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### When is a Voluntary Code Not Voluntary?

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# WHEN IS A VOLUNTARY CODE **NOT** **VOLUNTARY**



Many countries have adopted the 'comply or explain' approach to raise standards of corporate governance in listed companies. The approach has now found its way into the charity sector in Singapore. Mak Yuen Teen highlights some misconceptions about the voluntary nature of the approach and provides suggestions for its effective implementation.

Singapore's new Code of Governance for Charities and Institutions of Public Character (the Code) produced by the Charity Council<sup>1</sup> adopts a 'comply or explain' approach. Its provisions are not mandatory, but where they are not complied with, the body in question must provide an explanation. The 'comply or explain' approach has been widely adopted for the corporate sector internationally, including in Singapore, for raising corporate governance standards. It has also been used in the charity sector in the United Kingdom.<sup>2</sup>

When such an approach is used, the code in question is often described as voluntary. This may have contributed to a fundamental misunderstanding of what the approach entails in the first place.

#### **Voluntary or Not?**

Whilst it is true that a charity may decide whether or not to comply with a code's specific guidelines, it is not up to the charity to decide whether it should explain if it chooses not to comply. An explanation for any non-compliance is mandatory.

Requiring explanations for non-compliance enables stakeholders to assess whether there are sound reasons for a charity's actions. It may also encourage the charity to consider whether it has alternative checks and balances in place to address its non-compliance of specific guidelines.

In a study of Singapore-listed companies which I conducted for the Monetary Authority of Singapore and the Singapore Exchange in 2007<sup>3</sup>, I found that failure to provide explanations for non-compliance was relatively common among corporations. I attributed this to a number of factors, including the lack of controls that monitor implementation, lack of adequate internal implementation processes within companies, lack of understanding of principles and guidelines, and lack of practical guidance and education on implementation. Without similar follow-up actions implemented by the charity sector, similar problems encountered in the corporate sector are likely to arise.

It is important for charities to observe the letter and the spirit of the 'comply or explain' approach. In my opinion, this means charities must use their best efforts to comply, and where there are genuine grounds for non-compliance, they should provide clear explanations. However, it is equally important that regulators

and stakeholders understand that the 'comply or explain' approach acknowledges that one size does not fit all, and they should therefore take an enlightened approach when evaluating non-compliance.

#### **Regulatory Enforcement**

While many jurisdictions have adopted the 'comply or explain' approach in the corporate sector, the degree of involvement of regulators in monitoring implementation and enforcement differs. In Australia, for instance, the Australian Stock Exchange monitors a company's implementation of the 'comply or explain' requirement by conducting annual reviews. In contrast, British regulators leave monitoring and enforcement to the market.

Each country's regulatory body must find its own solution for making the 'comply or explain' approach work effectively by balancing the roles of the regulator and other stakeholders, while taking into account its own environment.

#### **Comply or Explain?**

I have often heard directors and professional advisers of listed companies express the sentiment that it is better to "just comply" rather than have to explain because it may be "difficult for regulators and stakeholders to understand" the reasons for non-compliance. I have heard similar comments from those involved in the charity sector. In my view, this leads to box-ticking, which yields no real benefit and may, in turn, lead to a false sense of security, and create a 'lose-lose' situation. For example, if a charity merely puts in place various committees which are recommended in a code, but these committees do not have the requisite independence or skill sets, or are inactive, it can give the impression that the proper corporate governance is in place when it is not.

Regulators need to help change the mindset of mere compliance with form. If a governance practice is considered by regulators to be so critical that non-compliance is unlikely to be acceptable under any circumstances, then it should not be left in a voluntary code but should, instead, be incorporated into mandatory regulations.

#### **The Role of the Players**

It has been said that "corporate governance is owned by the board" – the board must take ultimately responsibility for good governance in the charity. Similarly, the boards of charities should ensure that the proper processes are in

place. This includes coming up with a checklist on the extent to which guidelines have been implemented and setting target dates for those which have not yet been implemented. This process, when repeated annually, becomes easier and the time involved is progressively reduced as future reviews of compliance and implementation focus mainly on changes and new initiatives.

Stakeholders, too, have their part to play. In the corporate sector, I have heard sentiments like: "Since shareholders don't ask questions about corporate governance practices, why should companies and regulators care?" Similar stakeholder apathy will hinder the improvement of governance in the charity sector. Stakeholders should question charities about their governance practices as disclosed in the annual report or the charity portal. Their maturity and degree of sophistication are important components in the equation.

Meanwhile, the Charity Council needs to provide a clear rationale for, and practical guidance and education of, specific principles and guidelines so that their intent is properly understood, and the Code is implemented in spirit rather than just in form.<sup>4</sup> The dialogue sessions organised by the Charity Council together with the regulators for the different sectors of charities and IPCs were designed to assist charities to understand the Code better and to explain how it should be implemented. An additional step that can perhaps be considered is to issue a 'basis for conclusions' which explains why the council has taken a particular position on key issues. This is similar to what accounting regulators already do with new or revised accounting standards and interpretations.

### Moving Forward

I think it is heartening that the Charity Council and administrators in the charity sector are taking practical steps to ensure that the Code and its 'comply or explain' approach are implemented effectively in spirit rather than just in form. Based on my experience serving on the Charity Council and dealing with members of the charity sector, I feel that they do understand the need to help charities and IPCs to build capacity, including the capacity for good governance.

While charities and IPCs should be given sufficient time and guidance to help them properly implement the 'comply or explain' approach, those which continue not to comply and do not have good grounds for not complying,

should face enforcement actions. Such enforcement actions can be in various forms, such as revocation of IPC status, public censure of the charity and its trustees, or disqualification from serving as trustees.

Donors and other stakeholders, such as the media and corporate governance advocates, can also play an important role in promoting improved governance. For example, the media can highlight examples of good or poor corporate governance. Following examples in the corporate sector, awards for good corporate governance can also be introduced to provide positive incentives for improving governance. Ultimately, efforts to improve corporate governance in the charity sector are most likely to succeed if the Charity Council, regulators, donors, the media and other stakeholders work together, and charities understand that it is in their self-interest to adopt high corporate governance standards.

The real test of whether corporate governance practices are implemented in spirit rather than just in form is whether there have been changes in the 'culture' of the charity and in the way the board members and management work. The point is this: compliance with a code of practice is an ongoing process of improvement. It is a journey, rather than a specific destination. □

<sup>1</sup> The Code aims to support the board members in the work they carry out as charity trustees. The recent years have witnessed a few local charities being probed for what seemed to be spending irregularities and lack of transparency. Amidst these controversies, charity trustees are put under greater pressure to upkeep the quality of charity governance to retain public trust. Yet, bearing in mind the voluntary nature of the trustees' involvement, regulators will need to operate a code that does not impose responsibilities and commercial-style pressures that are beyond the capacity of the trustees to handle. Taking the unique voluntary welfare ecosystem into account, the Code seeks greater transparency in charities' operation. In this way, the public is given an opportunity to exercise their shared responsibility to monitor the charities they are supporting (or are thinking of supporting) and to withdraw their support if the information provided does not gain their trust.

<sup>2</sup> It should be emphasised that countries which have adopted codes of corporate governance based on the 'comply or explain' approach in the corporate sector also have certain minimum corporate governance standards included in regulatory requirements, such as company law and listing rules. The codes of corporate governance are meant to supplement these minimum requirements without making them mandatory. Similarly, in the Singaporean charity sector, statutes and regulations, such as the Companies Act, Societies Act and regulations for Charities and IPCs contain minimum corporate governance requirements which may be applicable to charities and IPCs.

<sup>3</sup> Mak Yuen Teen, 'Improving the implementation of corporate governance practices in Singapore'. Report published by the Monetary Authority of Singapore and Singapore Exchange, 26 June 2007.

<sup>4</sup> I understand the Charity Council has plans to do this on an ongoing basis.



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