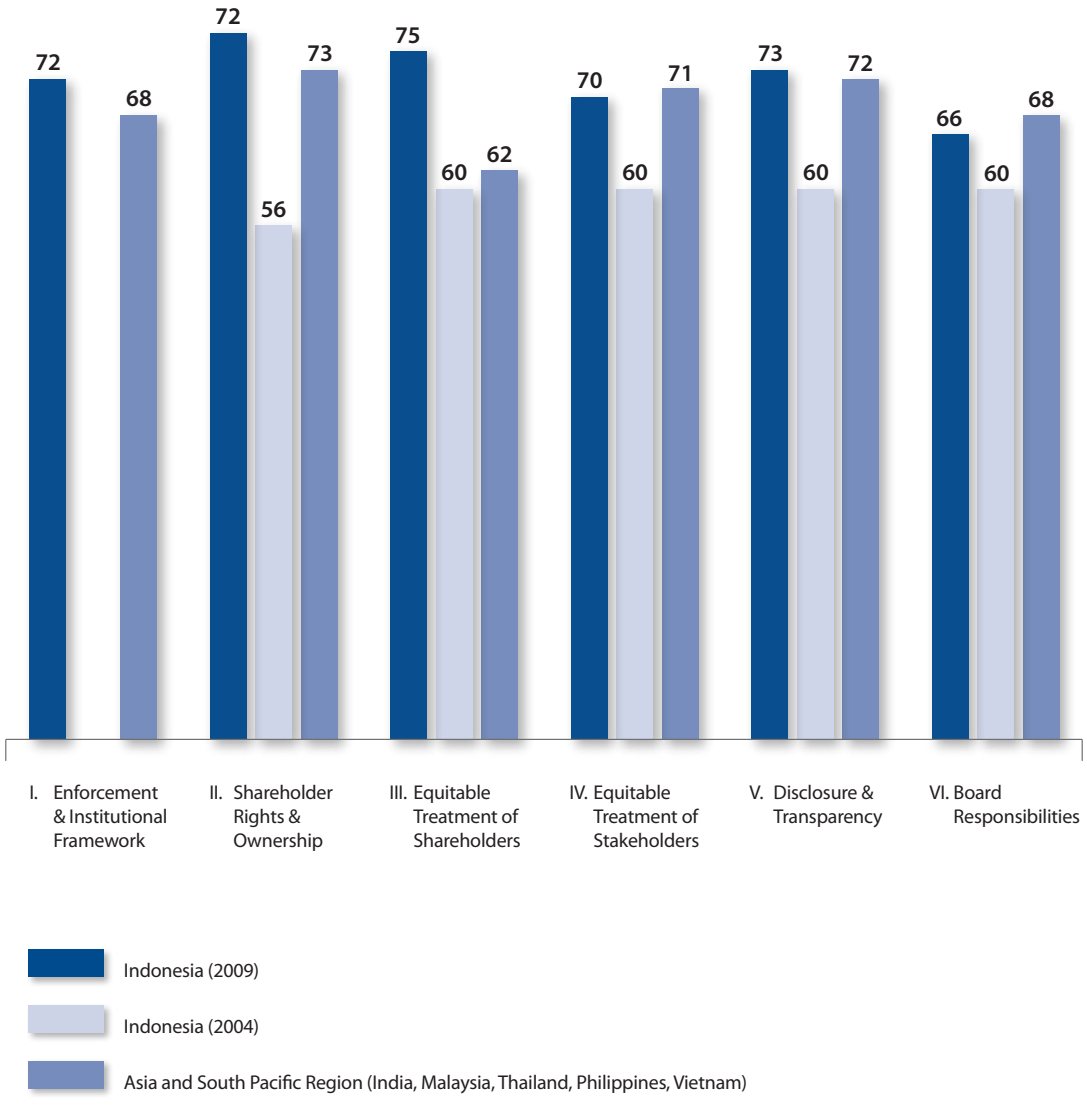
The lack of delisting/going private rules. Bapepam-LK appears to have made it more difficult for companies to delist or "go private" in 2008. While in some ways this does work to protect shareholders (since their rights cannot be violated during the delisting transaction if it is not allowed), it also reduces the incentive for controlling shareholders to list in the first place, because it removes their option to leave the exchange if they no longer see the benefits to remaining listed. Bapepam-LK should study the impact of the new rules, and attempt to ascertain its current impact.

Implementing electronic voting. Bapepam-LK should study the legal, procedural, and technical hurdles to implementing electronic voting at shareholder meetings.

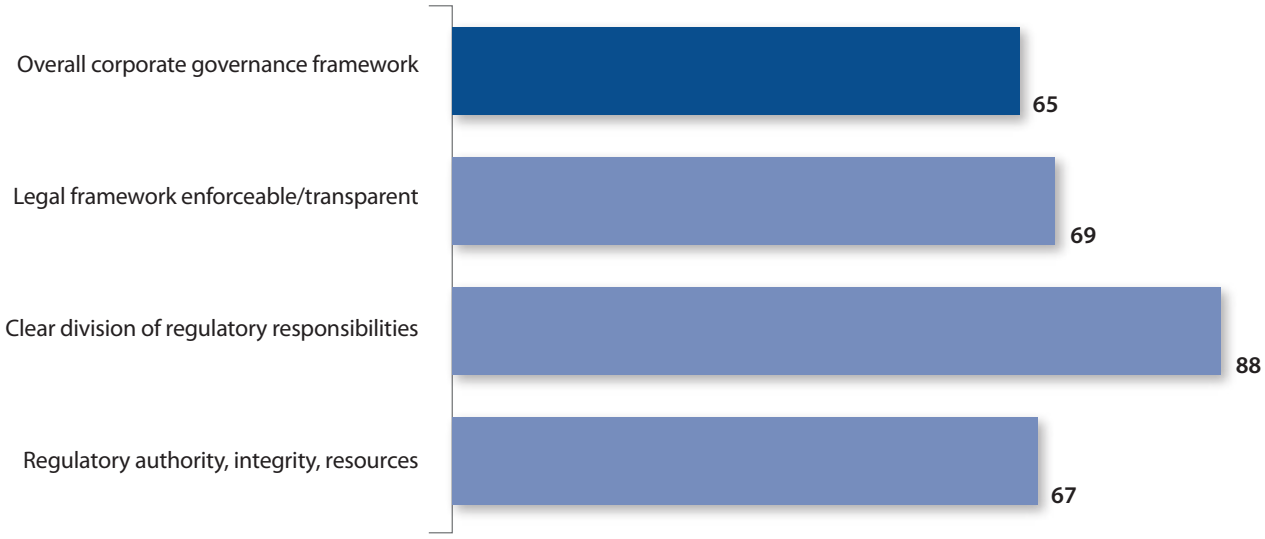
Reforms of the SOE sector should also continue.

While significant progress has been made with SOE governance, the Ministry of State Owned Enterprises should consider an additional, focused diagnostic on SOEs that could be the basis for improving their overall ownership policy and improving corporate governance in key specific SOEs.

Indonesia Country Assessment vs. Asia Regional Average

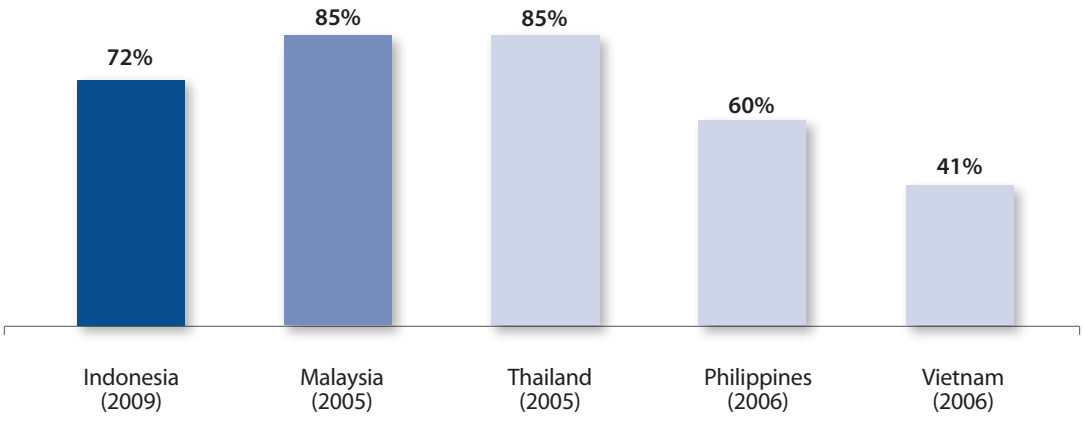


OECD Principle Assessment: Corporate Governance Framework | INDONESIA



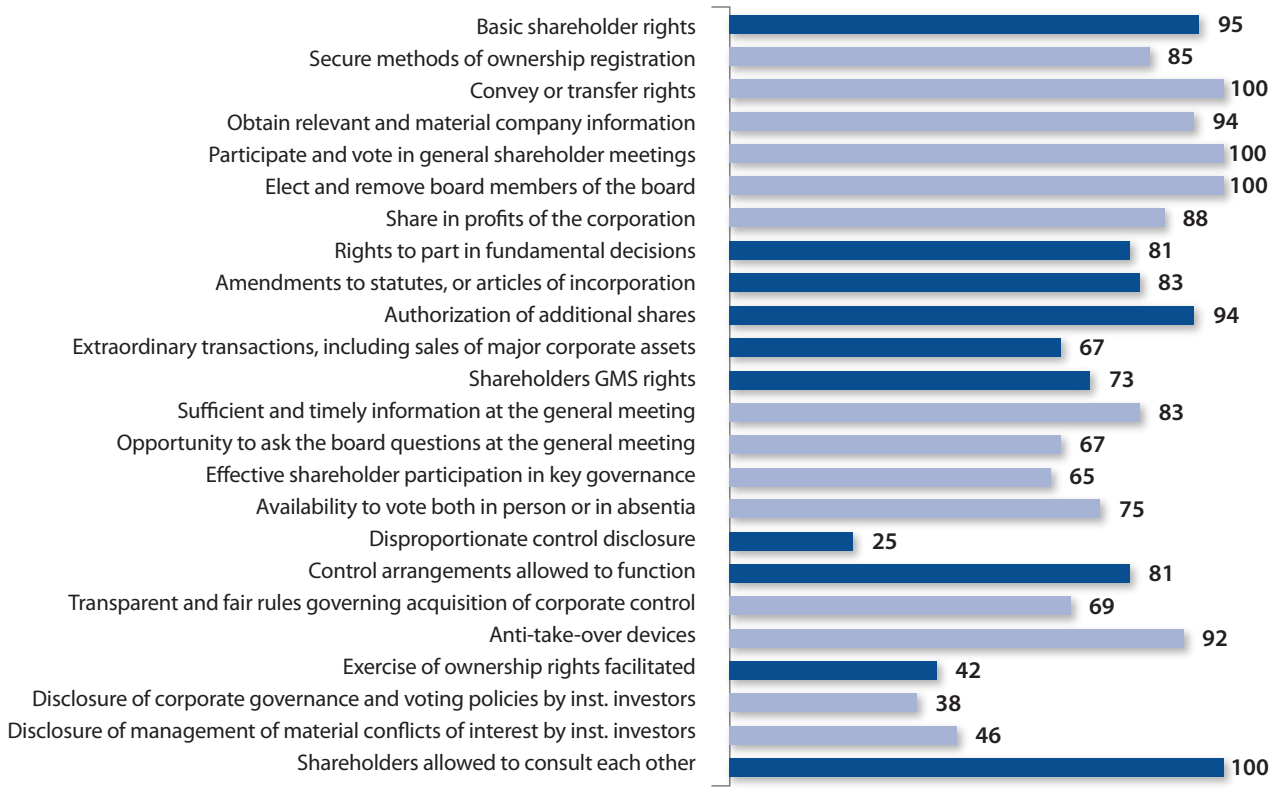
SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95 % = Fully implemented, 75-95 = Broadly Implemented, 35-75 = Partially implemented, and less than 35% = not implemented.

INTERNATIONAL COMPARISONS



SOURCE: Figures for other countries represent weight-averaging of scores from previous ROSCs. Averages should be interpreted with caution due to changing methodologies over time. Data from previous ROSCs are not directly comparable because reports were completed in prior years (year of ROSC publication in parenthesis).

OECD Principle Assessment: Shareholder Rights | INDONESIA



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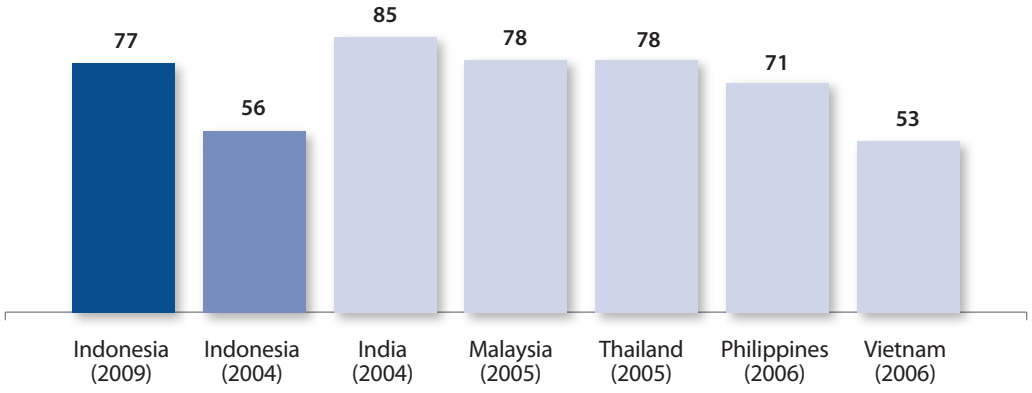
INTERNATIONAL COMPARISONS



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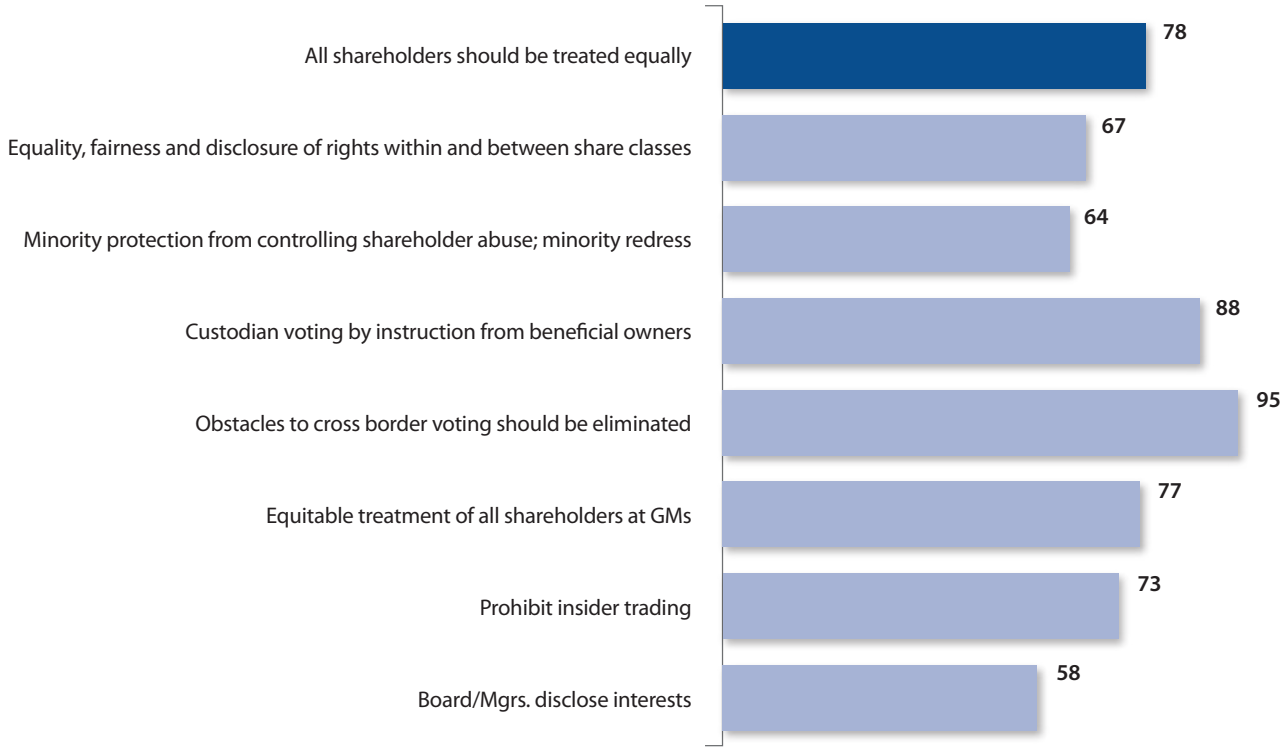
OECD Principle Assessment: Equitable Treatment of Shareholders | INDONESIA



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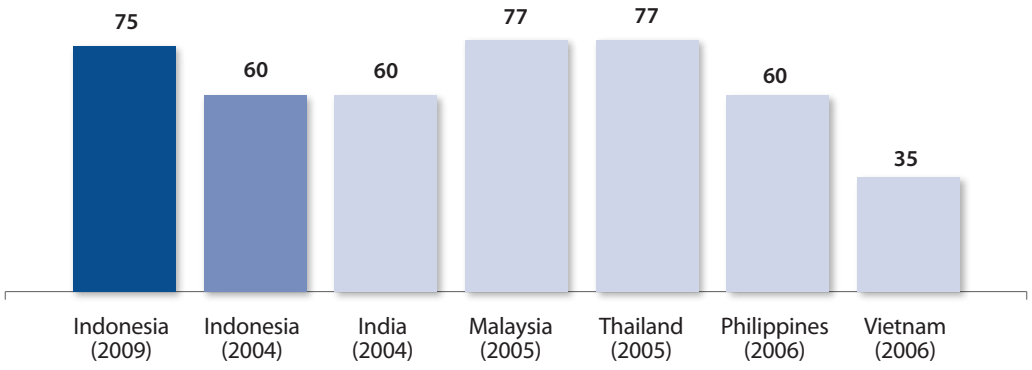
INTERNATIONAL COMPARISONS



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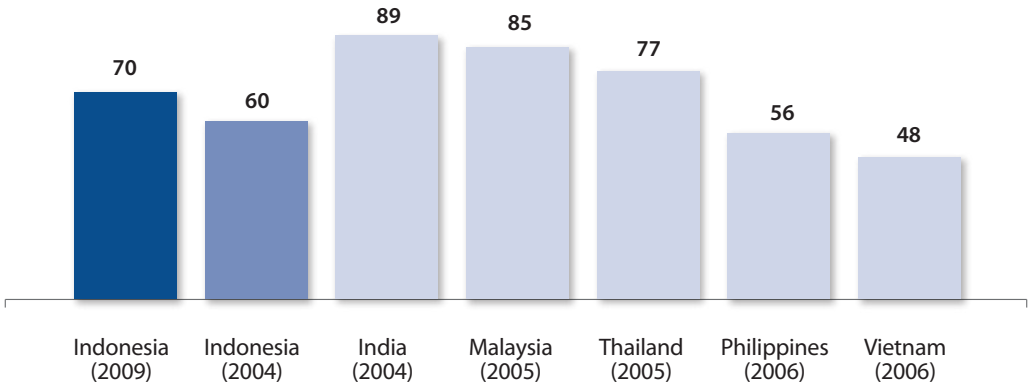
OECD Principle Assessment: Equitable Treatment of Stakeholders | INDONESIA

SOURCE: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95 % = Fully implemented, 75-95 = Broadly Implemented, 35-75 = Partially implemented, and less than 35% = not implemented.

INTERNATIONAL COMPARISONS



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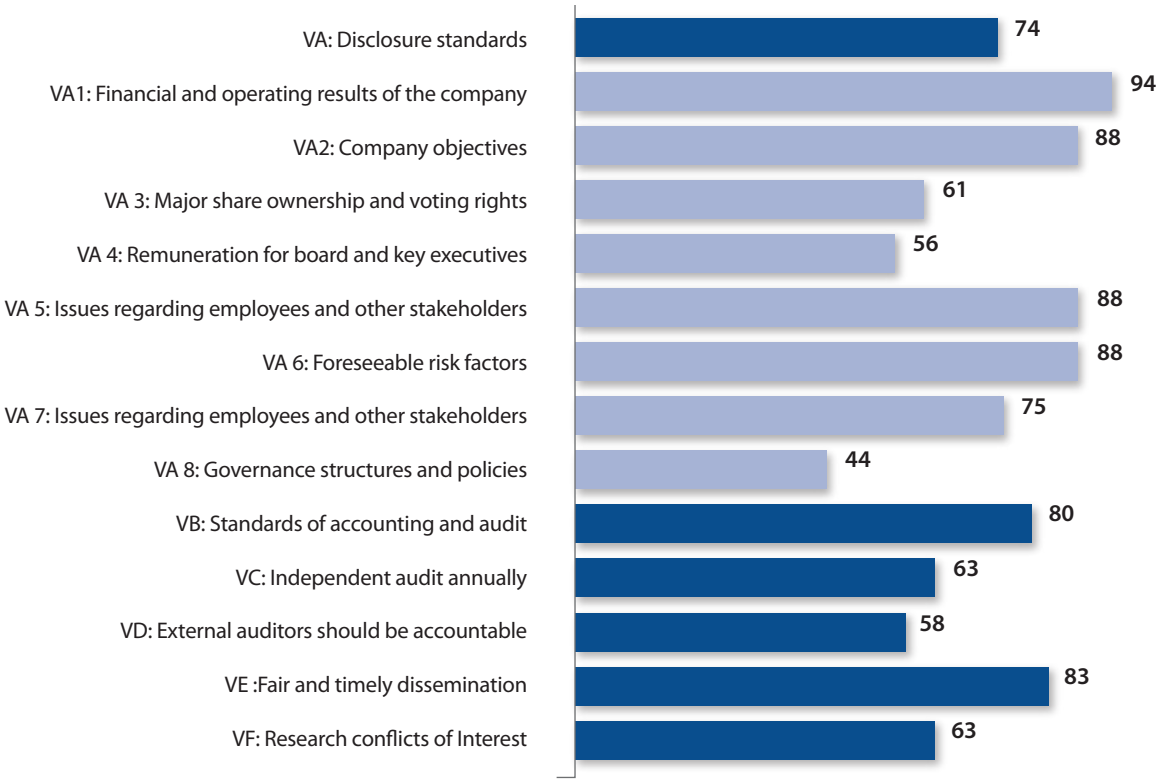
OECD Principle Assessment: Disclosure and Transparency | INDONESIA



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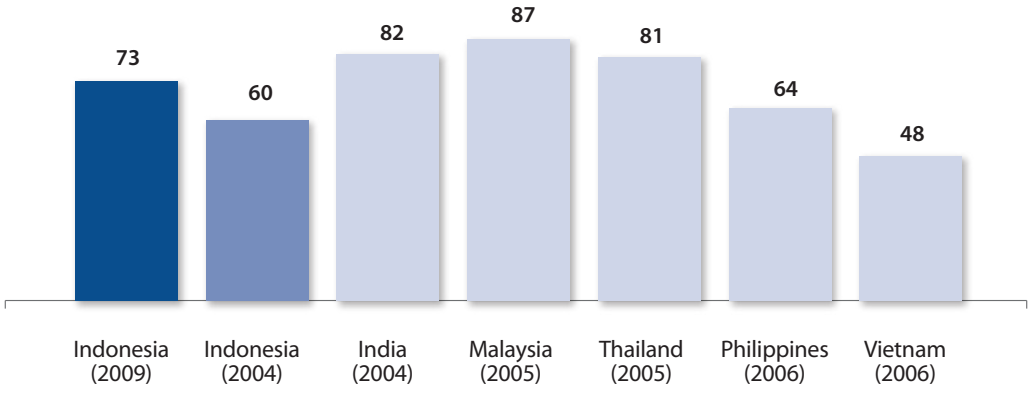
INTERNATIONAL COMPARISONS



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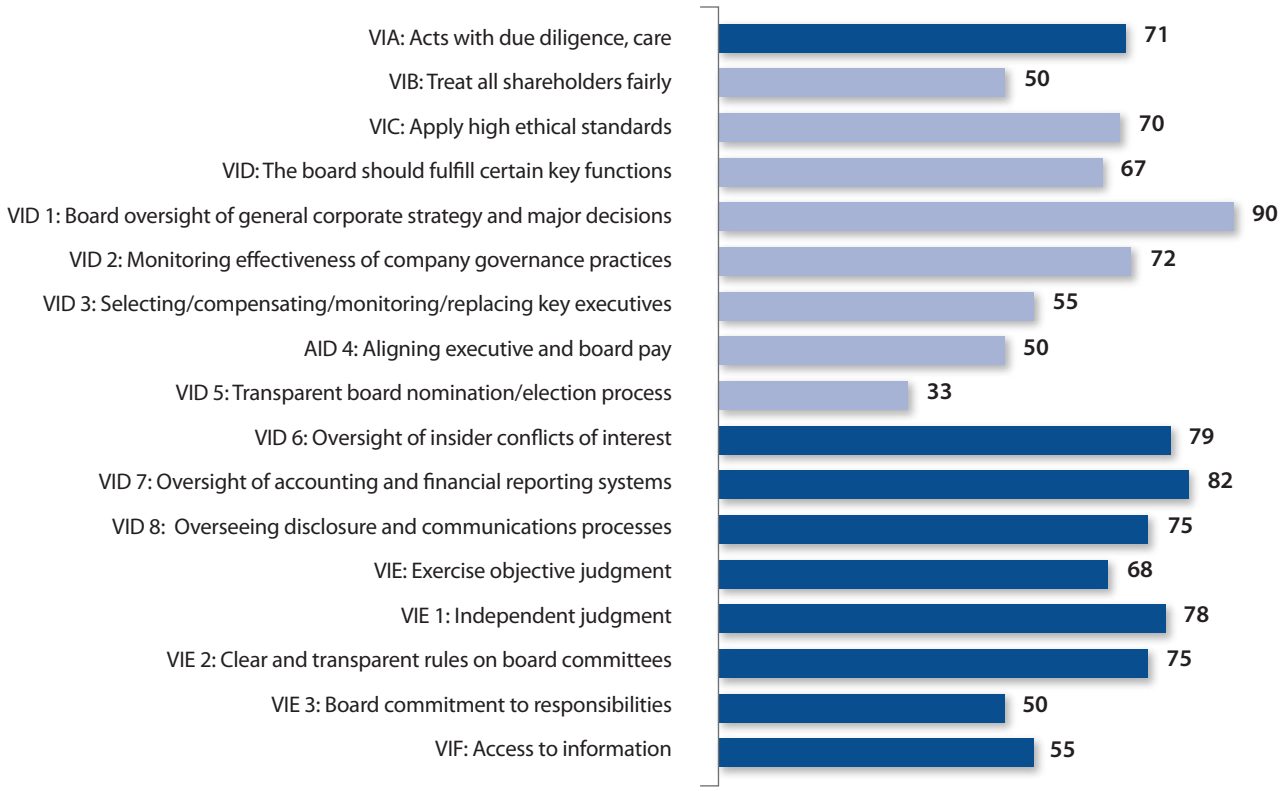
OECD Principle Assessment: Responsibilities of the Board | INDONESIA



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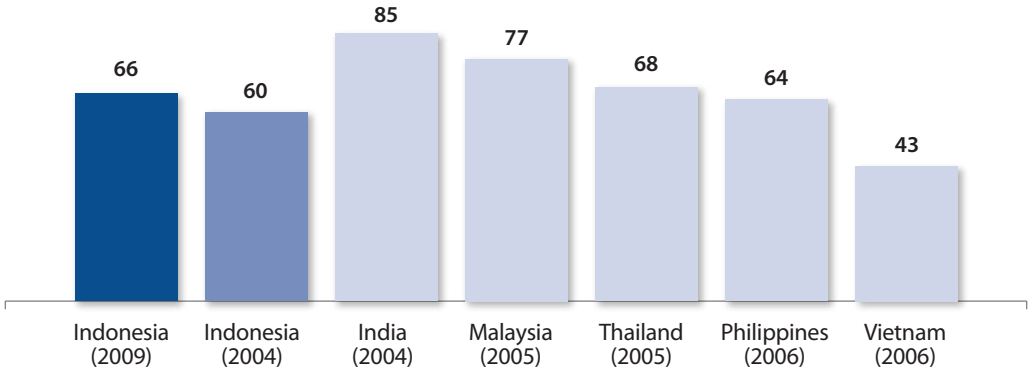

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TABLE 6: Summary of Observance of OECD Corporate Governance Principles

	Principle	FI	BI	PI	NI
I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK					
IA	Overall corporate governance framework			X	
IB	Legal framework enforceable /transparent			X	
IC	Clear division of regulatory responsibilities		X		
ID	Regulatory authority, integrity, resources			X	
II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS					
IIA	Basic shareholder rights				
IIA 1	Secure methods of ownership registration		X		
IIA 2	Convey or transfer shares	X			
IIA 3	Obtain relevant and material company information		X		
IIA 4	Participate and vote in general shareholder meetings	X			
IIA 5	Elect and remove board members of the board	X			
IIA 6	Share in profits of the corporation		X		
IIB	Rights to part in fundamental decisions				
IIB I	Amendments to statutes, or articles of incorporation		X		
IIB 2	Authorization of additional shares		X		
IIB 3	Extraordinary transactions, including sales of major corporate assets			X	
IIC	Shareholders GMS rights				
IIC 1	Sufficient and timely information at the general meeting		X		
IIC 2	Opportunity to ask the board questions at the general meeting			X	
IIC 3	Effective shareholder participation in key governance decisions			X	
IIC 4	Availability to vote both in person or in absentia			X	
IID	Disproportionate control disclosure				X

	Principle	FI	BI	PI	NI
IIE	Control arrangements allowed to function				
IIE 1	Transparent and fair rules governing acquisition of corporate control			X	
IIE 2	Anti-take-over devices		X		
IIF	Exercise of ownership rights facilitated				
IIF 1	Disclosure of corporate governance and voting policies by inst. investors			X	
IIF 2	Disclosure of management of material conflicts of interest by inst. investors			X	
IIG	Shareholders allowed to consult each other	X			
III. EQUITABLE TREATMENT OF SHAREHOLDERS					
IIIA	All shareholders should be treated equally				
IIIA 1	Equality, fairness and disclosure of rights within and between share classes			X	
IIIA 2	Minority protection from controlling shareholder abuse; minority redress			X	
IIIA 3	Custodian voting by instruction from beneficial owners		X		
IIIA 4	Obstacles to cross border voting should be eliminated		X		
IIIA 5	Equitable treatment of all shareholders at GMs		X		
IIIB	Prohibit insider trading			X	
IIIC	Board/Mgrs. disclose interests			X	
IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE					
IVA	Legal rights of stakeholders respected		X		
IVB	Redress for violation of rights			X	
IVC	Performance-enhancing mechanisms		X		
IVD	Access to information		X		
IVE	"Whistleblower" protection			X	
IVF	Creditor rights law and enforcement			X	

	Principle	FI	BI	PI	NI
V. DISCLOSURE AND TRANSPARENCY					
VA	Disclosure standards				
VA 1	Financial and operating results of the company		X		
VA 2	Company objectives		X		
VA 3	Major share ownership and voting rights			X	
VA 4	Remuneration policy for board and key executives			X	
VA 5	Related party transactions		X		
VA 6	Foreseeable risk factors		X		
VA 7	Issues regarding employees and other stakeholders			X	
VA 8	Governance structures and policies			X	
VB	Standards of accounting & audit		X		
VC	Independent audit annually			X	
VD	External auditors should be accountable			X	
VE	Fair & timely dissemination		X		
VF	Research conflicts of interests			X	
VI. RESPONSIBILITIES OF THE BOARD					
VIA	Acts with due diligence, care			X	
VIB	Treat all shareholders fairly			X	
VIC	Apply high ethical standards			X	
VID	The board should fulfill certain key functions				
VID 1	Board oversight of general corporate strategy and major decisions		X		
VID 2	Monitoring effectiveness of company governance practices			X	
VID 3	Selecting/compensating/monitoring/replacing key executives			X	

	Principle	FI	BI	PI	NI
VID 4	Aligning executive and board pay			X	
VID 5	Transparent board nomination/election process				X
VID 6	Oversight of insider conflicts of interest		X		
VID 7	Oversight of accounting and financial reporting systems		X		
VID 8	Overseeing disclosure and communications processes			X	
VIE	Exercise objective judgment		X		
VIE 1	Independent judgment		X		
VIE 2	Clear and transparent rules on board committees			X	
VIE 3	Board commitment to responsibilities			X	
VIF	Access to information			X	

Note: FI=Fully Implemented; BI=Broadly Implemented; PI=Partially Implemented; NI=Not Implemented; NA=Not Applicable

THE WORLD BANK

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OCED Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate govenance practices
- provide a benchmark by which countries can evalutate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- provide the basis for a policy dialogue which will result in the implementation of policy recommendations

To see the complete list of published ROSC's, please visit http://www.worldbank.org/ifa/rosc_cg.html

To learn more about corporate governance, please visit IFC/World Bank's corporate governance resource Web page at http.//rru.worldbank.org/Themes/CorporateGovernance/

Contact us at CG-ROSC@worldbank.org