Code of Best Practice of Corporate Governance

IBGC
Instituto Brasileiro de
Governança Corporativa

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SUMMARY

Code of Best Pratice of Corporate Governance

INTRODUCTION 06

OBJECTIVES AND BASIC PRINCIPLES 09

Transparency 09
Fairness 10
Accountability 10
Corporate Responsibility 10

1 Ownership 11
1.1 Owners 11
1.2 The "One Share = One Vote" Concept 11
1.3 Owners' Agreements 12
1.4 Owners' Records 12
1.5 The General Assembly 12
1.5.1 Main Powers 12
1.5.2 Advance Notice 13
1.5.3 Venue, Date, and Time 13
1.5.4 Agenda and Documentation 13
1.5.5 Owner Proposals 14
1.5.6 Questions in Advance from the Owners 14
1.5.7 Voting Rules 14
1.5.8 Conflicts of Interest during General Meetings 14
1.6 Acquiring Control 14
1.7 Leaving the Company 15
1.8 The use of Insider Information 15
1.9 Arbitration 15

1.10 The Family Council 16
1.11 Free Float 16
2 The Board of Directors 17
2.1 The Board of Directors 17
2.2 The Advisory Board 17
2.3 The Mission of the Board Of Directors 17
2.4 Responsibilities 17
2.5 The Internal Regulations of the Board of Directors 18
2.6 The Chairperson 19
2.7 The Chairperson and the CEO 19
2.8 Committees 19
2.9 The Audit Committee 20
2.9.1 Composition of the Audit Committee 20
2.9.2 Qualifications and Commitment 20
2.9.3 Relations with the Board of Directors, CEO, and Officers 21
2.9.4 Relations with Independent Auditors, Attorneys, Assessors, Actuaries, and Other Professionals 21
2.9.5 Relations with Subsidiaries, Associated Companies and Third Parties 22
2.10 Number of Members 22
2.11 Independent, External and Internal Directors 22
2.12 Independent Directors 22
2.13 Executive Session 24
2.14 Non-members Invited to the Board Meetings 24
2.15 Board and Director Evaluation 24
2.16 Director Qualifications 24
2.17 Composition of the Board 25
2.18 Term of Office 25
2.19 Age 25
2.20 Change of Main Occupation of Directors 26
2.21 Compensation 26
2.22 The Budget of the Board and the use of External Advice 26
2.23 Independent Board Leadership (Lead Director) 27
2.24 The Corporate Spokesperson 27
2.25 Relationship with the CEO and Officers 27
2.26 Evaluation of Officers 27
2.27 Succession Planning 27
2.28 Introducing New Directors 27
2.29 The Secretary to the Board of Directors 28
2.30 Meeting Dates and Agendas 28
2.31 Meeting Documentation and Preparation 28
2.32 Minutes of the Meetings 29
2.33 Relationship with Independent Auditors 29
2.34 Internal Audit 29
2.35 Relationship with the Fiscal Council 29

2.36 Deputy Directors 30
2.37 Continuing Education for Directors 30
2.38 Risk Management 30
2.39 Confidentiality 30
2.40 Disclosure of Corporate Responsibility 30
3 **Management** 31
3.1 Responsibilities - The Chief Executive Officer (CEO) 31
3.2 Officer Nominations 31
3.3 Stakeholder Relations 31
3.4 Disclosure 31
3.5 The Annual Report 32
3.5.1 Corporate Governance Practices 32
3.5.2 Shareholdings and Compensation of Directors and Officers 32
3.5.3 International Accounting Standards 32
3.6 Internal Controls 33
3.7 Code of Conduct 33
3.8 Evaluation of the CEO and Officers 33
3.9 Compensation 33
3.10 Access to Facilities, Information, and Files 34
4 **Independent Auditing** 35
4.1 Independent Auditing 35
4.2 The Opinion of the Independent Auditors 35
4.3 Selection, Fees, Maintenance, and Replacement of Independent Auditors 35
4.4 Observations and Recommendations from the Independent Auditors 35
4.5 Length of Mandate and Independence 35
4.6 Non-Audit Services 36
4.7 Professional Standards of Independence 36
5 **The Fiscal Council** 37
5.1 The Fiscal Council 37
5.2 Composition 37
5.3 Work Agenda 38
5.4 Relationship with the Owners 38
5.5 Relationship with the Audit Committee 38
5.6 Relationship with the Independent Auditors 38
5.7 Relationship with the Internal Auditors 39
5.8 Fiscal Council Compensation 39
5.9 Fiscal Council Opinions 39
6 **Conduct and Conflicts of Interest** 40
6.1 Code of Conduct 40
6.1.1 Scope 40
6.2 Conflicts of Interest 41
6.2.1 Related Party Transaction 41
6.2.2 Absence from Discussions and Decisions 41
ANALYTICAL INDEX 42

INTRODUCTION*

Corporate Governance is a corporate managing and monitoring system, involving relations with the Owners[1], Board of Directors, Officers, Independent Auditors, and Fiscal Council. Good corporate governance practices are geared to add value to a company, facilitate its access to capital and contribute to its perpetuation.

This is the third revised and enlarged edition of the Code of Best Practice of Corporate Governance issued by the Brazilian Institute of Corporate Governance (IBGC). Revising and making recommendations on corporate governance practices are tasks that require constant care and attention. This new edition of the Code of Best Practice of Corporate Governance tries to capture the business, legal, and regulatory changes that occurred and affect the corporate environment, in order to present a code that is both up-to-date and up to the challenges of our time.

The Code, now in greater detail, is designed to play an important educational role and lay the foundations of an effective application of good corporate governance practices in Brazil.

Since the Code's release in May 1999 – when even the expression corporate governance was virtually unknown in Brazil – the most important corporate governance models and practices have undergone exhaustive questioning. Our country has also seen a significant progress in its institutional and corporate environment. The first revision took place in April 2001, already under the auspices of legal and regulatory advancements, which bore witness to the importance of corporate governance. This is now the second revision, which thoroughly seeks to capture the main elements of such changes, and adapt them to the Brazilian context, suggesting courses of action which might help our companies become more competitive in their search for capital.

** T.N.: Although there are many references to Brazil, this code is applicable not only in most Latin American countries but also to large extend in developed countries.*

1. All references to "owners" made herein also extend to shareholders, quota holders, partners, members of associations, etc.

In June 2003 an ad-hoc committee was set up to revise the Code. This committee was headed by Eliane Lustosa and its members were Adhemar Magon, Aline de Menezes Santos, Bengt Hallqvist (also responsible for revising the English version), Celso Giacometti, Fernando Alves, Heloisa Belotti Bedicks, José Guimarães Monforte, Lélio Lauretti (also responsible for revising the Portuguese version), Leonardo Viegas, Maria Helena Santana, Mauro Rodrigues da Cunha, Nadine Baleeiro Teixeira and Paulo Villares. The Code was discussed and approved by the IBGC Board of Directors. All the work done by the Committee was *pro bono*. In addition to the regular revision meetings, the first draft of this edition's full text was ready in October 2003, after a weekend of total immersion and heated debates in the city of Campos do Jordão.

For two months the Code went through a lot of discussion and a public hearing, which yielded numerous suggestions from market entities, unions, professional associations, and knowledgeable specialists in the subject. The wealth of input received is no doubt one of the hallmarks of this new edition, and the Institute wishes to thank all for their support and contributions toward the improvement of our work. We especially wish to thank APIMEC/SP's (Analysts and Investment Profissionals Association) Corporate Governance Commission for its valuable contribution.

And, last but not least, no compilation and revision effort can be complete without undergoing the litmus test of practical application. We hope that the Code becomes a tool to support and encourage the constant improvement of corporate governance practices in our country. We also dedicate this Code to everyone who believes – as we do – in the importance of corporate governance practices.

THE IBGC

IBGC is an organization entirely committed to promoting corporate governance in Brazil and is the main advocate of its practices and debates, having conquered national and international recognition.

Founded on November 27, 1995, IBGC – a Brazilian nonprofit corporation – is aimed "to be the most important national corporate governance reference, by developing and promoting the best concepts and practices in Brazil, and contributing to improve corporate performance, leading to more equitable, responsible, and transparent businesses".

Composition of the IBGC Board of Directors

Chairman | Paulo Villares

Vice-Chairmen | José Guimarães Monforte
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Secretary General | Heloisa Bedicks

For further information on the Brazilian Institute of Corporate Governance, please visit our website www.ibgc.org.br. To join IBGC please call (5511) 3043-7008.

OBJECTIVES AND BASIC PRINCIPLES

The main object of this Code is to provide guidelines to all kinds of companies - publicly - or privately-held corporations, limited liability companies, service providers and non-governmental organizations – with the purpose of:

- Increasing company value
- Improving corporate performance
- Facilitating access to capital at lower costs[2]
- Contributing to the long term survival of the company

The Code is divided into 6 sections:

- Ownership
- Board of Directors
- Management
- Independent Auditing
- The Fiscal Council
- Conduct and Conflicts of Interest

The basic principles of the Code are:

- Transparency
- Fairness
- Accountability
- Corporate Responsibility

TRANSPARENCY

More than the duty to inform, Management should cultivate the desire to inform, knowing that good internal and external communications, particularly when spontaneous, straightforward and fast, lead to an atmosphere of trust, both internally and externally. Communications should not be confined to the economic and financial performance, but also contemplate other aspects – including intangible values – which drive managerial actions, such as the market, strategies, and activities leading to the creation of value.

2. "Access to capital" should be understood as the public or private offering of shares, long-term loans, and even reinvestment of cash flow funds.

FAIRNESS

Fairness typically conveys fair and equal treatment of all minority groups, whether of owners or other stakeholders, such as associates, customers, suppliers, or creditors. Discriminatory attitudes or policies, under any pretext, are entirely unacceptable.

ACCOUNTABILITY

Corporate governance agents should account for their actions to those who have elected them, and fully answer for all their acts throughout their terms of office.

CORPORATE RESPONSIBILITY

Directors and Officers must gear their efforts to the life-long existence of their organizations (long-term vision, sustainability) and should therefore include social and environmental concerns in defining businesses and operations of their company. Corporate responsibility is a broader view of corporate strategy, contemplating all kinds of relations with the community where the company operates. The "social role" of the company should include the creation of wealth and job opportunities, work force skills and diversity, promotion of scientific advancements through technology, and improved standards of living through educational, cultural, social, and environmental initiatives. This principle should include preferred treatment of local people and resources.

1 OWNERSHIP

1.1 Owners

Every shareholder is a company owner, commensurate with his/her respective share in the company's capital. This principle should be extended to all kinds of companies and organizations, as applicable.

1.2 The "One Share = One Vote" Concept

Voting rights should be extended to all owners in proportion to the number of shares they may hold and regardless of class of shares. This principle should prevail in all types of companies and organizations, to the extent applicable.

The proportionate voting rights of individual holdings are essential to align the interests of all the owners. As a matter of fact, voting is the best and most efficient oversight instrument.

Companies planning to go public should contemplate common shares[3] only. Companies that have both common and preferred shares should evolve to the *one share = one vote* concept. In case this is not possible, we suggest extending voting rights to preferred[4] shares under certain circumstances, which should be entered in the bylaw of the company. These may include:

- Transformation, split-up, incorporation, merger, and sale of relevant assets, with the concept of relevance clearly defined in the bylaw of the company;
- Approval of relevant contracts between companies in the same group and approval of subjects relating to a compensation plan based on stocks and stock options;
- Conflict of interest situation, which should be set forth in the bylaw of the company, or existing code of ethics;

3. Common shares: Class of shares entitling their holders to vote at General Meetings, in addition to holding interest in the company's revenues. Each common share corresponds to a vote at General Meeting decisions.
4. Preferred shares: Class of shares entitling their holders to certain benefits of a financial or political nature in exchange for partial or total restrictions to their voting rights. Benefits may include priorities in dividend payouts and/or capital refunds, tag along, dividends 10% higher than those paid out to common shareholders, and even voting rights, when established in the bylaw of the company.

- Approval of appraisal report on assets, which shall be added to the capital stock, change of corporate object and reduction of mandatory dividends.

1.3 **Owners' Agreements**

Owners agreements on sales or purchases of their shares or units, share acquisition preference, and the exercise of voting rights or controlling power should be available to all other owners and filed at the headquarters of the company, as well as their amendments and termination.

Owners agreements should not in any way bind or restrict any voting rights of the Director, as they all should loyally and diligently perform their duties to the company, above the personal interests of those who elected them.

There should be no Officer nominations in owners agreements.

1.4 **Owners' Records**

The company should make available to any of its owners all owners records, with their respective holdings in the company and class of shares or units and any other securities issued by the company.

1.5 **The General Assembly**

The top governing body of a company is its General Assembly (of Owners). All references to "General Assembly" made herein also extend to the general meetings of the owners.

1.5.1 **Main Powers**

The following powers are exclusive to the General Assembly:

- increasing or decreasing capital stock and other amendments to the bylaw/articles of association;
- electing or removing Directors or members of the Fiscal Council at any time;
- examining Management accounts on an annual basis and making decisions about the financial statements; and

- making decisions on company transformation, consolidation, merger, incorporation, split-up, termination or liquidation.

1.5.2 **Advance Notice**

A minimum 30 days' notice of the Annual General Meeting should be given to all owners.

It is desirable that information of the date of the Annual Meeting be available to all owners by the end of the fiscal year.

Any owner is free to request the governing body of the company to stop counting notice time prior to a General Meeting expected to address more complex issues, such request should be duly justified.

1.5.3 **Venue, Date, and Time**

The venue, date, and time of the General Meetings must be selected so as to allow most owners to be present.

1.5.4 **Agenda and Documentation**

The agenda of the General Meeting, as well as its respective documentation – which should be as detailed as possible – should be made available to all owners on the date of its first notice, so that all owners can take a stand as to the matters to be voted on. The agenda should not include "other subjects", to make sure important matters are mentioned with enough notice.

Any dissenting votes on the approved decision should be minuted, if so required. Listed companies should forward all their minutes in full to CVM (Brazilian Securities and Exchange Comission) and/or to the Stock Exchange where they are listed, even if they have published just a summary of the minutes.

The bylaws should establish that any subjects not expressly included in the agenda may only be voted on upon full owner attendance and unanimous agreement, including preferred shareholders with voting rights on the issue.

1.5.5 Owner Proposals

Mechanisms should be encouraged for the timely receipt of proposals from owners wishing to include them in the agenda of the upcoming General Meeting.

1.5.6 Questions in Advance from the Owners

The owners should always have a chance to request and receive information from company management in a timely fashion. Questions should be asked in writing and addressed to the company's Chief Executive Officer or the Investors' Relations Officer.

1.5.7 Voting Rules

Voting rules should be well-established and available to all owners as of the publication of the first notice of the General Meeting. These rules should be made to facilitate voting, including proxy voting, or other voting methods. Votes by proxy should be given according to the specific instructions of the owners. The proxies should be analyzed in good faith, reducing red-tape requirements to a minimum.

1.5.8 Conflicts of Interest during General Meetings

Should an owner for any reason have a personal or conflicting interest with that of the company during the debate of a particular issue at the General Meeting, he/she should abstain from taking part in the discussion and voting, both in his/her own name or on behalf of a third party.

The bylaws should contain rules for deciding cases of conflicts of interest (see Section 6.2).

1.6 Acquiring Control

The offer to buy shares resulting in the transfer of controlling ownership should be offered to all owners, not just those who are part of the controlling group of the company. All owners should have the option of selling their shares under the same conditions. If the purchaser pays a control premium, this should be shared among all owners. If the buyer has no intention of buying all the shares, the bid should equally be shared among all owners. The price for which

control is being sold should be transparent. If the entire controlling block of shares is sold, the buyer should make a public bid to all owners under the same conditions enjoyed by the previous controller (tag along).

1.7 **Leaving the Company**

The bylaw or article of association of the company should clearly set forth the rights of an owner to leave the company and the corresponding conditions that should be based on economic value. All company transformation (including incorporation, split-up, merger, or going private) should meet the interests of the organizations involved.

The conditions for owners to leave, or for the company to go private should be clearly stated and detailed in the bylaws/articles of association, and should never be below the economic value.

1.8 **The use of Insider Information**

The use of insider information, not yet disclosed to the market and protected by secrecy, should be prohibited to any of the persons mentioned in the following paragraph, as it could bring unfair advantage to the insider or to third parties while trading shares in the insider's own name or on behalf of a third party.

The company should have a relevant information disclosure policy in place, in addition to rules establishing times when share trades by insiders with access to privileged information are expressly forbidden. The adherence to this policy of information disclosure and the prohibited use of insider information shall be mandatory to all owners, Directors, Officers, Fiscal Council members, members of technical or advisory units, as well as persons who, on account of their positions, are deemed insiders with access to confidential information.

The company should adopt controlling mechanisms to enforce these rules.

1.9 **Arbitration**

Conflicts between owners, or between owners and the company, should preferably be settled by arbitration. This should be included in the bylaws and, if possible, individually signed and executed on a separate document.

1.10 The Family Council

Family companies should consider setting up a Family Council. A Family Council is a small group set up to discuss family matters and organize expectations regarding the company. The main responsibilities of the Family Council include:

- drawing the line between family interests and company interests;
- preserving family values (history, culture, shared vision);
- establishing and agreeing on policies to protect company property, growth, diversification, and securities and real property management;
- succession, property transfer and inheritance planning;
- viewing the company as a factor of aggregation and family continuity;
- tutoring family members regarding succession within the company, vocational aspects, professional future, and continuing education; and
- establishing criteria to appoint members to make up the Board of Directors.

Family Council objectives should not get mixed up or confused with those of the Board of Directors, which are company-oriented.

1.11 Free float[5]

Publicly-held companies should make an effort to keep in circulation as many shares as possible, and support their free float, to enhance their liquidity when trading.

5. Free float (shares in circulation): Number of shares available for trading on a capital market, i.e., all the shares issued by a company, except: (i) those held by the Controlling Shareholder, his/her spouse, companion, and dependents included as deductions in his/her annual income tax return; (ii) treasury shares; (iii) held by company-related parties, as well as other companies in the same group; (iv) held by the parties related to the controlling shareholder, as well as companies in the same group; and (v) special preferred shares granting their holders specific political rights exclusive to the privatization authority.

2 THE BOARD OF DIRECTORS

2.1 The Board of Directors

Every organization, whether publicly- or privately-owned, regardless of its type, should have a Board of Directors, elected by its owners. It should take into account other stakeholders, its corporate objectives and the company sustainability.

The Directors should always decide in the best interest of the organization, regardless of the parties who elected them.

2.2 The Advisory Board

It is good practice for a company to have an Advisory Board, particularly private companies in development, family companies, and third-sector organizations. It lets independent board members contribute to the organization, and the organization can gear its efforts toward gradually improving its corporate governance.

In these cases the roles, responsibilities and competences of the members of the Advisory Board should be well established. It is advisable that the Advisory Board have a temporary character in privately-held companies planning to go public.

2.3 The Mission of the Board Of Directors

The mission of the Board of Directors is to protect and add value to the company and maximize the return on the investment.

The Board of Directors should be fully aware of company values, objectives, and owner beliefs and seek their enhancement. It should additionally prevent conflict of interest situations and administer dissenting opinions, making sure that the company's interests always prevail.

2.4 Responsibilities

The main responsibilities of a Board of Directors include the determination of strategies, election and removal of the CEO, approval of the selection or removal of Officers proposed by

the CEO, oversight of management, monitor company risks, and appointment and replacement of Independent Auditors.

It is also duty of the Board to oversee relations between the CEO and other stakeholders.

The Board is also in charge of approving the company's Code of Conduct and its own Internal Regulations[6].

The Officers should implement the strategies and the general business direction approved by the Board. The Board of Directors should not interfere with operating matters, but be free to request all the necessary information for the performance of its functions from whoever can best provide it, including external specialists, if necessary.

2.5 The Internal Regulations of the Board of Directors

The activities of the Board of Directors should be laid down in its own Internal Regulations, so as to clarify its responsibilities and functions and prevent conflict of interest situations with the Officers, particularly the CEO. The rules and regulations might include the following items:

- Scope of activities and objectives
- Work rules
- Rules for managing conflicts of interest
- Composition
- Terms of office
- Appointment of the Chairperson (and, if applicable, the Vice Chairperson) if not elected by the owners
- Voting system including the role of the Chairperson
- The Secretary to the Board
- Meetings, notices, agendas, minutes, and documentation

6. The Internal Regulations of the Board: A set of standards and rules defining Board of Directors or Fiscal Council responsibilities, attributions, and work routines, preventing conflict situations with the Executive Management, especially with the CEO.

- Committees
- Interaction with Fiscal Council
- Board Budget (see item 2.22)

2.6 The Chairperson

It is the basic responsibility of the Chairperson to ensure the efficiency and good performance of the Board and each of its Members.

The Chairperson should lay down objectives and programs, so that the Board may fulfill its purpose of representing all the owners, and overseeing and assessing Management actions.

It is also the duty of the Chairperson to preside over meetings, harmonizing Board activities with the interests of the company and its owners, organize and coordinate the agenda, coordinate and supervise the activities of the other Directors, assign responsibilities and deadlines, monitor the assessment process of the Board and lead it in accordance with good corporate governance principles. The Chairperson should also make sure Directors get full and timely information on the topics to be discussed at meetings.

2.7 The Chairperson and the CEO

The responsibilities of the Chairperson are quite different from the CEO's. In order to avoid concentration of power and to enable an adequate supervision of management, the two positions should be filled by different people.

The CEO may be a Director, provided the Board also holds regular executive sessions[7].

2.8 Committees

Several activities of the Board of Directors need more thorough analysis that may exceed the meeting time available and might be better handled by special Board Committees. Different committees, each made up of a few Directors may be set up. For example: the Audit

7. Executive Session: The part of the Board meeting attended neither by the CEO nor the Officers.

Committee, the Compensation Committee, the Finance Committee, the Governance Committee, etc. (see specific comment on the Audit Committee under item 2.9).

The committees examine the specific issues of their area and prepare the proposals to be submitted to the Board. The material necessary for Board examination should be made available along with its voting recommendation. Directors may request additional information, if needed. Only the Board can make decisions.

The Internal Regulations of the Board should guide the formation and the composition of the committees and their coordination by independent Directors.

The information requested by a Director and/or committee member should be made available to all the other members of the Board and/or committee.

2.9 The Audit Committee

Every company Board of Directors should encourage the implementation of an Audit Committee to analyze the financial statements in detail, support financial supervision and accountability, making sure that Management adequately develops and adheres to sound internal controls, that the Internal Audit Department satisfactorily fulfills its role and that the Independent Auditors assess and review Management and Internal Audit Department practices. The Audit Committee should additionally see that the organization's Code of Conduct is enforced.

2.9.1 Composition of the Audit Committee

The Audit Committee should preferably be made up of independent members of the Board of Directors. Directors also serving as Officers should not take part in the Audit Committee.

2.9.2 Qualifications and Commitment

The Board of Directors should provide a formal description of the qualifications, efforts, and time commitment expected from the Audit Committee. The Committee should set up its own Internal Regulation and consist of at least three members, all of

whom familiar with basic financial and accounting matters. At least one member should be more experienced in accounting issues, audits, and financial management.

The term of office of the Audit Committee can be limited through an automatic rotation system and/or by restricting the number of committees in which a member can serve in other companies.

Independent auditors' recommendations and assessments on the control and risk environment should be permanently monitored by the Board of Directors and/or Audit Committee, which should enforce the accountability of the Officers for recommendations made by the auditors.

2.9.3 Relations with the Board of Directors, CEO, and Officers

The Audit Committee should regularly meet with the Board of Directors, the Fiscal Council, the CEO, and the other Officers. Management should supply the Audit Committee with (i) timely and periodical reviews of the financial statements and related documents prior to their disclosure; (ii) presentations concerning changes in accounting principles and criteria; the accounting treatment adopted for the main operations; and any significant variations between budgeted values and actual values under a certain account; (iii) information relating to any "second opinions" obtained by Management from an independent auditor regarding the accounting treatment given to a certain event or operation; and (iv) any exchange of correspondence with the Internal Audit Department or the Independent Auditors.

2.9.4 Relations with Independent Auditors, Attorneys, Assessors, Actuaries, and Other Professionals

The Audit Committee should discuss with the Independent Auditors: (i) changes in or maintenance of accounting principles and criteria; (ii) the use of reserves and provisions; (iii) relevant estimates and conclusions in preparing the financial statements; (iv) risk assessment methods and findings; (v) changes in auditing scope; (vi) high risk areas; (vii) relevant deficiencies and significant flaws in the internal controls; (viii) awareness of illegal activity; and (ix) external factor impacts (economic, regulatory, and industry) on

the financial statements and auditing process. The discussion should include issues such as clarity with regard to financial disclosures and level of aggressiveness or conventionalism of the accounting principles and underlying estimates.

The Audit Committee should also assess on a regular basis other relevant aspects of its relations with third parties, such as their professional competence and independence, and, whenever necessary, get second opinions on any work done by these parties.

2.9.5 Relations with Subsidiaries, Associated Companies and Third Parties

The Audit Committee should ensure quality information from subsidiaries, associated companies and third parties (such as experts), in view of the impact of such information on the consolidated financial statements.

2.10 Number of Members

The number of members that make up the Board of Directors should be between 5 and 9, depending on the profile of the company.

2.11 Independent, External and Internal Directors

There are three types of Directors:

- Independent (see item 2.12).
- External: Directors without any current ties to the organization, but not independent. For example: former Officers and former employees, attorneys that provide services to the company, controlling owners or employees of the controlling group, close relatives of Officers, etc.
- Internal: Directors that are also Officers or company employees.

2.12 Independent Directors

The Board of the company should consist mostly of independent members, hired through a formal process, with well-defined scope of activity and qualifications. An independent board member:

- has no ties with the organization, with the possible exception of some shares of its capital;
- is not a controlling owner, nor a member of the controlling group, spouse, or relation up to the second degree of kinship or affinity to any party in the aforementioned group, or having any ties with organizations related to the controlling owner;
- is not a former employee or Officer of the organization or any of its subsidiaries;
- is not directly or indirectly providing or buying company services and/or products;
- is not an employee or Officer of any company supplying service and/or product;
- is not a spouse or relative up to the second degree of kinship or affinity to any company Officer or manager; and
- receives no payment from the company other than his/her Directors fees (dividends from any interest in the share capital of the company are not hereby restricted).

Directors should seek the maximum independence possible with regard to the owner, equity group or stakeholder that may have nominated them to their positions, and be aware that once elected, their responsibility is to all the owners of the company.

Depending on the situation, it might be necessary to make a distinction between a listed company and a privately-owned family company. Listed companies are advised to appoint only – or mostly – independent Directors. However, it is natural for private companies under family control to have a few non-independent members on their Boards.

Should a Director identify pressures or constraints from the controlling owner affecting the performance of his/her duties, he/she should have an independent attitude when voting, or tender his/her resignation, as the circumstances may warrant.

The independent board member who has served at the same company board for several years should judge whether his/her independence remains intact.

2.13 Executive Session

In order for the Board to appraise Management performance without constraints, it is important for External and Independent Directors to be able to meet regularly, without any Officers and/or Internal Directors being present.

2.14 Non-members Invited to the Board Meetings

Key company personnel, technical assistants or advisors may occasionally be invited to meetings of the Board of Directors in order to provide information, explain their activities, or give their opinion on subjects of their area of specialty.

2.15 Board and Director Evaluation

Every year a formal performance evaluation of the Board and each Director should be conducted. The evaluation system should be adapted to each organization's individual situation. It should, however, be supported by formal processes with a well-defined scope of action and qualifications.

The Chairperson is responsible for assessing this process.

The individual assessment of the Directors – particularly with regard to attendance and active participation in meetings – is key to his/her nomination for reelection.

2.16 Director Qualifications

Directors should:

- Be able to read and understand management and financial reports;
- Have no conflicts of interest;
- Align their values with those of the organization;
- Be familiar with the Best Practice of Corporate Governance;
- Have personal integrity;
- Have enough time available;
- Be motivated;

- Be capable of working on a team; and
- Have a strategic vision.

A Director must have a constant focus on the organization and understand that his/her duties and responsibilities are comprehensive, and not merely limited to Board meetings.

2.17 Composition of the Board

The composition of the Board should seek diversified board member experience, background and profiles, so that it includes:

- Experience serving on other Boards of Directors;
- CEO experience;
- Experience in managing crises;
- Experience in identifying and controlling risks;
- Financial knowledge;
- Accounting knowledge;
- Knowledge of the businesses of the organization;
- Knowledge of national and international markets; and
- Connections of interest to the organization.

2.18 Term of Office

Directors should preferably have one-year terms of office. Reelection is desirable to build a seasoned, productive Board, but should never be automatic. It should only be possible after a formal performance evaluation. All Directors should be elected at the same General Meeting.

2.19 Age

Once a Director meets the requirements under items 2.16 and 2.17 to serve on the Board, the only concern about his/her performance is his/her effective contribution to the Board, organization, and owners — age is not so relevant.

To prevent a Director from becoming permanent in his/her position, a maximum number of years of continuous service should be established in the bylaws of the Board.

2.20 **Change of Main Occupation of Directors**

The main occupation of the Directors is an important factor in choosing him/her for Board service. Whenever a significant change occurs, the Director should let the Chairperson know. It is up to the Board of Directors to determine whether or not it is convenient for the Director to continue serving, or if he/she should leave.

2.21 **Compensation**

Directors should be paid for their work and this compensation should be established by the owners.

Director compensation should (i) adequately reflect time, effort and experience dedicated to their functions; (ii) provide an adequate incentive to align the interests of the Directors to those of the owners; and (iii) not compromise the ability of the Director to use his/her own judgment in serving the best interests of the organization and its owners.

A recommendation is to establish the fees of the Director on the same hourly basis used for the CEO, including bonuses and benefits commensurate with the time effectively dedicated to his/her function.

All kinds of compensation, including stock options and Board of Directors, Management, or Fiscal Council benefits should be disclosed by group, if not individually.

2.22 **The Budget of the Board and the use of External Advice**

The Board of Directors should have its own annual budget, approved by the owners.

Directors should be entitled to consult with outside professionals (lawyers, auditors, and tax and human resource specialists, among others), paid by the company, in order to get specific advice on relevant matters.

The necessary expenses incurred by Directors in attending meetings should be covered by the company.

2.23 **Independent Board Leadership (Lead Director)**

If the Chairperson and the CEO positions cannot be separated and are held by the same person, it is recommended that the Board count on another key leader, respected by his/her colleagues and the business community in general, who can counterweigh the power of the person serving in both capacities.

2.24 **The Corporate Spokesperson**

The Board of Directors should appoint just one person in charge of speaking on behalf of the corporation, to avoid any risk of contradictions between the Chairperson and the CEO. The Investor Relations Officer has powers delegated by the corporate spokesperson.

2.25 **Relationship with the CEO and Officers**

One of the main responsibilities of the Board is to select and/or replace the CEO and define his/her compensation and benefits.

It is the responsibility of the CEO to name the Officers and their respective compensation for submittal to the Board.

2.26 **Evaluation of Officers**

The Board of Directors should make, on an annual basis, an official evaluation of the CEO. The CEO will be in charge of submitting the evaluation of his/her team to the Board, suggesting specific actions for improvement, making notes of positive aspects of the performance of the members and opining on their reelection.

2.27 **Succession Planning**

The Board of Directors should always have an updated succession plan in place for the CEO and all other key persons in the organization.

2.28 **Introducing New Directors**

A new Director should be given an introduction program, which should include a folder provided by the Board of Directors with the description of duties and activities of a Director, the latest

annual reports, minutes of regular and special General Meetings, minutes of Board meetings, strategic planning, risk management and control system, and other relevant company information. The new Director should be introduced to his/her team mates, to the Officers and key persons in the organization. He/she should also visit the main places where the company operates.

There should be no difference in treatment between Directors elected by different classes of owners, as provided by Brazilian legislation.

2.29 **The Secretary to the Board of Directors**

On an annual basis, the Board should appoint a secretary, who will assist the Chairperson in formal aspects, such as documenting the distribution of reading materials and preparing the minutes. The Secretary should also be in charge of all bureaucratic Board tasks and procedures.

It is preferable that this position is not filled by a Director, to avoid a dispersion of his/her attention and efforts.

2.30 **Meeting Dates and Agendas**

The Chairperson shall be in charge of proposing an annual calendar of regular meetings and convening special meetings whenever necessary.

Board meeting frequency should be determined by each company's needs. They should be held often enough to ensure the effectiveness of Board work, but not exceed one per month, to avoid undue interference in the operation of Management.

Board meeting agendas should be prepared by the Chairperson, discussed with the other Directors and, if necessary, with the CEO and Officers.

2.31 **Meeting Documentation and Preparation**

The effectiveness of Board meetings depends, to a great extent, on the quality of the documentation distributed in advance (minimum of 7 days) to Directors. Proposals should be adequately supported. Directors must have read the entire documentation and be well-prepared for the meeting.

The agenda of a meeting should include a description of the items in progress showing when decisions were made, and containing a progress report, expected dates of completion, and other relevant aspects.

2.32 **Minutes of the Meetings**

The minutes should be clearly worded and all the decisions made should be recorded, as well as voting abstention due to conflicts of interest, responsibilities and deadlines, and be signed by all present. The minutes should be formally approved.

Dissenting votes and relevant discussions should be minuted upon request.

2.33 **Relationship with Independent Auditors**

The relationship with Independent Auditors is a Board duty that cannot be delegated to other parties. It is the Board that selects Independent Auditors, approves their respective fees and work plans, and assesses their performance. If there is an Audit Committee, it should take care of these matters and submit them to the Board for final approval.

2.34 **Internal Audit**

The Internal Audit should report to the Audit Committee, or, in its absence, to the Board of Directors. Its job is to monitor internal controls, and check whether regulations, instructions, and policies are being complied with.

The Board should also approve the annual plan, analyze results, and monitor the implementation of Internal Audit recommendations. If this activity is outsourced, internal audits should not be conducted by the Independent Auditors. It is recommended that the Audit Committee and the Board of Directors effectively take part in planning Internal Audit work.

2.35 **Relationship with the Fiscal Council**

The Fiscal Council is elected by the owners. Directors cannot serve on the Fiscal Council.

It is good practice for the Board of Directors (or indicated appointees) to meet with the Fiscal Council from time to time to address matters of mutual interest. By law, the Fiscal Council has

the right, as well as the duty, to take part in Board of Directors meetings whenever it has to opine on any items being discussed.

The Fiscal Council is discussed in more detail in Section 5 of this Code.

The Board of Directors should provide to all Fiscal Council members a full copy of the minutes of all its meetings.

2.36 Alternate Directors

It is not a good practice to elect Alternate Directors, except in cases when a Director needs to leave on a permanent basis. Alternate Directors sitting in for members temporarily absent cannot be adequately prepared or familiar with the challenges facing the organization.

2.37 Continuing Education for Directors

Consistent with the need for Directors to improve their performance and focus on the long run, it is essential that they attend continuing training and refresher courses in order to update their knowledge.

2.38 Risk Management

The Board of Directors should ensure that Management identify well in advance – through an adequate information system — and list the main risks to which the company is exposed, the odds of their actually occurring, as well as the measures and plans adopted to prevent or minimize them.

2.39 Confidentiality

The decisions of the Board of Directors should be strictly confidential. There should be no privileged information for any owner.

2.40 Disclosure of Corporate Responsibility

At least once a year and with prior approval from the Board, every organization should disclose its policies and social, environmental, occupational and health safety practices.

3 MANAGEMENT

3.1 Responsibilities – The Chief Executive Officer (CEO)

The Chief Executive Officer is accountable to the Board of Directors and is in charge of implementing its directives. The loyalty of the CEO should be to the company.

Each of the Officers is personally answerable for his/her responsibilities within Management and should account for them to the CEO and, whenever required, to the Board of Directors, the owners, and other stakeholders, in the presence of the CEO.

3.2 Officer Nominations

It is up to the CEO to nominate Officers to be submitted to the Board of Directors.

3.3 Stakeholder Relations

The stakeholders are the individuals or entities that undertake a certain kind of direct or indirect risk with regard to the company. In addition to the owners, they include the employees, customers, suppliers, creditors, and governments, among others. The CEO and Officers are accountable for a transparent relationship with stakeholders.

3.4 Disclosure

The CEO should make pertinent information accessible to all the parties concerned, as soon as available, in addition to information that is mandatory by law or regulation, with substance prevailing over form.

Management should seek clarity and straightforwardness when providing information by using language that is accessible to the target audience.

The company should provide balanced and top quality information addressing both positive and negative points, to enable the reader to correctly understand and appraise the organization.

Any information that may influence investment decisions should be disclosed immediately and simultaneously to all parties that may have an interest. The internet and other technologies

should be used as much as possible to improve speed and allow for a broad and timely disclosure of such information.

3.5 The Annual Report

The Annual Report is the most important and comprehensive source of company information, and therefore should not be limited to legally-required data. It involves all aspects of business activities in a full year compared with previous years, except for those items that are justifiably confidential, and targeted to a specific audience.

The Annual Report should include the opening message, written by the Chairperson or the CEO, the Management Report, and the entire set of financial statements, along with the Independent Auditors' and the Fiscal Council's opinions, when applicable.

Preparing the Annual Report is a Management duty, but the Board of Directors should approve it and recommend its acceptance or rejection by the General Meeting.

3.5.1 Corporate Governance Practices

The Annual Report should mention the corporate governance practices that are being adhered to or will be shortly implemented by the company.

3.5.2 Shareholdings and Compensation of Directors and Officers

The Annual Report should specify the shareholdings and compensation of the Directors and Officers on an individual or aggregate basis. Changes in shareholdings during the year should be reported as well as the variable remuneration system and its impact on results.

3.5.3 International Accounting Standards

Companies should acknowledge international trends and market requirements, as well as prepare financial statements consistent with internationally accepted accounting standards.

3.6 **Internal Controls**

The CEO is in charge of creating internal control systems that organize and monitor the flow of correct, actual, and complete information on the organization, such as financial, operating and legal compliance information, among others, which may carry important risks to the organization. The effectiveness of such systems should be reviewed at least once a year.

3.7 **Code of Conduct**

Management should develop a Code of Conduct to be approved by the Board of Directors, and see that it is followed throughout the organization. (See Section 6)

3.8 **Evaluation of the CEO and Officers**

The CEO is evaluated by the Board of Directors on an annual basis, and is in charge of evaluating the Officers and submitting results to the Board of Directors.

3.9 **Compensation**

Management compensation should be structured in a way that links it to results, through intelligent and coherent incentives, so that performance coincides with results that are in the best interests of the organization and the owners.

Compensation should be established to create the appropriate incentives and to promote the long-term creation of value, not just with regard to Management, but also other employees on all company levels.

Organizations should have a formal and transparent procedure in place, in order to develop their compensation policy and establish the compensation package of their management. No Officer should be involved in any decision concerning his/her own compensation.

Company stock purchasing options at discount prices should be avoided.

Evaluation and compensation systems should have a long-term character, in addition to risk symmetry to prevent attitudes that could benefit the Officers to the detriment of the owners.

The compensation package, for instance, should be sufficiently attractive, without exaggeration, always bearing in mind its value-creating potential for the owners.

The incentive structure should avoid that the same person oversee the decision process and its corresponding control.

3.10 Access to Facilities, Information, and Files

Management should provide Directors and Fiscal Council members with easy access to the facilities of the company, information, files, and all necessary documents for the performance of their duties.

4 INDEPENDENT AUDITING

4.1 Independent Auditing

Every organization should have an independent auditor. It is an important corporate governance instrument for all stakeholders, since its basic function is to make sure financial statements adequately reflect the reality of the organization.

4.2 The Opinion of the Independent Auditors

The Independent Auditors should express, as clearly as possible, their opinion as to whether the financial statements prepared by Management adequately reflect the equity and financial position of the organization and the results for the period. The auditors' report includes the scope, the work performed, their opinion, and consequently their responsibility.

4.3 Selection, Fees, Maintenance, and Replacement of Independent Auditors

The Board of Directors and/or the Audit Committee should establish a work plan with the Independent Auditors and agree on their fees. The Audit Committee should submit to the Board its recommendations as to hiring independent auditors, their fees, continuance, or replacement.

4.4 Observations and Recommendations from the Independent Auditors

The Independent Auditors should report the following issues directly to the Audit Committee, or, in its absence, to the Board of Directors: discussion of the main accounting policies, relevant deficiencies, and significant flaws in the internal controls and procedures, alternative accounting treatments, disagreements with Management, risk assessment, and possible fraud analysis.

4.5 Length of Mandate and Independence

It is recommended that auditors, for the sake of their independence, be hired for a preestablished period, with the possibility of being rehired after a formal and documented evaluation by the Audit Committee and/or Board of Directors of their independence and performance, in compliance with professional standards, legislation and regulations in force. It is recommended that any potential contract renewal with the audit firm after a maximum period of five (5) years be approved by the majority of the shareholders present at the General Meeting, including both common shareholders and preferred shareholders. Listed companies should observe applicable rules.

4.6 Non-Audit Services

The Board of Directors should make sure that the procedures adopted by the audit firm support their independence and objectivity, especially if the same auditors provide other professional services as well. The Audit Committee or, in its absence, the Board should be aware of all the services provided by the Independent Auditors, (including their fees) so that no doubt is raised as to their independence, and potential conflicts of interest are avoided.

When independence is compromised, the Board should decide whether other consultants or auditors should be hired.

The Board should disclose to the stakeholders fees paid to the Auditors for auditing and for any other services.

The independence of the auditors also applies to situations where few customers account for a substantial portion of the revenue of a sole audit firm. The Audit Committee and/or the Board of Directors should ensure that the Independent Auditors do not financially depend on the audited company.

4.7 Professional Standards of Independence

The Independent Auditors shall annually renew, in writing, to the Audit Committee, or, in its absence, to the Board of Directors, their independence vis-à-vis the company.

The relations between Independent Auditors and the CEO, the Officers, and the company generally should be typically professional and independent. The Independent Auditors and the Officers should report to the Audit Committee or, in its absence, the Board of Directors, any event when an Independent Audit firm member is hired by the company to provide supervisory services regarding the financial statements. In the event that the technical member in charge of the Independent Audit team is hired by the company, the Board of Directors should decide whether or not it is in the interest of the company to continue its relation with the same independent audit firm.

5 THE FISCAL COUNCIL

5.1 The Fiscal Council

The Fiscal Council, an essential part of the Brazilian companies' governance system, is a non-mandatory institution whose purpose is to oversee the actions of their administrative bodies and give its opinion on certain matters to the owners.

It should be seen as a tool designed to add value to the company, since it works as an independent control for the owners of the company.

5.2 Composition

The law has established the form of election of the members of the Fiscal Council. The controlling owners should waive the privilege of electing most of the Fiscal Council members, allowing the last Fiscal Council member to be elected by owners representing most of the share capital of the company, during an assembly meeting where each share — regardless of its type or class — represents a vote.

Controlling and minority[8] shareholders should have equal participation, with an additional member elected by the shareholders representing total share capital.

Controlling and minority shareholders should discuss the composition of the Fiscal Council prior to its election, in order to achieve a desirable diversity of professional backgrounds, relevant to the functions of the Board and to the field of activity of the company.

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8. Minority shareholder: Shareholder whose total shares do not allow him/her to hold a controlling interest in the company. Majority shareholder: Individual or corporation, or group of persons bound by a voting agreement, or under a common control, which: a) have owner rights entitling them to the majority of votes during General Assembly Meeting decisions and empowering them to elect most of the administrators of the company;b) effectively use their power to lead corporate activities and direct the activities of the company.

5.3 **Work Agenda**

In order for work to be more fruitful, Fiscal Council priorities should be outlined by its members, and attuned to the expectations of the owners.

The Fiscal Council should decide on a minimum agenda, which should focus on its activities throughout the year. This agenda should include a list of regular meetings, as well as information that should be sent to the members of the Fiscal Council on a regular basis.

The Fiscal Council should introduce its own Internal Regulations, provided these do not inhibit the freedom of each member of the Fiscal Council in his/her individual actions. No Fiscal Council document should prevent any individual Council member from acting in accordance with the law. However, every Council member should avoid abusing this privilege and always try to work in harmony with the other Council members.

5.4 **Relationship with the Owners**

The responsibility of the members of the Fiscal Council is to the corporation, regardless of the parties who nominated them. Thus, their actions should always be led by fairness, transparency, independence, and, as a general rule, confidentiality.

5.5 **Relationship with the Audit Committee**

The Fiscal Council does not replace the Audit Committee. While the latter is a monitoring instrument with functions delegated by the Board of Directors, the former is a controlling instrument with functions directly defined by the owners. When both are in place, some overlapping of functions might be expected. In this case, both the Board and the Fiscal Council should coordinate their activities. It is advisable that they hold a few joint meetings, possibly attended by the Independent Auditors.

5.6 **Relationship with the Independent Auditors**

The Fiscal Council should follow up on the Independent Auditors' work and their relations

with Management. The auditors should attend the meetings of the Fiscal Council whenever requested by its members, and provide information relating to their work. The Fiscal Council and Independent Auditors should seek a productive and mutually beneficial work agenda.

Management should not hinder communications between any Fiscal Council members and the Independent Auditors, or make them difficult in any way. Management should also make reports or recommendations issued by Independent Auditors or other specialists available to Fiscal Council members.

5.7 **Relationship with the Internal Auditors**

The Fiscal Council should monitor the activities of the Internal Audit Department, in cooperation with the Audit Committee. The Board of Directors can even establish communication channels between the Internal Audit Department and the Fiscal Council, as a way of ensuring an independent oversight of all company activities.

5.8 **Fiscal Council Compensation**

Fiscal Council members should be adequately compensated, bearing in mind their experience and necessary qualifications for the job. They should be entitled to reimbursement of their work-related expenses.

5.9 **Fiscal Council Opinions**

The information disclosure policies of the company should include Fiscal Council opinions and documents (whether or not dissenting), including votes and justifications by Fiscal Council members on financial statements.

6 CONDUCT AND CONFLICTS OF INTEREST

6.1 Code of Conduct

Under the concept of the best practice of corporate governance, and besides abiding by the laws of the country, every organization should have its Code of Conduct to be followed by its entire administration and employees, prepared by Management, in accordance with the principles and policies set forth and approved by the Board of Directors. The Code of Conduct should also establish the social and environmental duties of the organization.

6.1.1 Scope

The Code of Conduct should comprise the relations between Directors, owners, employees, suppliers, and other stakeholders. Directors and officers should not exercise their authority for their own benefit or for the benefit of third parties. The Code of Conduct should mainly cover the following subjects:

- Law abidance and tax payments
- Questionable payments/receipts
- Conflicts of interest
- Privileged information
- Gift receiving
- Discrimination at the workplace
- Donations
- The environment
- Moral or sexual harassment
- Occupational safety
- Political activities
- Community relations
- Substance abuse
- The right to privacy
- Nepotism
- Adult or child labor exploitation
- Company share-trading policies
- Lawsuits and arbitration
- Loans between related parties

- Fraud prevention and treatmentc

6.2 **Conflicts of Interest**

A conflict of interest exists when someone is not independent with regard to the subject at hand, and may influence or make decisions based on interests that differ from those of the corporation. The person in question should disclose in due time his/her conflict of interest or private interests. If this does not occur, any other person may do it.

Independence definitions have been set forth in this Code to Directors (see item 2.12), owners (see item 1.5.8) and independent auditors (see item 4.7). Similar criteria also work for Officers or any other company employees or agents. Directors, as well as officers, have a duty of loyalty to the organization and the owners as a whole, not just to those who elected them.

6.2.1 **Related Party Transaction**

It is duty of the Directors to monitor and manage potential conflicts of interest, whether from Officers, Directors or Owners, to avoid an inappropriate use of the organization's assets, and particularly abusive transactions between related parties. The Directors should make sure that such transactions are conducted within market parameters, in terms of deadlines, rates, and guarantees, and that they are all clearly reflected in the corporate reports.

Whenever possible, these operations should be backed by independent assessment reports, based on realistic assumptions and information confirmed by third parties, unrelated to the parties involved in the operation, whether banks, lawyers, specialized consultancies, or others.

In principle, loans to the controller and related parties should be prohibited. The bylaws of the company should ban such operations.

6.2.2 **Absence from Discussions and Decisions**

As soon as a conflict of interest is identified with regard to a specific issue, the person involved should physically leave the meeting room and stay away from the discussions and decisions. The temporary absence should be recorded in the minutes of the meeting.

ANALYTICAL INDEX

The number of each item is shown according to each aspect and action

	Definition	Decision Making	Implemented improvements	Assessment
1 Ownership	1.1, 1.3, 1.4	1.2, 1.3, 1.7, 1.8	1.6, 1.9 1.11	
2 The General Assembly The General Owners' Meeting	1.5, 1.5.1	1.5.2, 1.5.3, 1.5.4, 1.5.5, 1.5.6, 1.5.7	1.5.8	
3 The Family Council	1.10	1.10		
4 The Advisory Board	2.2			
5 The Role, Powers, and Duties of the Board of Directors	2.1, 2.3, 2.4, 2.25, 2.34	2.8, 2.33, 2.38, 2.39, 2.40	2.5	2.15
6 The Chairperson	2.6, 2.7			2.15
7 The Composition and structure of the Board of Directors	2.10, 2.11, 2.12, 2.16, 2.17, 2.18, 2.19, 2.20, 2.21, 2.22, 2.28	2.13, 2.14	2.23, 2.24, 2.36, 2.37	
8 Board organization and meetings **9** Committees	2.29, 2.30, 2.31, 2.32 2.8			
10 The Audit Committee	2.9, 2.9.1, 2.9.3, 2.9.4, 2.9.5	2.9.2, 2.33		

	Definition	Decision Making	Implemented improvements	Assessment
11 Internal Audit	2.34, 5.7			
12 CEO and Officer roles and duties	2.25, 3.1, 3.4, 3.6, 3.10	2.27, 3.2, 3.7	3.3	2.26, 3.8
13 CEO compensation	3.9			
14 Accountability to to shareholders and stakeholders	2.4, 3.3			
15 The Annual Report	3.5, 3.5.2		3.5.1, 3.5.3	
16 The Independent Auditors	4.1, 4.2, 4.3, 4.5, 4.6	4.4	4.5	
17 Independent Auditor relations	2.9.4, 4.7, 5.6			
18 The Fiscal Council	2.35, 5.1, 5.2, 5.3, 5.8	5.9		
19 Fiscal Council Relations	5.4, 5.5, 5.6, 5.7			
20 Code of conduct	3.7, 6.1, 6.1.1			
21 Conflicts of interest	2.3, 2.9.4, 2.12,2.16, 2.32, 4.6, 4.7, 6.2	6.2.1	1.2, 1.5.8, 1.9, 2.5, 6.2.2	

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