The Failure of Corporate Internal Controls and Internal Information Sharing: A Conceptual Framework for Taiwan

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The Failure of Corporate Internal Controls and Internal Information Sharing: A Conceptual Framework for Taiwan

Chang-hsien Tsai*

Although East Asian jurisdictions such as Taiwan have been adopting similar models of Anglo-American independent directors and audit committees in recent years, we can find that common issues are failure of internal controls, in general, and dysfunctional internal information-sharing mechanisms, in particular. To accommodate Taiwan’s reform trend towards furthering the adoption of independent directors and audit committees, this article offers a roadmap for conceptual solutions which are harmonic with each other as prerequisites to enable monitors of management to have the incentives and means to exercise their oversight. First, the board’s duty to monitor should be reiterated while being transplanted into corporate governance rules. Second, independent information channels should be established to enable internal governance information to flow to corporate monitors, thus facilitating their decision-making in oversight. Finally, external market forces should be channelled to safeguard internal corporate governance.

I. Introduction

Effective corporate internal controls and internal audits have long been the key elements of corporate governance. International fraudulent cases, from Enron and WorldCom in the United States to Toyota and Olympus in Japan, and even the outbreak of the global financial crisis (GFC), have been repeatedly illustrating the severe consequences of failed internal controls.

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The earlier cases (Enron and WorldCom) in the United States pushed the US Congress to enact the Sarbanes-Oxley Act (SOX), which was attributed to two main kinds of failure. First, all corporate organs relevant to internal controls (including external auditors, the management, the board of directors and audit committees) did not function as designed. Second, their internal control mechanisms, especially standard operating procedures to record, collect and gather internal information, did not function. The GFC further aroused our concerns over whether enterprise risk management (ERM) played its role effectively, as the board of directors should have been able to prevent excessively risky investments before corporate managers made them. US commentators believed the financial industry should reform its risk management mechanisms for future investments. Similar corporate fraud also appeared in Japan, as shown by two representative cases in Section II.A below. Corporate organs with the responsibility to monitor management (ie, corporate monitors including independent/ outside directors or traditional supervisors) were unable to complete their tasks without sufficient information. In Taiwan, dysfunctional internal control systems and lack of information also played an important role in recent corporate governance scandals as discussed in Section II.B, which might severely decrease investors’ confidence in the capital market.

The reason this article begins with an introduction of Japanese cases is that, as summarised in Table 1, with similar civil law origins, East Asian jurisdictions represented by Japan and Taiwan traditionally adopted the binary or dual board model (also known as the “two-tier system”) where both directors and supervisors (or company/statutory auditors) are elected by shareholders. However, in the first decade of the 21st century, both Japan and Taiwan began to transplant a unitary Anglo-American style of board of directors and independent directors (also known as the “one-tier system”) into corporate governance structures, with audit committees replacing supervisors. Therefore, it would be meaningful to compare the Japanese and Taiwanese cases since both of them experienced similar transformation of corporate governance structures, and these cases illustrate similar internal control failure.

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4 Methodologically speaking, “qualitative research tends to focus on a smaller number of ‘observations’ or ‘data sources,’ … There are various sampling techniques that may be employed.
Table 1: Simplified Classification of Corporate Governance Structure

<table>
<thead>
<tr>
<th>Type of structure</th>
<th>One-tier system (Anglo-American style): Taiwan’s reform trend</th>
<th>Two-tier system (Japanese/Taiwanese traditional style)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Task of the board of directors</td>
<td>Monitoring managerial performance</td>
<td>Performing management function</td>
</tr>
<tr>
<td>Internal oversight</td>
<td>Independent directors/audit committees</td>
<td>Supervisors (Kansayaku in Japanese)</td>
</tr>
</tbody>
</table>

In order to prevent internal illegal activities or managerial misconduct, independent directors are generally viewed as a magic bullet in corporate governance by Taiwan’s government. As illustrated in Table 2, the Financial Supervisory Commission (FSC)\(^5\) has announced that all listed companies in Taiwan are required to have independent directors by 2017. Regarding mandates to establish audit committees in lieu of supervisors, the first deadline for enumerated financial institutions and listed companies with a contributed capital larger than $NT10 billion is 2017, while the second deadline for listed companies with a contributed capital larger than NT$2 billion but less than NT$10 billion is 2019.\(^6\) This illustrates a typical regulatory strategy in the general belief that independent directors ensure good corporate governance.

\(^5\) The FSC is the competent authority generally in charge of all financial markets in Taiwan, including the securities market. Its position in Taiwan is similar to that of the Securities and Exchange Commission in the United States. See FSC’s website, http://www.fsc.gov.tw/en/home.jsp?id=9&parentpath=0 (visited 24 Feb 2014).

\(^6\) According to the FSC, listed companies in all industries are required to have at least two independent directors; if they currently do not have enough independent directors, independent directors should be elected in the next election for new directors. See Order of the FSC, Jin Guan Zheng Fa Zi No. 1020053112 金管證發字第1020053112號令 (passed on 31 Dec 2013) (Taiwan). There are staged requirements on establishing audit committees: enumerated financial institutions as well as listed companies with contributed capital of over NT$10 billion will have to immediately establish audit committees in lieu of supervisors; the deadline for this is 2017. Listed companies with contributed capital between NT$2 billion and NT$10 billion will have to establish audit committees in lieu of supervisors from 1 January 2017; the deadline for this is 2019. Other companies with contributed capital of less than NT$2 billion will not be affected by the above requirements. See Order of the FSC, Jin Guan Zheng Fa Zi No. 10200531121 金管證發字第10200531121號令 (passed on 31 Dec 2013) (Taiwan).
Table 2: New Requirements Imposed by the FSC on the Establishment of Independent Directors and Audit Committees

<table>
<thead>
<tr>
<th>Contributed Capital (NTD)</th>
<th>&lt;2 billion</th>
<th>2–10 billion</th>
<th>≥10 billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Directors</td>
<td>All listed companies: by 2017</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audit Committee</td>
<td>Not required</td>
<td>2017–2019</td>
<td>By 2017</td>
</tr>
</tbody>
</table>

To accommodate Taiwan’s reform trend towards further adoption of independent directors and audit committees, this article suggests a conceptual regime where different solutions act in concert to strengthen each other. Specifically, in order to get the above reforms to function, several supporting tools are prerequisites. First, the board’s duty to monitor should be reiterated while being transplanted into corporate governance rules. Second, independent information channels should be established for internal governance information to flow to corporate monitors such as traditional supervisors or independent directors, thus facilitating their decision-making in oversight. Finally, external market forces should meanwhile be channelled to safeguard internal corporate governance.

This article is organised into three parts. Section II instances two Japanese cases and three Taiwanese corporate governance failures across industries, pointing out that common issues among the East Asian cases are failure of internal controls in general and the dysfunctional internal information-sharing mechanism in particular. Section III delves into the above failures of internal controls not only to demonstrate the link between the malfunction of internal controls and the role of internal information flow but also to highlight the fact that the cosmetic independence of the board of directors would not solve the failure in board oversight. Furthermore, Section III proposes a scheme of conceptual solutions which complement each other, hoping that this article will lead the way to a discussion on how to resolve the corporate governance failures in East Asia, especially in Taiwan. Section IV concludes by arguing that the transplant effect should be considered when East Asian jurisdictions exemplified by Taiwan continue to import from the United States the one-tier system in lieu of the traditional two-tier system.

II. Failures of Internal Information Sharing and Internal Controls in East Asia

In this section, two Japanese cases and three Taiwanese cases will be explored, and the lessons on the failure of internal self-regulating mechanisms will be drawn from these cases. The comparison among these cases would further highlight the common issues in internal control,
which would need to be fixed through legal and market approaches as exhibited in Section III.C.

A. Japanese Cases

1. Toyota’s corporate governance model

Japanese corporate legislation adopts a mixture of two corporate governance models. The first one is the traditional management model, or the two-tier system, where both directors and supervisors (kansayaku) are elected by shareholders. In this model, the board of directors proactively manages corporate operations while supervisors (also known as company/statutory auditors) monitor its management. The second one is the new monitoring model, or the one-tier system. This unitary Anglo-American style of board of directors is designed to supervise operations by itself, mainly through independent directors.7

The Toyota Motor Corporation (Toyota) has adopted the traditional two-tier system, in which Japanese laws do not require shareholders to elect outside directors. In this kind of company, supervisors are in charge of monitoring managers’ job performance and corporate operations. However, since supervisors do not have the power to dismiss directors or managers, it is very difficult for them to discharge their duty of oversight.8

The Toyota recall crisis, in 2010, involved design failures in its products, which resulted in serious safety issues and even casualties.9 Faced with this crisis, Akio Toyoda, the CEO of Toyota, suggested several measures to improve Toyota’s public image, including establishing an effective internal information-sharing mechanism and improving communication with the authorities concerned.10

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10 Aronson (n 8 above), p 69.
The Toyota scandal revealed that, within companies which adopt the Japanese traditional management model (two-tier system), a serious issue of internal information-sharing may exist, demonstrating one dimension of internal control failure. According to Japanese corporate law, in corporations with supervisors such as Toyota, the board of directors also has the responsibility to establish an internal control system to ensure that directors and managers obey laws and articles of incorporation when performing their duties. Nonetheless, the Toyota case showed that its internal auditing department, the main organ for internal control, just needed to directly report to the board of directors; it is possibly the reason why important information was unable to be efficiently conveyed to their supervisors. Another incident in 2009 exemplifies internal control failure inside Toyota, indicating a noticeable communication gap within this multinational company. All of the problems mentioned above have displayed that retardation of internal information flow may have caused Toyota’s disasters.

The Olympus case below is another example, which shows that even in corporations with outside directors – which are a minority in Japan – the obstruction of information flow can also contribute to corporate governance failure.

2. Olympus’s corporate governance model
Most Japanese companies are still keeping the traditional model (two-tier system) where the monitoring task is done by supervisors, even though Japan has undergone a reform trend towards gradually adopting independent directors. Nevertheless, the Olympus case exhibited that even if an audit committee were formed without the committee...
being given actual power to monitor their senior managers, a failure of corporate governance could still arise. Before the scandal was unveiled in 2011, the Olympus Corporation (Olympus) had three outside directors out of a total of 15 directors, contrasting sharply with other Japanese companies, of which only half had any outside director. The core corporate governance issue in the Olympus scandal was that their board, even if they included outside directors, had long been unaware of illegal activities organised by their senior managers and therefore were unable to react in time.

The Olympus scandal in 2011 might be the most serious corporate governance failure in Japan. In short, the senior managers in Olympus by any means prevented information on dubious activities from flowing to the board of directors; thus, the board could not have effectively exercised their oversight. This case is a vivid example that if outside directors cannot gather correct information to fulfil their obligation to monitor, then the board is actually of no use in terms of corporate governance.

3. Lessons from the Japanese cases
From the two Japanese cases discussed above, we can find that a common phenomenon across them is the dysfunctional internal information-sharing mechanism, no matter which of the two corporate governance models a company adopted. Apparently neither of the two corporate monitors, outside directors and supervisors, could be real players in overseeing managers' performance. Blocking corporate monitors from receiving essential information on business operations might have caused serious corporate governance failures like the Toyota and Olympus scandals.

In the following Section II.B, examples of corporate governance failures from Taiwan will be elaborated, and we would observe that common features across those cases appear to be similar to those in Japan.

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18 Aronson (n 7 above), p 107. Meanwhile Olympus’s external accounting auditors should have uncovered or stopped this scandal as a gatekeeper in the whole story, but the concept of gatekeepers had not attracted much attention in Japan. See Bruce Aronson, “Corporate Governance Models and Practices in Japan and East Asia: Proceedings of a Panel Discussion” (2013) 27 Columbia Journal of Asian Law 220, 248.
19 Aronson (n 7 above), pp 106, 110, 112, 132.
20 Ibid., pp 130–131.
21 Ibid., pp 131–132.
22 Aronson (n 8 above), pp 76–78.
B. Taiwanese Cases

As further discussed in Section II.C below, internal self-regulating mechanisms consist of internal controls, legal compliance programmes and ERM frameworks. In addition to internal controls, the importance of legal compliance programmes to corporate governance will be illustrated in this section, and the three are closely connected. Because of Taiwan’s critical position in the global supply chain, the range of legal compliance for Taiwanese corporations has already been extended to foreign laws. Hence, if a legal compliance programme embedded in an internal control system can direct Taiwanese corporations to comply with local and foreign laws, a certain number of unwanted illegal scandals can be prevented in advance. Although Taiwanese corporations under internal and external pressure have been recently lending more and more value to internal controls, corporate governance scandals still occur. In this section, several recent cases of internal control failures will be introduced, in order to find out what common governance issues Taiwanese companies face in their day-to-day operations.

When it comes to corporate governance structure, Taiwanese companies usually adopt the traditional two-tier system – that is, monitoring tasks are done by supervisors, and companies are managed by the board of directors, which is similar to the two-tier system (traditional management model) in Japan. Nonetheless, Taiwan’s current reform trend mentioned in the Section I favours the one-tier system imported from the United States. Therefore, an increasing number of Taiwanese companies will be required to adopt the one-tier system and establish an audit committee to replace supervisors. Although there is a mixture of different corporate governance models in Taiwan,23 the common failure in internal controls appears in the cases below.24

23 Under Taiwan’s current regulations, there are three sorts of corporate governance structures among public companies. Under the first structure, a company would have an audit committee consisting of all independent directors without supervisors. Under the second “hybrid” structure, a company would have independent directors and supervisors at the same time without audit committees. Under the third traditional structure, a company has supervisors only. As mentioned in the Section I, all the listed companies in Taiwan are currently required to adopt the first or the second structure instead of the traditional third structure. As explained below, Fubon Financial Holding Company, Limited (featured in Section II.B.3) is a financial institution and adopts the one-tier system, whereas Genome International Biomedical Company Limited (featured in Section II.B.2), a non-financial firm, adopts the two-tier system.

24 Document analysis is one of the qualitative empirical legal research methods. Articles in newspapers and periodicals, albeit non-legal documents, can be used as sources of data. Webley (n 4 above), pp 938, 941. Document analysis is criticised as a research method, in part, because “documents are not susceptible to scientific, systematic analysis in keeping with positivist traditions”, but “[f]or many researchers, documents provide evidence of policy directions, legislative intent, understandings of perceived shortcomings or best practice in the legal system, and agenda for change ….” Ibid., pp 939, 948. Therefore, several Taiwanese cases are analysed through mostly press reports in this section to find shortcomings in the current policy direction.
1. Taiwanese LCD panel makers involved in overseas anti-trust lawsuits
Since the end of 2006, four Taiwanese LCD panel makers have been involved in anti-trust lawsuits in the United States, European Union and South Korea, where they were accused of price-fixing cartels. Specifically, AU Optronics Corporation (AUO), the biggest Taiwanese LCD panel maker, was one of them; three AUO senior managers were finally given heavy penalties in the United States. In addition to the penalties imposed by the US government, the European Commission later in 2010 fined four major Taiwanese LCD panel makers ~ €434 million under EU competition law. The Korea Fair Trade Commission also fined four of the Taiwanese firms. Among those companies fined was Chi Mei Optoelectronics Corporation. Ho Chao Yang, the former vice-chairman of the company, who had completed his jail term in the United States, reiterated in public the importance of complying with foreign anti-trust law based on his own experience. These lawsuits to an extent illustrated the comprehensive failure of legal compliance programmes in Taiwan.

2. Insider trading in Genome International biomedical company limited
A more recent case in Taiwan happened in August 2013, when Top Pot Bakery (TPB) was accused of deceptively advertising their bakery as “complete natural products”, and a wave of criticism arose. However, towards furthering the adoption of independent directors and audit committees, as well as to understand perceived problems in or causes of corporate governance failures among Taiwanese companies, for example, whether they are financial or non-financial firms, and whether they adopt the one-tier or two-tier system. As an agenda for change and in an attempt to solve issues in internal controls and information flow, this article will put forth reform proposals in Section III.C.

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this incident later unveiled another scandal in Genome International Biomedical Company Limited (Genome), TPB's controlling shareholder or the parent company. The chairman of the board, a supervisor and several major shareholders of Genome were suspected to have committed insider trading. Specifically, after the news of TPB's deceptive advertisement was widely known, Genome's chairman of the board, the supervisor who was also the wife of the chairman and several major shareholders were accused of engaging in insider trading. That is to say, they sold their shares prior to the disclosure that TPB had made a deceptive advertisement. In addition, two of Genome's independent directors both resigned immediately before the scandal was revealed and a TPB supervisor resigned as well in September 2013. The resignation of corporate monitors (including supervisors and independent directors) was a warning signal to the capital market.

3. Taiwan sports lottery scandal
The Taiwan Sports Lottery Corporation (TSLC), a 100 per cent-owned subsidiary company of Fubon Financial Holding Company Limited (Fubon), was established in August 2007 and commissioned by Taipei Fubon Bank (TFB, another 100 per cent-owned subsidiary company of Fubon) under the supervision of Taiwan’s Sports Affairs Council to run the sports lottery business. In 2011, a fraud was uncovered inside TSLC. Its assistant manager Lin Hao-chin had abused his authority in order to win abnormally lottery prizes for himself. This incident revealed that...
TSLC's internal control system had not been successfully established and maintained.\textsuperscript{38} According to the FSC's written Assessment of Civil Money Penalty (Assessment),\textsuperscript{39} the FSC, as the authority concerned with financial holding companies, assessed a NT$4 million civil penalty against Fubon for not establishing and operating an effective internal control and audit system towards its two subsidiary companies, thus violating the Financial Holding Company Act.\textsuperscript{40} The Assessment included detailed determinations of Fubon's internal control failures. First, Fubon failed to file “Material Emergency Reports”, as required by the FSC's regulations on material information communication by the banking industry, thereby revealing its failure in operating internal controls and monitoring the legal compliance of its subsidiary companies. Second, Fubon failed to control its subsidiary companies' reporting of operational risks and to ensure the reliability and timeliness of information from them, which demonstrated a failure in Fubon's ERM framework towards its subsidiary companies. Finally, the internal information-sharing and flow inside Fubon was problematic, contributing to internal control failures in the two subsidiary companies – that is, TSLC and TFB. In connection with that Assessment, three members of Taiwan's Control Yuan\textsuperscript{41} issued an investigation report, concluding that Fubon's two subsidiary companies' reporting to their parent company for the purposes of monitoring and oversight of compliance activities was materially deficient; that Fubon lacked adequate and necessary board and management oversight of legal compliance programmes and internal control systems of TSLC and TFB; and that there were, therefore, comprehensive internal control failures among Fubon, TSLC and TFB.\textsuperscript{42}


\textsuperscript{39} See Order of the FSC, Executive Yuan, Jin Guan Yin Kong Zi No. 1000383461 行政院金融委員會令 (passed on 12 Dec 2011) (Taiwan).

\textsuperscript{40} Jin Rong Kong Gu Gong Si Fa (Financial Holding Company Act 2015), Arts 51 and 60 (Taiwan).

\textsuperscript{41} The founding father of the Republic of China (Taiwan), Dr Sun Yat Sen, drew from the Western system of checks and balances among legislative, executive and judicial powers and added two traditional Chinese government powers of examination and supervision (control) to complete the five-power system. The Constitution of the Republic of China (Taiwan) was enacted on 25 December 1947; on 5 June 1948, the Control Yuan was officially established, following the enactment of the Constitution. See Control Yuan’s website, http://www.cy.gov.tw/ct.asp?xItem=6036&amp;ctNode=989&amp;mp=21 (visited 26 Jan 2015) (Taiwan).

After the incident, Fubon held an extraordinary stockholders’ meeting to re-elect two independent directors and a board meeting to re-examine the internal control systems across 10 major subsidiaries within the financial conglomerate, aiming to strengthen internal controls.43 This scandal was actually a crisis for Fubon, a renowned financial conglomerate, because credit is an essential asset to financial institutions and cannot be retained without well-functioning internal controls.44 Therefore, there is more room for improvement for Fubon’s corporate governance.

4. Lessons from the Taiwanese cases
The Taiwan Sports Lottery Scandal represents a “critical” case, illustrating the identified corporate governance defects – that is, problems in internal controls, legal compliance programmes, ERM frameworks and internal information flow – might have led to these Taiwanese scandals.45 Also, we can find that a common issue besides dysfunctional internal control systems was corporate non-compliance with local and foreign laws. For example, the LCD anti-trust lawsuits exemplify the operational risk of violating foreign anti-trust laws. The lesson drawn from them is that companies should have had the ability to avoid this kind of legal risk by way of its internal controls and the incorporation of legal compliance programmes.

In addition to cases of high-tech firms illustrating problems with legal compliance, financial firms like Fubon are another high-risk group now under serious scrutiny by the FSC; meanwhile, they are required by the FSC to appoint a chief legal compliance officer in each company with a duty to ensure the effectiveness of ERM frameworks in particular, through which the FSC aims to advance the integrity of financial market in general.46

Fraud, Which Scandal Is an Internal Control Failure; What Were the Authorities’ Mechanisms to Manage and Monitor Sports Lottery? Were the Mechanisms Properly Operated? Was There Any Administrative Deficiencty?“ (2012), pp 1, 8–10, available at http://www.cy.gov.tw/ AP_HOME/Op_Upload/eDoc/%E8%AA%BF%E6%9F%A5%E5%A0%B1%E5%91%8A/1 01/10100078%E8%AA%BF%E6%9F%A5%E5%A0%B1%E5%91%8A%E5%85%AC%E5 %B8%83.pdf.
43 See Chen Huilin, “Yun Cai Bi An Hou… Tsai Ming-Zhong Ju Gong Zhi Qian Fu Bang Jin
Pin Gu Wen Quan Mian Nei Kong Zong Ti Jian (Chairman Tsai Apologised after the Sports
Lottery Fraud While Fubon Financial Holding Company Engaged External Advisors to
Comprehensively Examine Its Internal Controls)” Hua Shi Xin Wen Wang (CTS News) (6 Oct
44 See Yeh Shihhung and Huang Chioulun, “Wu Bi Tuo Qian Fu Bang Xin Yong Yi Zai Po Chan
(Fubon Lost Its Credibility Due to Fraudulent Cases)” Zhong Guo Shi Bao (China Times) (25 July
45 FSC’s Assessment and Control Yuan’s Investigation Report demonstrated a rigorous analysis of
the potential causes of this Taiwanese scandal, that is, internal control failures in a broader sense.
46 See Hung Chengchi, “Jin Guan Hui Ni Tui Fa Zun Zhu Guan Qian Shu Zhi (The FSC Plans
to Mandate Institution of Chief Legal Compliance Officer)” Zhong Guo Shi Bao (China Times)
In sum, the cases presented above, to an extent, substantiate that internal control systems within those companies did not work properly.

C. Internal Self-Regulating Mechanisms and Corporate Governance

The aforementioned cases clearly showed that if internal self-regulating mechanisms do not work effectively, serious scandals would probably follow, hence hurting investors’ confidence in companies. These cases also illustrated the significance of internal self-regulating mechanisms, which embrace internal control systems, legal compliance programmes and ERM frameworks. First, there might be something wrong with legal compliance programmes so that LCD panel makers suffered from strict punishment due to their violation of foreign anti-trust laws. Second, in the Genome case, the internal controls seemed functionless in detecting insider trading.\(^{47}\) Third, the internal control system did not prelude TSLC’s scandal.

Moreover, to explore the link between information flow and internal controls that prevent insider trading, one way to preclude insider trading is to control information flow inside corporations. Therefore, corporations need to establish a precautionary system to control the use of internal information.\(^{48}\) In other words, information control (preventing the improper use of information) is essential to regulate insider trading. On the other hand, the premise of effective internal controls is to ensure that internal information will be properly shared with corporate monitors such as supervisors and outside directors. Furthermore, internal self-regulating mechanisms have to cooperate with these monitors, since only with well-functioning internal controls can governance information flow to these monitors, and they can thus fulfil their obligation of oversight.\(^{49}\)

\(^{47}\) An empirical study showed that internal controls on financial reporting are closely related to insider-trading profits. See Hollis A Skaife et al., “Internal Control over financial Reporting and Managerial Rent Extraction: Evidence from the Profitability of Insider Trading” (2013) 55 Journal of Law and Economics 91, 107. Effective internal controls on financial reporting are able to weaken those insiders’ ability to gather internal information and their ability to make profit from insider trading, hence lowering the possibility of insider trading and indirectly decreasing the agency cost. See Dan Li and Yong Zhang, “Internal Control Effectiveness and Insider Trading”, (2011) p 30, available at http://ssrn.com/abstract=1798409.


A survey done by the COSO committee after the financial crisis also showed that in a majority of US corporations, their risk management measures were still underdeveloped and mostly equipped with unsatisfactory monitoring procedures. Some of those problems were due to incomplete internal information-sharing, which impeded risk management. Another study indicates that two main factors hinder the board from fulfilling its obligation to monitor: first, board members were unable to control information supply, so that it is impossible for them to gather necessary information of risks created by managerial activities; second, board members lacked the ability to process risk-related information, thus lacking incentives or authority to affect managers’ decision-making. Therefore, after the GFC, key to enhancing the efficacy of ERM frameworks are solidifying risk management process, strengthening the board’s oversight in risk management and completely incorporating risk management procedures into every aspect of business operations.

The concept of ERM frameworks has already encompassed internal controls. These two mechanisms are no longer interchangeable, but complement each other. Additionally as early as the Institute of Chartered Accountants in England and Wales released the “Turnbull Report” in 1999, the intrinsic connection between risk management and internal controls (directing legal compliance programmes as well as information flow) has been emphasised. In short, the integrated structure of internal control systems can be presented as in Figure 1 below. Inside
the internal self-regulating mechanisms, legal compliance programmes are the core; internal control systems are expanding the scope to include ERM frameworks.59

In the next section, we will discuss why the cosmetic independence of the board cannot serve as a magic bullet to fix internal control failure, especially in Taiwanese cases. Further, we will propose solutions to the failure, conceptually suggesting a complementary regulatory framework to accommodate Taiwan's reform trend towards a US style of one-tier system. In other words, after dissecting the problems revealed by Taiwanese corporate governance failures, in the next section, we will discuss how to make corporate monitors (including supervisors and independent directors of audit committees) have the incentives and means to establish and maintain this integral internal control system as shown in Figure 1.

In other words, the most useful characteristics of the US corporate governance system are not always independent directors only, but rather a better operating environment where the US system furnishes those monitoring management with incentives and the means to perform their functions.60 In Section III.C below, this article hence argues that to resolve internal control failures in Taiwan, practical measures should not be limited to independent directors (and related structural and compositional board reforms). More importantly, we need to enhance the effectiveness of monitors of management by giving them incentives

59 Furthermore, there is a tendency that internal control would be mainly based on risk management. See Wu Cong Fan, Shen Ji Xue: Shi Wu Ying Yong Yu Fa Lü Guan Dian (Auditing: Practical Application and a Viewpoint of Law) (Taipei: Wu Cong-Fan Self-Publishing, 4th ed., 2009) p 146.
60 Aronson (n 7 above), pp 104–105.
(by imposing the duty of oversight clearly) and means (by strengthening the ability to gather information or building independent information channels).

III. Problems Revealed by Corporate Governance Failures and the Proposed Solutions in Taiwan

After reviewing the examples from Taiwan and Japan, we find that in order to maintain the function of internal controls, information flow is a key element in addition to cosmetic independence, or independence of the board merely in form. This section would then provide the reasons for these governance failures and conceptual solutions to the issues, particularly in Taiwan.

A. Internal Control Systems and Legal Compliance Programmes Do Not Fully Work

1. Common issues among the cases: Why internal controls fail

Taking the LCD anti-trust lawsuits as the first example, if internal control systems in the fined companies had sounded an alarm and their directors had tried to maintain the systems with legal compliance programmes embedded in them, would the LCD makers still have violated the foreign laws on such a large scale?

In the TSLC case, although the company appeared to have a standard operating procedure of internal controls to prevent internal fraudulent activities, the necessary internal audit reports were not properly reviewed by internal audit divisions, which should have been supervised by Fubon’s board and executive officers, but just directly archived long before the fraud was uncovered.61 We can conclude that Fubon did not establish and operate an effective internal control and audit system towards its subsidiaries.

The Genome case is another example in which the company’s internal control system was not able to prevent illegal insider trading. Effectively utilising financial statements as an internal control tool is one of the key measures which should be taken to prevent insider trading.

More importantly, Fubon is a financial firm adopting the one-tier system, whereas Genome, a non-financial firm, adopts the two-tier system. This comparison between these critical cases illustrates, to an extent, that

61 Hsu Chingwen, “San Ke Song Dong De Luo Si Mai Xia Yun Cai Wu Bi De Yin Zi (Three Factors Lead to Lottery Fraud)” (2011) 771 Jin Zhou Kan (Business Today) 80, 80.
internal controls failed to work properly and internal information was not shared smoothly within Taiwanese companies, regardless of the industry and the governance system adopted.

Furthermore, the Genome case might better illustrate the reasons underlying the Taiwanese scandals – that is, controlling shareholders in control of internal control systems and internal information flow. As per Genome's annual financial report in 2013, the top four shareholders were Genome's chairman's wife (who owned 33.5 per cent of Genome's shares and was one of its three supervisors), Genome's chairman (who owned 19.64 per cent and was also the general manager), a private corporation controlled by the family of Genome's chairman (which owned 17.97 per cent) and Genome's chairman's father (who owned 6.18 per cent and was another of its three supervisors); Genome's chairman's family therefore owned more than 77 per cent of Genome's outstanding shares. The ownership structure of publicly traded companies in Taiwan is comparably concentrated such that family groups and controlling shareholders are common in the capital market, as typically represented in the Genome case. This phenomenon leads to controlling shareholders' domination of the election of directors and supervisors as well as of decision-making around management and monitoring. This means that in public companies, there is less likelihood of the board being independent of the controlling shareholders. For instance, Genome's chairman served as its general manager and controlled a majority of its shares, together with his family group. Since he could control information flow inside Genome, if he intended to withhold and manipulate internal information, even though the board was formally independent with independent directors, they could not detect the intentional fraud committed by the controlling shareholders, not to mention the fact that at least two of Genome's three supervisors were from its chairman's family group.

In sum, as the two Japanese cases suggested in Section II.A, a common phenomenon is the dysfunctional internal information-sharing.
mechanism, whether a company adopted the one-tier or two-tier system. This is because neither outside directors nor supervisors could receive governance information to oversee managerial performance properly. Likewise, no matter which of the two corporate governance models the companies adopted in the Taiwanese cases, the identified issue of internal information flow might, to some extent, cause the corporate monitors (supervisors in the Genome case and Fubon’s independent directors inside its audit committee in the TSLC case) to fail to exercise their oversight, eventually contributing to the internal control failures.

2. An essential prerequisite for internal controls to work: Internal information flow

Based on the aforementioned examples in Section II, a lesson we learn is that the board of directors has to shoulder the legal obligation to monitor, that is, to establish and maintain an internal control system. The US Delaware Supreme Court decided in *Graham v Allis-Chalmers Mfg. Co.* in 1963 that the board did not have such a duty to actively establish an internal detective system to monitor any suspicious activities within a company. 66 However, in 1996, the Delaware Court of Chancery restated in *In re Caremark International Inc. Derivative Litigation* not only that the duty to monitor did exist but that the board also bore this legal duty. 67 The *In re Caremark International Inc. Derivative Litigation* decision also held that only if the board actively established an information system providing directors with accurate information in time, could the directors fulfil their fiduciary duty of oversight; therefore this duty was called the “Caremark Duty”. 68 This decision confirmed that the board’s duty to monitor would embrace establishing and maintaining an internal information-sharing mechanism.

Therefore, according to *In re Caremark International Inc. Derivative Litigation*, it is clear that the focus should be placed on internal information-sharing and information flow. In fact, when it comes to ensuring legal compliance, to precluding insider trading or even to maintaining internal controls, the prerequisite for the board of directors to fulfil its duty to monitor depends on independent information channels, which can supply the necessary governance information without obstruction from insiders and management. In other words, independent information channels are essential to those who bear the duty to monitor within a corporation (including supervisors in the two-tier system or audit committees in the

66 188 A.2d 125 (Del. 1963).
67 698 A.2d 959 (Del. Ch. 1996).
one-tier system). With an efficient flow of internal information to these corporate monitors, internal self-regulating mechanisms can play a real role in corporate governance.

B. Cosmetic Independence of the Board of Directors Would Not Solve Failure in Board Oversight

1. The traditional view overemphasising cosmetic independence of the board

The agency theory states that the main function of the board is to exercise its oversight and to reduce agency costs incurred when managers are authorised to operate a firm; the institution of the board is one of the ways to alleviate the agency problem.\(^69\) Nevertheless, the recent trend of board reforms internationally is primarily focused on enhancing board independence by altering board composition and structure.\(^70\) For instance, a Taiwanese commentator emphasised how board independence can improve corporate internal control: when we cannot rely on managers to operate internal controls, then the law should enhance board independence, and an independent board should be allowed to lead internal auditors to implement internal control systems.\(^71\) From a comparative law perspective, US legislators have long been focusing corporate governance reforms on this type of compositional and structural change in the board.\(^72\) The SOX set of requirements for board independence was passed with an assumption that board independence would reduce illegal activities inside a corporation; the Dodd-Frank Act echoed this with the concept that enhancing board independence would increase board efficacy.\(^73\) As discussed in the Section I, Taiwan’s FSC requires all listed companies in Taiwan to have independent directors by 2017. As to mandatory audit committees, listed companies with a contributed capital larger than NT$10 billion will be required to establish an audit committee in lieu of traditional supervisors by 2017, while those with a contributed capital between NT$2 billion and 10 billion have to do so by 2019.

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\(^70\) Ibid., p 293.

\(^71\) Lin Jen Guang, “Dong Shi Hui Gong Neng Xing Fen Gong Zhi Fa Zhi Ke Ti - Jing Ying Quan Gong Neng Zhi Qiang Hua Yu Nei Bu Jian Kong Ji Zhi She Ji (Legal Issues Regarding Division of Board of Directors’ Functions: Enhancing Managerial Function and Designing Internal Monitoring Mechanisms)” (2006) 35 Tai Da Fa Xue Lun Cong (National Taiwan University Law Journal) 157, 237.

\(^72\) Sharpe (n 69 above), pp 274–279.

Overall, it is theoretically expected that by enhancing board independence — through establishing board committees fully with independent directors, for example — the board will not be controlled by senior managers, and directors can thus exercise their oversight appropriately.74

2. Views other than those merely stressing the board’s cosmetic independence

Nevertheless, solely substituting independent directors for inside directors would not enhance the board’s independence, because the question would just turn to whether independent directors can monitor operations effectively.75 There are three elements constraining independent directors’ ability to monitor: time, information and knowledge.76 In this regard, the true strength of the US one-tier system is to provide “tools” to the board of directors, and “good access” to information is definitely one of the important tools.77 It infers that merely stressing board compositional and structural reforms will not automatically enhance the board’s monitoring function. Until today, we can observe that Taiwanese legislators and regulators have been concentrating on strengthening the independence of board members and requiring the institution of independent board committees as a regulatory strategy; this reform tendency can be exemplified by statutory requirements on independent directors,78 audit committees79 and compensation committees.80

We can substantiate the ineffectiveness of enhancing cosmetic independence through board composition and structural reforms via one of the Taiwanese cases — Taiwan Sports Lottery Scandal discussed in Section II.B.3. In this example, Fubon, TSLC’s parent company adopting the one-tier system, had earlier established an audit committee, a corporate governance committee and a compensation committee; it could thus be deemed to be a role model of good corporate governance in Taiwan and even across Asian industries.81 Their audit committee consisted entirely of independent directors; their audit committee’s meeting frequency was much higher than the FSC required.82 According to their internal rule, the planning and procedure of the audit committee’s meetings were as

74 Ibid., p 1444.
76 Sharpe (n 73 above), p 1450.
77 Aronson (n 18 above), pp 232, 246.
78 Zheng Quan Jiao Yi Fa (Securities and Exchange Act 2015), Arts 14-2 and 14-3 (Taiwan).
79 Ibid., Arts 14-4 and 14-5.
80 Ibid., Art 14-6.
82 Ibid., pp 24–25.
C. The Proposed Solutions to Corporate Governance Failures in Taiwan

1. Transplanting the board’s duty to monitor

Following *Graham v Allis-Chalmers Mfg. Co.* and the *In re Caremark International Inc. Derivative Litigation* in Section III.A.2, the Delaware Supreme Court in *Stone v Ritter* in 2006 clearly explained the elements constituting the board’s oversight liability. In concrete terms, they required the plaintiff to prove one of the two situations: First, board members do not establish any reporting, information and control system at all; or second, although the board establishes such a system, they intend not to maintain and monitor the system, so that they have no knowledge of risks or issues that they should have known.

Subsequent to the GFC, the Delaware Court of Chancery in *In re Citigroup Inc. S’holder Derivative Litigation*, in 2009, stated that even if the board made inaccurate predictions of business risks, they had not breached the duty to monitor, and that even if the board made a decision that was considered unwise *ex post*, the board would not be legally liable for the decision. The reason is that if the board’s duty to monitor would be expanded too far, that means that the court second-guesses the board’s business judgments, thus contradicting the business judgment rule.

Even though the above US court decisions did not completely agree on the scope of the duty to monitor (whether the board should monitor only legal compliance programmes and internal controls, or even ERM frameworks), one thing is for sure, that the board has the legal duty of oversight.

83 Ibid., p 28.
84 911 A.2d 362 (Del. 2006).
85 Ibid., p 370.
86 964 A.2d 106 (Del. Ch. 2009).
87 Miller (n 2 above), p 120.
89 For example, in *In re Caremark International Inc. Derivative Litigation*, the court held that only if there is a sustained and systematic failure of the board in performing its duty of oversight, then the board’s liability would result; for example, there is a complete failure in attempting to ensure the existence of a proper information and reporting system. Under the Caremark Duty, directors’ duty of oversight therefore embraced an aggressive duty to establish information.
From the Shining Building Business Company case (the *Shining* case), we can demonstrate the necessity of transplanting the board's duty of oversight as well as that of articulating this duty in more detail under Taiwan's Company Act. In this case, the plaintiff, who was a former general manager of the Shining Company (*Shining*), claimed that his former employer had not made two of his bonus payments before he left his job. The main issue in question was whether the plaintiff can be recognised as a manager in a legal sense. In fact, neither the appointment of the plaintiff nor the internal rule on bonus payments were approved by the board, but both should have been approved by the board in accordance with Art 29 of Taiwan's Company Act.90 The court of appeals, Taiwan High Court Taichung Branch Court, made two decisions respectively,91 but rendered two conflicting judgments which were based on the same facts.92 Nevertheless, Taiwan's Supreme Court made a final decision in 2013,93 in which the Supreme Court stated:

"When the company made its financial statements, although the board might not have been directly involved in the drafting, they had to review those financial statements with the due care of a good administrator. If the board had reviewed all reports, it would have needed to take the responsibility for the truthfulness of the statements".

The Supreme Court added that because the plaintiff’s name as a general manager and the relevant bonus payments were exhibited in the financial statements, it would be sufficient to prove that Shining and the plaintiff entered into a mutual agreement on the bonus payments. The Shining case not merely demonstrated that the credibility of Shining’s financial statements should be questioned but also implied that the board probably did not fulfil its duty to monitor, hence resulting in internal control failures, including the dubious reliability of their financial statements, the appointment of managers and related compensation arrangements.94

As shown in Figure 1 in Section II.C, according to the US and Taiwanese court decisions above, we may note how important the board’s systems with a view to overseeing business performance, even though the test for liability would be strict. The Caremark Duty would drive the board to set up internal control systems and increase expectations concerning directors’ role in monitoring corporate compliance with laws. See Fairfax (n 68 above), p 424.

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90 Gong Si Fa [Company Act] 2015, Art 29 (Taiwan).
92 Tsai (n 11 above), p 1851.
93 *Shining Building Business Company v Wei Jia Ming* (Supreme Ct. Judgment 102 Tai Shan Zi No. 360, 21 Mar 2013) (Taiwan).
94 Tsai (n 11 above), p 1858.
duty to monitor, including the duty to establish and maintain a company's internal self-regulating systems, would be. Nonetheless, as stated below, even though recent reforms were concentrated more on the cosmetic independence of the board in order for outsider directors to monitor managers, we should also realise that the sharing of sufficient internal information with corporate monitors would actually enhance their ability or means to exercise oversight in terms of corporate governance. Therefore, we need to fortify independent information channels.

2. Building independent information channels

After the Enron scandal, the New York Stock Exchange (NYSE) offered instruction on the corporate governance of listed companies. Art 303A of NYSE Listed Company Manual requires every listed company to establish corporate governance guidelines; the guidelines should contain access to the management and access to independent advisors when proper and necessary.95 In addition, a Taiwanese commentator indicated that if Taiwan's Company Act and Securities and Exchange Act require a listed company to have independent directors and audit committees consisting fully of independent directors, not merely should the position of supervisors be legally abolished but that the position of the board should also be viewed as a purely monitoring organ, instead of a management one.96 Accordingly, independent directors' liabilities would depend on whether the board has fulfilled its duty to found the company's sound corporate governance system, as well as whether the board has proactively and with good faith established and maintained an objective and well-functioning internal-control and legal-compliance mechanism.97 Therefore, in order for corporate monitors (including supervisors, independent directors and audit committees) to monitor effectively, the law should ensure that they have sufficient information. A supplementary legal toolkit may embrace: (1) authorising the above corporate monitors to directly control internal and external auditors; (2) strengthening the whistleblowing system; (3) providing the corporate monitors with access to internal information through assistance from external legal or other professional consultants.

The first legal tool is to authorise corporate monitors to directly control internal and external auditors. Most Taiwanese companies have adopted the traditional two-tier corporate governance structure where both the board of directors and supervisors coexist. However, top managers not

95 NYSE Listed Company Manual § 303A.
96 Huang Ming Jye, “Gong Si Zhi Li Yu Dong Jian Min Shi Ze Ren - Yi Du Li Dong Shi Zhi Shuang Zhong Ze Ren Wei Zhong Xin (Corporate Governance and the Civil Liabilities of Directors and Supervisors—the Dual Obligations of the Independent Director)” (2011) 303 Kui Ji Yan Jiu Yue Kan (Accounting Research Monthly) 74, 81–82.
97 Ibid., pp 82–85.
only in Japan but also in Taiwan would sometimes block information flow.\(^98\) Hence, supervisors should be furnished with transparent and formal communication channels\(^99\) to directly reach internal audit divisions and external accounting auditors.\(^100\) In order to make internal and external auditors of real help to supervisors, corporate law should allow supervisors to meet with internal auditors and external accountants alone, without participation by managers or inside directors, with an aim to prevent insiders from impeding the flow of internal information.\(^101\) In addition, the authority to appoint and dismiss internal and external auditors as well as the authority to assess their performance and related compensation should vest in supervisors in order to maintain these auditors’ independence from management.\(^102\)

Likewise, when it comes to companies with audit committees in a one-tier corporate governance structure, to preclude inside directors and managers from retarding information flow, corporate law can grant members of audit committees the power to directly communicate with internal auditors and external accountants.\(^103\) Meanwhile, compensation arrangements, assessment of job performance, appointment and dismissal of internal and external auditors should not be determined by inside directors and the CEO.\(^104\) Since the decisions of Taiwan’s audit committees in listed companies may be replaced by a super-majority vote of the board,\(^105\) there should be relevant law amendments to allow audit committees (albeit

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98 Aronson (n 18 above), pp 246–247.
99 Theoretically, supervisors have strong statutory power to investigate and request disclosure of information. Specifically, Arts 15 and 16(1) of Regulations Governing Establishment of Internal Control Systems by Public Companies (Internal Control Regulations) stipulate that internal audit divisions shall report to supervisors respectively in a regular and ad hoc manner. In addition, Arts 218, 218-1, 218-2, 219 and 228 of Taiwan’s Company Act provide that supervisors may hire external lawyers and accountants to assist its oversight, which seems to show that supervisors have independent information channels. However, those hired professionals are still outsiders and not as informed as internal auditors directly under the management and CEO; in practice supervisors are still lacking in independent channels to gather internal information. Certified public accountants should play the role as an independent gatekeeper in corporate governance, with the responsibility to examine whether corporate internal control systems properly function.

100 Chen Yin Chi, Ru He Qiang Hua Gong Si Jian Cha Ren Jian Du Zhi Ze Ji Qi Nei Bu Kong Zhi Zuo Ye Cheng Xu (How to Strengthen Supervisors’ Responsibility of Oversight and Corporate Internal Control Process) (Taipei: The Securities and Futures Institute, 2002) pp 69–70 (Taiwan).

101 Ibid., pp 52–53.


104 Zheng Quan Jiao Yi Fa (Securities and Exchange Act 2015) (n 78 above), Art 14-5(2).
structured under the board) to have a final say over the aforementioned evaluation items of internal and external auditors as a board usually does, and audit committees only need to notify the board after their decisions have been made. Consequently, audit committees would possess a more direct control over internal and external auditors, to prevent them from being controlled by corporate insiders, and independent channels of gathering reliable governance information would therefore be assured.

The second legal tool is to strengthen the whistleblowing system. Art 301 of SOX required a whistleblowing channel within companies to be set up by audit committees, and its function is to process inside secret reports on accounting, internal control and auditing; the goal of this institution is to protect employees that blow their whistles and to advance the independence of internal auditing jobs. Art 806 of SOX contains a whistleblower provision, explicitly protecting employees providing evidence of illegal inside corporate conducts from negative treatments by their corporations, such as lay-off, demotion, suspension, threat, attack or discrimination. The Dodd-Frank Act further strengthened related protections for whistleblowers. In addition to the US legislation, Japan passed a whistleblowing system for employees as well – the Whistleblower Protection Act of 2004, which came into force in 2006. In the Taiwanese legal system, the direction of law reform should pay equal attention to building whistleblowing channels, which would encourage employees to resist participation in illegal internal activities and expose illegalties earlier. To sum up, on condition that the substantive independence of Taiwan’s audit committees and supervisors can be better assured, these corporate monitors can serve as information reporting centres within companies, so that they can be guaranteed the ability to gather the necessary and reliable internal governance information in a more effective way.

107 18 USC § 1514A. See also (n 104 above), p 21.
108 15 USC § 78u-6.
109 See (n 104 above), pp 19, 21; Tsai Ying Hsin, “Lun Gong Si She Hui Ze Ren Zhi Gui Fan Mo Shi: Yi Ri Ben Fa Zhi Jing Yan Wei Li (The Regulation of Corporate Social Responsibility: The Experience of Japan)” (2008) 37 Tai Da Fa Xue Lun Cong (National Taiwan University Law Journal) 189, 199–200 (Taiwan).
111 (n 104 above), p 19. Over recent years, Taiwan’s legislature has been considering transplanting whistleblower protections in specific fields. See eg, “Chui Shao Zhe Bao Hu Tiao Kuan Ni Ding, Li Wei: Bao Zhang Shen Su Lao Gong Bu Yin Zi Xun Xie Lou Zhi Quan Li Shou Sun Hai (Legislators Consider Enacting Whistleblower Protection Law to Protect Reporting Employees)” LawBank (28 Jan 2013), available at http://www.lawbank.com.tw/news/NewsContent_print.aspx?NID=108363.00.
112 See (n 104 above), p 23; Chen, Ru He Qiang Hua Gong Si Jian Cha Ren Jian Du Zhi Zhi Ji Qi Nei Bu Kong Zhi Ziuo Ye Cheng Xu (n 101 above), p 68.
As for the third legal tool, from the perspective of comparative law, US laws grant authority to audit committees to gain access to internal information by means of assistance from external legal or other professional consultants; the expenses of the assistance would be covered by their companies.\textsuperscript{113} The right of access to information is an inevitable and essential prerequisite for the board to perform their fiduciary duties.\textsuperscript{114} The Company Act should thus be modified to provide the right of access to information to both independent and inside directors equally, with a suitable restriction on the range of information.\textsuperscript{115} As a reform direction, companies should provide directors with the necessary information and assistance in a reasonable time prior to board meetings; the board of directors should also be able to engage external professionals, such as lawyers, accountants and financial experts to process information. Traditional supervisors have already had a similar right of access to information based on Arts 218(2) and 219(2) of Taiwan’s Company Act. For audit committees, before relevant hard laws are amended, the authorities concerned should clarify this right through soft laws such as the Corporate Governance Best-Practice Principles for Taiwan Stock Exchange Corporation (TWSE)/GreTai Securities Market (GTSM) Listed Companies (Corporate Governance Principles), which is jointly written by two major stock exchanges in Taiwan: TWSE and GTSM. The above guidelines are nonetheless nonbinding, so that it may eventually be necessary for Taiwan’s Company Act to vest directors with the general right of access to information, together with punishments placed on corporate insiders that try to block information flow.\textsuperscript{116} Meanwhile, Art 14-4(4) of the Securities and Exchange Act should also be amended for the above penalty provisions to be applied \textit{mutatis mutandis} to companies with audit committees in lieu of supervisors.

3. External discipline imposed by the capital market
Besides the legal reforms discussed above, we can invoke market forces to supervise corporate governance as well.\textsuperscript{117} For example, if Taiwanese

\textsuperscript{114} Arts 8(1) and 23(1) of Taiwan’s Company Act impose fiduciary duties and liabilities on directors and other corporate responsible persons, while Arts 210 and 218 may be interpreted to be the legal basis of a right of access to information since sufficient information is the premise for directors to fulfil their fiduciary duties. See Wang Wenyu, “Dong Shi Zhi Zi Xun Qing Qiu Quan [Directors’ Right of Access to Information]” (2009) 86 Yue Dan Fa Xue Xiao Shi (Taiwan Jurist) 18, 18 (Taiwan).
\textsuperscript{115} \textit{Ibid.}, p 19.
\textsuperscript{116} The penalty provisions can be patterned after Art 218(3) of Taiwan’s Company Act.
\textsuperscript{117} Under the concept of regulatory humility, this author argues that we should count on not just mandatory legal rules but also capital market discipline to safeguard corporate internal governance. This concept should also remain as guidance for future amendments to Taiwan’s corporate law. Specifically, humble regulation embraces lessening unnecessary regulations,
LCD panel makers made a horizontal agreement to fix the price, and if any director of these companies opposed this agreement, dissenting directors might request the company appointing them to record their dissent on board meeting minutes.\textsuperscript{118} Whenever opposition was made by an independent director, the dissent is required to be made public and the disclosure would produce a signalling effect across the capital market.\textsuperscript{119} In addition, as discussed in Section II.B.2, closely prior to the outbreak of the Genome scandal, two independent directors of the parent company Genome resigned, followed by the resignation of a supervisor of the subsidiary company TPB in September 2013. The resignation of these independent directors and supervisor served as a public signal to the capital market, which not only alerted individual investors but also brought in capital market discipline.\textsuperscript{120}

Furthermore, market discipline underlying the “comply or explain” rule\textsuperscript{121} (including mandatory disclosure and professional evaluation of disclosure quality) can be utilised to drive corporate monitors (ie, supervisors and independent directors of audit committees) to exercise their oversight diligently. For example, Art 10 of the Regulations Governing Information to Be Published in Annual Reports of Public Companies requires public companies in Taiwan to disclose how they implement corporate governance, any departure of such implementation from the Corporate Governance Principles and the reason for any lowering transaction costs and shifting the regulatory focus from ex ante restrictions to ex post remedies. See Larry E Ribstein, “Sarbox: The Road to Nirvana” (2004) 2004 Mich. St. L. Rev. 279, 296–297; Tsai Chang-hsien, “Cong Fa Yu Jing Zheng Guan Dian Lun Zui Di Zi Ben Zhi Zhi Bian Qian; Jian Lun Wo Guo Mian E Zhi Zhi Ke Neng Gai Ge (A Jurisdictional Competition Perspective on Changes of Minimum Capital Requirements: With a Look at Taiwan’s Probable Reforms on Par Value Rules)” 42 (2013) Tai Da Fa Xue Lun Cong (National Taiwan University Law Journal) 553, 610.

\textsuperscript{118} Gong Si Fa [Company Act] 2015 (n 90 above), Art 193(2).

\textsuperscript{119} Lin (n 3 above), p 401 (“In practice, dissenting opinions from independent directors are rare. Nevertheless, once the companies make such opinions public, the market and government will watch carefully. Such opinions usually bear signaling effects.”).

\textsuperscript{120} Ibid., p 408. As to an economic analysis of the theory of signalling, see Eric A Posner, Law and Social Norms (Cambridge, MA: Harvard University Press, 2000) pp 19–27. Important events such as resignation of independent directors or supervisors in Taiwanese listed companies must be publicly announced; it is required in several provisions of listing rules, exemplified as in Art 2 of the GTSM Procedures for Verification and Disclosure of Material Information of Companies with GTSM Listed Securities.

\textsuperscript{121} The “comply or explain” technique originating in the United Kingdom spread not just to Taiwan but also to the Japanese system. Aronson (n 7 above), p 105. For instance, in its preliminary report issued in December 2011, the Corporate Law Subcommittee of the Legislative Council within the Ministry of Justice in Japan, whose task is to propose amending the Companies Act, used to adopt a “comply or explain” provision. This provision would require a reporting company that does not have any outside director to elaborate why it lacks outside directors.\textsuperscript{121} Ibid., p 119. As noted in footnote 15, a new “comply or explain” governance code came into effect in June 2015, meaning that Japanese listed companies have to appoint at least two outside/independent board directors or explain why they have not.
such departure. This author recommends that the TWSE and GTSM incorporate guidelines on best practice of corporate monitors into the Corporate Governance Principles, such as the minimum number of times for which each corporate monitor attends board meetings, that public companies should be required to disclose how corporate monitors interact with internal and external auditors, as well as the disclosure of whether public companies prepare written internal rules governing the exercise of powers by supervisors or audit committees. What follows is that a neutral third-party professional organisation or institutional investors should be encouraged to evaluate the state of each public company’s implementation of corporate governance, and then make the evaluation reports public. Then external market forces would be channelled to safeguard internal corporate governance in this respect.

IV. Implications and Conclusion

With Taiwanese high-tech firms prospering, their operations have expanded worldwide. Therefore, by exploring such a case as the LCD anti-trust law violation, it becomes obvious that foreign laws have already entered the scope of legal compliance from the perspective of Taiwanese law. What is more, based on the cases of Genome and TSLC, the importance of complying both with local and foreign laws is no longer ignorable. These scandals in Taiwan further remind us of the connection between internal control failure and internal self-regulating mechanisms, which include legal compliance programmes, internal control systems and ERM frameworks.

This kind of failure, however, cannot be fixed solely by enhancing the cosmetic independence of the monitors of management. As explicated in this article, a common issue among the cases is the lack of internal information flow. Specifically, corporate monitors cannot work without governance information. For instance, in the TSLC case, Fubon as a parent company obeyed all corporate governance standards required by law and even surpassed its peers in this regard, but a serious corporate scandal in its subsidiary company still broke out. It might be because necessary information did not flow to persons in charge of monitoring business performance. In short, as elaborated in Section III.A.1, whether a company adopted the one-tier or two-tier system in the Japanese and Taiwanese cases, the perceived problem of internal information flow

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122 Chen, Ru He Qiang Hua Gong Si Jian Cha Ren Jian Du Zhi Zhi Ze Ji Qi Net Bu Kong Zhi Zuo Ye Cheng Xu (n 101 above), pp 73–74.
caused by the domination of senior managers and controlling shareholders might lead to the corporate monitors’ failure in exercising their oversight, resulting in the failure of internal controls.

Moreover, Taiwan’s regulatory trend towards furthering the adoption of the US style of the one-tier system may be deemed as an example of the transplant effect: merely transplanting foreign “advanced” corporate law provisions into local regulatory infrastructure may not prove a success-guaranteed solution to existing corporate governance problems. Hence, when the FSC, the authority concerned with corporate governance of public companies in Taiwan, is eager to transplant independent directors and audit committees in a full-scale manner, one question should be asked first: Does Taiwan’s corporate law currently provide supplementary legal toolkits such as a well-interpreted duty to monitor, facilitating corporate monitors’ fulfilling their fiduciary duties? Only with sufficient preparations before legal transplantation and with a delicate adjustment during the transplant process, through which the local culture and course of regulation have been taken into account, can the new corporate governance rules function as well as desired.

Finally, according to the reflection on previous corporate governance failures in Taiwan, we need to ensure that corporate monitors can effectively exercise their oversight. In other words, it is necessary to make sure that monitors of management have the incentive and ability to monitor the effectiveness of the internal self-regulating mechanisms. This article offered a roadmap for conceptual solutions which are harmonic with each other as prerequisites to make corporate monitors have incentives and the means to exercise their oversight: not only should the duty to monitor and the accompanying liabilities be formally transplanted and articulated to produce oversight incentives for corporate monitors, but independent information channels should also be built up for internal governance information to flow to corporate monitors, thus vesting them with the ability or means to monitor. Together with the external discipline imposed by the capital market, failures in corporate governance in Taiwan might be alleviated.
