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Case study on corporate governance disclosures in the Russian Federation

Executive summary

The nineteenth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) requested that field cases studies be conducted in the area of transparency and disclosure requirements in corporate governance. Accordingly, five country case studies were conducted focusing on major issues in implementing corporate governance disclosure requirements. The case studies were undertaken for Brazil, France, Kenya, the Russian Federation and the United States of America.

This report presents the findings of a case study on implementation of corporate governance disclosure requirements in the Russian Federation. It provides an overview of the transition of the Russian economy from a centrally planned one to a market economy through privatization. The report covers public sector initiatives aimed at promoting transparency and disclosure in corporate governance. These include the Joint Stock Company Law, Protection of the Rights and Legal Interests of Investors on the Securities Market, the Code on Administrative Offences, the Criminal Code, the Commission on the Securities Markets Regulation, and accounting and audit. The report also includes a discussion of private sector initiatives and concludes by identifying implementation issues. The report uses as reference points the transparency and disclosure requirements discussed at the nineteenth session of ISAR.

The main objectives of the study are to draw lessons from the experiences of the Russian Federation in promoting improved transparency and disclosure in the corporate sector and to share the findings with member States that wish to strengthen transparency and disclosure in their respective countries.

CONTENTS

	Pages
CONTENTS.....	2
I. INTRODUCTION.....	3
II. PUBLIC SECTOR	4
A. THE JOINT STOCK COMPANY LAW.....	4
B. THE LAW ON THE PROTECTION OF THE RIGHTS AND LEGAL INTERESTS OF INVESTORS ON THE SECURITIES MARKET	6
C. THE CODE ON ADMINISTRATIVE OFFENCES	7
D. THE CRIMINAL CODE.....	7
E. RUSSIAN FEDERAL COMMISSION ON SECURITIES MARKETS (FCSM)	7
(i) <i>FCSM By-laws on General Meetings</i>	8
(ii) <i>FCSM Code of Corporate Governance</i>	8
F. ACCOUNTING AND AUDIT	10
III. THE PRIVATE SECTOR.....	11
A. STOCK EXCHANGES	11
B. CORPORATE GOVERNANCE RATINGS	12
C. COMPANY PRACTICES AND INITIATIVES	13
D. THE PRESS	14
IV. IMPLEMENTATION ISSUES.....	14

I. INTRODUCTION

1. The emergence of corporate governance in the Russian Federation took place within the context of Russia's transition to a market economy. Today the country has a new set of institutions and a functioning capital market that were scarcely imaginable in the not too distant past.

2. The challenges encountered during the transition can hardly be overstated. The Russian Federation's securities markets emerged at a time of strong economic contraction and profound societal change when markets were viewed with deep suspicion and skilled technocrats with market experience were non-existent. The Russian Federation was unique among transition economies, not only for the size of the transfer of State property to private owners and its speed, but also for the untamed nature of its privatization. Companies were privatized into the most rudimentary of share markets that lacked functional oversight and regulation.

3. The legal and regulatory frameworks are now largely in place. The revised Joint Stock Company Law (JSC Law) and the rules and regulations of the Russian Federal Commission on the Securities Markets (FCSM) determine the essentials of governance and disclosure. Progress has been no less dramatic in the governance of Russian corporations. Companies are increasingly attuned to shareholder needs, and financial intermediaries now have obligations under law to provide relevant information to investors. Stock exchanges are introducing more listing requirements and an active business press digs for stories. Altogether, a much improved disclosure framework should in the future provide for most necessary information.

4. The importance of corporate governance is now broadly recognized and there are efforts everywhere to improve it. The regulatory authorities and a small number of companies have been in the forefront of the drive to improve corporate governance practices. The Russian Federation has its own governance code, and market participants are becoming better at assessing the quality of governance and taking action. A growing number of Russian companies, whose controlling shareholders and executives see opportunities in the growth of the financial markets, have put governance on their reform agendas. And the benefits to companies are increasingly visible in terms of recognition and treatment by investors. Yet the number of such companies remains limited¹ and considerable challenges remain.

5. The Russian Federation's corporate governance problems can be traced back to its privatization programme that made insider dominance the most prominent feature of its enterprises. Mass privatization took the form of voucher distribution to the population with special advantages for employees of enterprises and corporate insiders.

6. A process of consolidation of control began at the very earliest stage of privatization. The result was that immediately afterwards some 60-65 per cent of company shares were held by insiders, 20 per cent by outsiders and 15-20 per cent by the Government on average.² The consolidation of ownership and control was characterized by extensive abuse of minority shareholders.

7. Today, employees are no longer significant shareholders, having disposed of vouchers and shares early in the privatization process. The role of the State has also decreased while the role of managers and large outside shareholders has increased significantly.

8. The financial crisis of 1998 sparked an interest in governance issues that had been largely ignored during privatization and during the rapid development of the stock market, which has been growing since 2000 when the macroeconomic outlook for the Russian Federation had improved significantly, industrial production was on the rise, political stability had asserted itself and government authority was strengthened. Generally pushed by a concern to attract foreign investors and nudged by the regulatory authorities, a number of companies developed codes of corporate behaviour and began to adopt improved governance policies.

9. Some optimism is warranted in the face of the country's difficult market history, but optimism should be guarded. While improvement is visible everywhere, it is recognized that further work on corporate governance is needed, including strengthening the regulatory framework for protection of shareholder rights and enforcement mechanisms, as well as improvement of transparency. Enforcement in particular requires attention, as does the ability to seek recourse for violations and to actually win remedies from the courts.

10. The paper gives an overview of recent developments in both the public and private sectors in the Russian Federation and summarizes some questions on implementation of corporate governance disclosure in the country with a view to providing an input to the issues paper on corporate governance disclosure (TD/B/COM.2/ISAR/19).

II. PUBLIC SECTOR

11. Corporate governance is determined by a set of laws, including the Civil Code, the Joint Stock Company Law, the Law on Securities Markets, the Law on the Protection of the Rights and Legal Interests of Investors on the Securities Market, the Law on Insolvency (Bankruptcy), the Administrative Procedural Code and the Corporate Governance Code, as well as other regulatory acts by the Federal Commission on Securities Markets (FCSM) and other agencies. Disclosure of governance-related information is required primarily by the Russian Joint Stock Company Law (JSC Law) and regulations issued by the Ministry of Finance and the FCSM (specifically the 1999 Law on the Protection of the Rights and Legal Interests of Investors on the Securities Market).

A. The Joint Stock Company Law

12. The Joint Stock Company Law defines principal shareholder rights and corporate responsibilities. It was completed in December 1995, and a new amended version came into effect on 1 January 2001. The new law provides for better accountability, and for better protection of minority investors.³ A summary of its key disclosure requirements follows:

- *General disclosure requirements:* Under article 89 of the JSC Law, shareholders have the right to obtain copies of financial statements, accounting records, internal documents of the company approved by the shareholder general meetings and other governance bodies; documents on the status of branches and offices; the prospectus; minutes of shareholder, board of directors⁴ and “revision commission”⁵ meetings; a list of affiliated parties; the opinions of the revision commission, external auditor and government control agencies; a list of persons who have the right to take part in general meetings; the reports of independent appraisers; and other documents containing information which the company must disclose under the JSC Law or under other laws or regulations. Shareholders have the right to obtain copies of annual reports under FCSM regulations as well.
- Under article 91 of the JSC Law, shareholders who have no less than 25 per cent of voting shares have the right to obtain copies of bookkeeping records and the minutes of meetings of the management board.⁶ Companies may charge shareholders for information, although fees may not exceed copying and mailing costs.
- *Related party transactions:* Members of the board of directors who are also part of management must disclose when they: (a) are parties to a transaction by the company; (b) hold at least 20 per cent of the voting shares of a legal entity that is party to a transaction; or (c) hold office in the management of an entity which is party to a transaction. Individuals must disclose their relationship to the board of directors, the revision commission and the external auditor. There is no requirement to disclose to shareholders.
- *Affiliated persons:* Under FCSM Resolution # 03-19/ps of 1 April 2003, all open joint stock companies are required to disclose information about their affiliates by submitting a list to a registrar within 45 days after the close of the quarter. Changes in the list of affiliates must be posted on the Internet within three days after the date when the company learned, or should have learned, about these changes. A letter must be submitted to the shareholder registry within three days after the date when the list is posted on the Internet to confirm that the list has been posted. If the website address is changed, and if access to the website is unavailable and later restored, the company must inform the registrar within three days of such an event.
- *Requirements for audit and compliance with legislation:* Joint stock companies must have their annual financial statements audited. The auditor must be approved at the annual general meeting, as must the amount of fees. Auditors also verify compliance of companies with Russian law. Either the auditor or the “revision commission” must prepare a report confirming the accuracy of the financial statements and report on violations of procedures in preparing financial statements and/or violations of law or regulations.
- *Remuneration of board members and top executives:* Aggregate remuneration for the board and management board must be disclosed.

- *General Meetings (GMs)*: Under the JSC Law, notification must be made 20 days before the GM, and 30 days before the GM, if the agenda covers the company's reorganization. Under the JSC Law and FCSM regulations, information that must be presented to a shareholder before the general meeting includes: (a) annual financial statements, in particular the auditor's report and the revision commission's report on the verification of annual financial statements; (b) information on the nominees to the company's management board, board of directors, revision commission and vote counting commission; (c) draft amendments to the charter of the company or a new version of the charter of the company; (d) draft internal documents of the company; (e) draft decisions of the general meeting of shareholders; (f) the annual report; and (g) information stipulated by the charter of the company and the JSC Law.

B. The Law on the Protection of the Rights and Legal Interests of Investors on the Securities Market

13. The 1999 law imposes penalties for violations of information disclosure. The law was perceived as a watershed in Russian disclosure; as a result of its passage, filings with the FCSM increased by a factor of over 100.⁷ Some of its specific requirements are:

- *Disclosure of significant ownership*: Investors must disclose to the FCSM when they have: (a) 20 per cent or more of an issuer's securities; or (b) increased or reduced their share of any issuer's securities by a multiple of 5 per cent in excess of 20 per cent.
- *Shareholder lists*: Lists must be provided to shareholders who own 1 per cent or more of the company's voting shares. Lists must include the names of the registered owners and the number, category and nominal value of their shares.
- *Quarterly statements*: Issuers must publish quarterly statements within 30 days of the end of the quarter. Statements must include: (a) a balance-sheet, a profit and loss statement, and a statement of sources and uses of funds; and (b) a discussion of factors causing changes in profits of more than 20 per cent compared with the previous quarter.
- *Controlling shareholders*: Quarterly reports are required on: (a) the members of the management bodies; (b) changes in the management bodies if members own more than 20 percent of the company's capital; and (c) changes in the list of companies in which the issuer owns 20 per cent or more of the authorized capital.
- *Material changes in financial position*: Issuers must advise the FCSM of material changes within five days of an event. Disclosure could be triggered by: (a) factors causing a change in assets or net profit of more than 10 per cent; (b) transactions involving 10 per cent or more of company assets; (c) material changes in the information disclosed as part of the securities issue, and; (d) shareholders acquiring more than 25 per cent of the issuer's securities.
- *Prospectuses*: Prospectuses must include: (a) the structure of the issuer's governing bodies, including a list of members of the board of directors; (b) a list of companies in which the issuer holder more than 5 per cent of the authorized capital; (c) the issuer's balance sheet, profit and loss statement, and

report on sources and uses of funds; (d) information on the issuer's authorized capital; and (e) information on prior securities issues.

C. The Code on Administrative Offences

14. The revised Code of Administrative Offences replaces penalties previously found in the Law on the Protection of the Rights and Legal Interests of Investors on the Securities Market. The code deals with violations of disclosure requirements. Effective since July 2002, it provides for fines of up to 150,000 Rubles or approximately US\$ 5,000 for violations of securities law. At this level, fines are clearly insufficient to encourage compliance with securities legislation, although individuals may be held liable for penalties imposed against a legal entity. The FCSM may file claims with the Russian Arbitration Court for violations of securities legislation and for the application of fines and sanctions. It is, however, restricted to filing lawsuits on its own behalf and not that of shareholders.

D. The Criminal Code

15. Amendments to the Criminal Code (article 185, points 1 and 2) provide for penalties for knowingly: (a) giving false information in the prospectus; (b) approving a prospectus containing false information; (c) approving a report on the issue of securities and placement of securities (where the issue has not been registered by the State); (d) evading disclosure requirements by a person who must submit information to an investor or oversight body; and (e) disclosing incomplete or false information.

16. The following penalties may be incurred if the offence causes damages:

- A fine of 500 to 700 minimum wages
- A fine in an amount of the convicted person's wage or any other income for 5-7 months
- Mandatory labour for a period of 180-240 hours
- Corrective labour for 1 to 2 years.

17. Repeat offences are punishable by confinement of up to three years.

E. Russian Federal Commission on Securities Markets (FCSM)

18. The FCSM is a relatively new agency, having been established in 1996. It develops laws and regulations designed to improve governance practices and ensure better investor protection, although it has some weaknesses that prevent it from functioning like a classic securities markets regulator. It is not fully independent and its chairman holds the position of minister in the Federal Government. In addition, the FCSM lacks sufficient statutory authority over stock exchanges to ensure adequate regulation. Its statutory authority to investigate securities violations is limited, as seen by a recent court order to halt an examination of RAO UES (Russian joint stock power and electrification company). The FCSM's powers to sanction are also limited. Finally, the issue of a stable source of financing has not yet been resolved.

(i) FCSM By-laws on General Meetings

19. The by-laws of the FCSM mandate that joint stock companies provide the following additional information to shareholders while preparing General Meetings:

- Annual report;
- Report of the revision commission;
- Recommendation of the board of directors on disposal of profits, including payment of dividends.

20. The by-laws also mandate that the annual report shall contain the following information:

- Company's position in the industry in which it operates;
- Priority activities;
- Board of directors' report on priority activities;
- Company development prospects;
- Payment of dividends;
- Description of main risk factors;
- List of major transactions with details on each transaction;
- List of transactions with related (interested) parties, with details of each transaction;
- List of board members with their holdings of company stocks;
- Biography of CEO and members of the management board;
- Criteria for determining compensation of executives and board members;
- Level of compliance with the FCSM Code of Corporate Governance recommendations.

(ii) FCSM Code of Corporate Governance

21. The FCSM has developed a code on corporate governance. In order to do so it set up a Coordination Council on corporate governance that included representatives from companies, investors, business associations, securities market participants and governance experts. The Code, officially presented in April 2002, includes recommendations on all key aspects of corporate governance practices, including disclosure, but also devotes considerable attention to access to data. Furthermore, it proposes going beyond the requirements of current legislation. Although it provides some detailed recommendations, it takes a principle-based approach that leaves the specific required disclosures open-ended. It also provides useful explanatory text that outlines the reasoning behind its recommendations. The Code benefited from input from the OECD, the World Bank and other international organizations, and was completed in late 2001.⁸

22. Chapter 7 of the Code is specifically dedicated to disclosure and is focused on the following main issues:

23. *Section 1.1: Company information policy should guarantee unhindered and low-cost access to information about the company.* This section assigns the responsibility for disclosure policy to the board of directors, requires the company to have a written disclosure policy approved by the board of directors, and encourages broad dissemination via the press and the Internet.

24. *Section 2.1: Prospectuses should include all significant information about the company.* This clause recommends exceeding disclosure on the board and other governance bodies required by law. It underscores the importance of supervisory and management board disclosure, the executive structure of the company and dividend policies, and seeks to improve disclosure on control and related party transactions. Suggestions are made for a more detailed breakdown of financial statements and better analysis of performance than required by law, including a discussion of prospective performance.

25. *Section 2.2: Quarterly reports for the fourth quarter should disclose additional information.* This provision suggests expanding information required by law for the fourth quarter to the entire year.

26. *Section 2.3: Companies should promptly disclose information about all factors that may be material for shareholders and investors.* This section suggests open-ended disclosures of any material events or facts beyond statutory requirements such as decisions on: increasing (decreasing) the charter capital; acquisition by the company of its own shares; a change in the company's priority areas of operation; amendments to the company's charter concerning issuance of preferred stock of a category different from the category of shares issued previously; and a change in the company's auditor, registrar or depository.

27. *Section 3.1 Companies should seek additional ways of furnishing information to shareholders.* This clause appears to set the overall spirit and tone of disclosure efforts.

28. *3.2 The Company Secretary should provide shareholders with access to information about the company.* This clause sets out responsibilities for providing information to shareholders.

29. *Section 3.3 During preparations for a general meeting of shareholders and in the course of such meetings, shareholders should be provided with exhaustive information on each item of the agenda.* Beyond standard items such as annual statements, this section sets out information requirements in cases of fundamental reorganization of the company or significant sales of company assets. Its provisions seem to be designed to combat asset-stripping transactions.

30. *Section 3.4 The annual report for shareholders of the company should contain necessary information that would enable shareholders to evaluate the results of the company's operations for the year.* This clause requires certification of the annual report by the chief executive.

31. *Section 4.1 Information that constitutes trade or professional secrets should be protected.* This section recognizes that some information may be withheld from the public and suggests the definition of criteria for withholding information by the board.

32. The FCSM Code is not legally binding. In April 2002, the FCSM adopted a by-law which recommends that companies disclose in their fourth quarter and annual reports the extent to which their practices comply with the Code's recommendations and explain deviations from the Code's recommendations. The Code provides an important signal to the markets and some of its elements appear to be destined to find their way into legislation.

F. Accounting and Audit

33. Requirements for accounting in the Russian Federation⁹ are based on a number of different laws and codes, including the Law on Accounting, the Civil Code, accounting standards of the Ministry of Finance and other laws.

34. Russian authorities attach great importance to reforming Russian accounting towards International Financial Reporting Standards as the Government recognizes the benefits of adhering to a recognized international standard and has developed plans to converge Russian Accounting Standards (RAS) with IFRS.¹⁰ It has announced that starting from 2004 Russian listed companies will prepare their consolidated accounts in accordance with the IFRS. However, RAS still differ from IFRS and more work is needed. The most significant differences were outlined in a survey conducted by the Big 5 accounting firms entitled "GAAP 2001, A Survey of National Accounting Rules Benchmarked Against International Accounting Standards". This survey groups differences between RAS and IFRS into four major categories where: (a) rules comparable to IFRS are absent; (b) specific rules requiring disclosure are absent; (c) inconsistencies between rules could lead to differences with IFRS; and (d) other issues that could lead to differences from IFRS. Some of the differences in the first category (the area that could result in the greatest differences in financial statements) relate to: business combinations; consolidation of Special Purpose Entities (SPEs); inflation accounting; impairment of assets; accounting for pension plans and employee benefits; and financial instruments among others.¹¹ Since then more work has been done and new standards have been issued in such areas as discontinued operations, research and development costs, income tax and financial investments. However, compliance with IFRS in these and other areas, especially at the level of practical implementation, is still to be achieved.

35. In a reforming process Russia has expressed a number of concerns about convergence, including: (a) the complicated nature of IFRS; (b) disagreement with certain significant IFRS; (c) a limited capital market that may not make IFRS (which are designed for markets) practical; and (d) difficulties in accurately translating IFRS into Russian.¹² One of the major concerns is that the Russian Federation still does not have an official Russian translation of IFRS. Another acute practical issue related to the implementation of IFRS is a need to develop a link between financial accounting and tax legislation which requires a coordinating effort involving the bodies responsible for tax and accounting.

36. In the interim, companies accessing the international capital markets already prepare their financial statements in accordance with IFRS or US Generally Accepted Accounting Principles (US GAAP). Over 50 per cent of the companies currently listed on the Russian Trading System (RTS) prepare their statements in accordance with IFRS or US GAAP. The Russian business community has been pressing the Government to accelerate the

transition to IFRS and relieve companies that have already introduced IFRS or US GAAP of their dual record-keeping burden.

37. Russian audit standards are considered similar to the International Standards for Audit (ISA) as set by the International Federation of Accountants (IFAC). However, more effort is needed to ensure that Russian audit regulation and practices are in compliance with best international requirements. Many large companies still rely primarily on international firms for public audit services, especially when required for the purpose of international financing.

38. Further education and training both in international accounting and in international audit are vital. This is required for university students and for practising accountants.

III. THE PRIVATE SECTOR

A. Stock Exchanges

39. The Moscow Interbank Currency Exchange (MICEX)¹³ and the Russian Trade System (RTS)¹⁴ dominate trading in the Russian Federation, although there are nine other exchanges. At the end of 2000, market capitalization on MICEX was \$60 billion, most of which was in corporate fixed-income securities. Four companies¹⁵ represented some 90 per cent of trading volume, with one (RAO UES) representing one half. MICEX views transparency as fundamental to the functioning of its market and has sought to introduce better standards of disclosure into its listing requirements.

40. Trading on the RTS is more diversified than on the MICEX. However, even for RTS, 85 per cent of volume comes from just seven companies¹⁶ that have a 25 per cent free float. For most companies, the percentage of shares not held by controlling shareholders or company managers is well below 15 per cent. RTS lists companies according to tiers that are determined by governance and disclosure standards. The highest-level tier must file statements prepared under US GAAP or IFRS.

41. New rules that became effective in early 2003 set the following additional requirements for listing on the RTS and MICEX A-Level quotation (the highest level):

- The issuer must provide the issue organizer with the following: material facts that affect the issuer's financial and business operations; the number of the issuer's shareholders; quarterly reports in compliance with the requirements as to the content and deadlines of producing this information as set by the FCSM regulations, and disclose information no later than five days after the date when the issuer learned or could have learned that one person and/or his affiliates had become the owners of more than 75 per cent of its common stock.
- One person and/or his affiliates may own no more than 75 per cent of the issuer's common shares.
- The issuer must breakeven during two out of three years preceding listing.
- The issuers must have a financial history of at least three years.

- An A1-Level listing requires compliance with the FCSM Code of Corporate Conduct, and the submission of supporting documentation to the exchange.
- An A2-Level listing requires compliance with the disclosure requirements in Chapter 7 of the FCSM Code of Corporate Conduct and submission of supporting documentation.

B. Corporate governance ratings

42. Some conclusions on corporate disclosure in Russian companies could be drawn from surveys conducted by rating agencies and other organizations. Although not quite comparable owing to different methodologies used and also limited by nature as they have to be viewed within the context of economic performance, they still provide some insight into the state of affairs on corporate governance disclosure in Russia.

43. A number of organizations rate the governance practices of companies traded on Russian exchanges. The Investor Protection Association (IPA) and the Institute of Corporate Law and Governance (ICLG) have both published ratings. Brunswick UBS Warburg has conducted governance surveys with a component devoted to transparency. Standard & Poor's has established a corporate governance scoring service that covers 98 per cent of Russia's market capitalization and recently published a study devoted exclusively to transparency and disclosure in the largest Russian companies.

44. In December 2002 the Investor Protection Association (IPA) announced the results of the programme *Russian Leaders in Corporate Governance 2002*, which evaluates the quality of governance among leading Russian companies. The IPA is a non-commercial organization established in April 2000 for the protection of investor rights and the improvement of corporate governance in Russia. Assessments were conducted by IPA members comprising Russian and foreign companies with a total of over US\$ 10 billion invested in the Russian market. IPA members nominated *Vimpelcom*, *YUKOS*, *Sibneft* and *Norilsky Nickel* for best-governed company. *Vimpelcom* eventually won. *Norilsky Nickel* won the nomination for the company with the largest improvements in 2002.

45. The ICLG singles out *RAO UES* and *Sibneft* as companies that had improved their governance significantly. The ICLG ascribes *RAO UES*'s high rating to its adoption of a Corporate Governance Code and other factors, including enhanced monitoring by the Board of Directors and improved disclosure. *Sibneft* was highlighted because of its decision to cancel treasury shares (that could potentially be used to dilute existing shareholders) and the addition of an independent member of the Board of Directors.

46. Despite the improvements at *Sibneft*, the ownership structure remains unclear and ICLG warned against continued potential for shareholder manipulation. This prediction came true a number of months after the survey when *Sibneft* first bought, and then sold back, a 27 per cent stake in the company to the same shareholder under obscure conditions. *RAO UES* was also criticized for a restructuring that resulted in the expropriation of minority shareholders.

47. Standard & Poor's Ratings Services publishes a transparency and disclosure study that includes the 42 largest companies in the Russian Federation.¹⁷ Only the shares of the 10 largest companies are liquid and most of the companies in the index have very concentrated ownership; one or more connected shareholders control more than 50 per

cent. According to S&P, concentrated ownership appears to be related to lower levels of transparency in Russian companies.

48. The survey highlights the large spectrum of disclosure found among Russian companies. The top two companies in the study, *Mobile Telesystems* (MTS) and *Wimm-Bill-Dann*, made more than 70 per cent of the desired disclosures, which is comparable with disclosure levels in many Western European companies. *YUKOS*, *Vimpelcom*, *Golden Telecom* and *Rostelecom* reported on approximately 50 per cent of the desired disclosures. The remaining 36 companies exhibited significantly lower levels of disclosure, with the bottom of three companies making only 10 per cent of the needed disclosures. Of the largest 42 companies, 26 produce financial reports in accordance with internationally recognized standards.

49. In comparison to other regions of the world where S&P applies the same assessment methodology, disclosure among Russian companies is comparable with disclosure levels in Latin America, the global region with the lowest level of transparency. The survey reveals that the weakest aspect of Russian disclosure is executive remuneration. Lack of disclosure in this area as well as in the area of related parties, transactions and ownership structure downgraded S&P ratings of some Russian companies, which are well compared with best international practices in other respects. Further negative factors found in some companies are the absence of disclosure of the contractual relationship with the external auditor and the absence of an independent audit committee.

C. Company practices and initiatives

50. Increasing numbers of companies have published corporate governance policies, including, most recently, *Gazprom* and *Rostelecom*; this makes about 20 companies in total. They are generally short and acknowledge the need for transparency, the need for independent audit committees and disclosure according to international standards. Governance statements of Russian companies are increasingly becoming available in the public domain.

51. In the second half of 2002 and the first half of 2003, some of the Russian Federation's largest companies started to disclose their ownership structure. *Yukos* and *LUKoil*, the largest and second largest Russian companies, and *AFK Systema*, a major diversified holding company, disclosed their beneficiary ownership structures and individual remuneration of their top managers. These steps were made in the wake of preparing for placing level 3 American Depository Receipts. In general large improvements in governance performance and transparency tend to come as a result of ADR's or direct listings on foreign exchanges. It is expected that other Russian companies will follow suit in the very near future.

52. Traditional views on the role and function of an audit committee have recently been challenged. Russian company law neither requires nor prohibits having a board audit committee. The law requires enterprises to have "revision commissions".¹⁸ Yet a number of Russian companies, aspiring to attract foreign portfolio investors, have voluntarily set up audit committees. For example, in *Yukos* and *United Heavy Machinery* independent expatriate directors head audit committees.

53. The mission and scope of revision commissions required by law are narrower than those of an audit committee. The revision commission focuses on monitoring compliance with law and regulation. It has the power to: (a) monitor compliance with regulations governing the economic activities of the company; (b) express an opinion as to whether reports and other financial statements of the company provide a true view and whether there are breaches of laws and regulations; (c) ascertain whether business and financial transactions are recorded properly; and (d) review controls. In practice, the members of commissions do not always have adequate training and the liberty to pursue investigations. The question arises as to which of these two structures (audit committee or revision commission) is better able to oversee the preparation of financial information and assess the systems of internal controls.

54. Many of the top-tier traded companies maintain websites that include reports on the company's financial and operating results. However, the websites of most traded companies are not updated regularly and it may be difficult to obtain copies of company reports from them or the FCSM. The FCSM may wish to consider improved access to company's financial statements on the Commission's public website.

55. One of most recent private sector initiatives is the establishment of the Russian Institute of Directors (RID). This is a not-for-profit organization established in November 2001 by a group of the largest Russian companies to: (a) promote improved corporate governance; (b) develop professional standards and rules of ethics for directors and company secretaries; (c) conduct research and training. It is also planning to launch a ratings system. The RID has also been active in a number of other areas. It has held a series of events dedicated to greater transparency and disclosure, including surveys and round tables. Its training programme for board members includes a special module on disclosure. The RID, in cooperation with foreign partners, published a manual for board members with an extensive chapter on disclosure.

D. The press

56. In the Russian Federation, an important component of the corporate governance framework has been the press. In recent years, the Russian press has played an active role in strengthening the corporate governance framework by highlighting cases of abuses and by providing information and background to international correspondents. The Russian press has, for example, reported cases of asset stripping by company managers and shareholder meetings where minority shareholders are physically prevented from participating. Critics have pointed to the sensationalistic taste of Russian reporting. However, it seems that while the press may not always get the substance of matters right or be able to actually prevent abuses, it ensures that they remain in the public spotlight.

IV. IMPLEMENTATION ISSUES

57. The basic institutional structures seem to be in place; the regulatory framework has improved significantly and a reasonable number of disclosures are required that, on a general level, compare with the requirements of countries with larger and more developed securities markets. In practice, however, issuers disclose less information than required

and users continue to voice concerns. In particular, they point to inadequate or distorted information with respect to ownership structures and the unreliability and inaccuracy in financial information,¹⁹ and note the importance of successful legislation against offences related to non-disclosure or the provision of false information.²⁰

58. For example, in spite of numerous requirements in law and regulations on disclosure of ownership, it is still difficult for shareholders and other stakeholders to obtain accurate information regarding the ultimate ownership and control of Russian enterprises.²¹

59. More information should be disclosed about candidates proposed for board seats, their background and material interests in enterprises, the function of the board and its committees and board policies, internal control and risk oversight mechanisms. There is also a need to develop and implement performance evaluation in order to monitor the adherence of the board to accepted codes of governance.²²

60. The majority of Russian enterprises do not disclose remuneration information nor do boards disclose remuneration policies. The absence of disclosure may illustrate the lack of sound internal rules for determining compensation. Companies will need to introduce more rational approaches to setting executive and director compensation and to the disclosure of their policies.

61. Much effort is needed to ensure the practical implementation of the IFRS and the development of the accounting and audit profession. Consideration should be given to the levels of training, testing and certification that are needed to implement new accounting/reporting requirements.

62. Consideration should also be given to strengthening the effectiveness of the FCSM in particular in ensuring that a stable and adequate level of financing for the FCSM is available and that imposed fines are sufficiently high to force compliance. The current level of sanctions for non-compliance with the legislation and FCSM regulations is regarded as clearly insufficient.²³

63. Access to information remains a concern. In particular, lack of information in English creates problems for foreign investors. Furthermore, disclosed enterprise information is not standardized, and this makes comparative analysis difficult.

64. There is a need to decide how to treat revision commissions and consider whether they can serve as audit committees. If one supports Western-style audit committees, amendments to the law would be required.²⁴

65. There cannot be good governance or good transparency in the absence of educated executives and directors. More intensive training of executives and directors is needed since their understanding of governance is limited. Confusion seems to reign with respect to the difference between an outside director and an independent director, and the purpose of communications. Many boards are of the opinion that disclosure is not a part of their responsibilities.

Notes

¹ Igor Belikov, Director, Russian Institute of Directors.

² Source: Dimitry Vasiliev, Executive Director of the Institute of Corporate Law and Corporate Governance.

³ Copies of most governance-related laws, including the amended Joint Stock Company Law, can be found at the websites of the Federal Commission for Securities Market, www.fcsm.ru; the Russian Institute of Directors, www.rid.ru and Corporate Governance in Russia: http://www.corp-gov.org/bd/index.php3?base_id=1. Most laws are available only in Russian. The Institute of Corporate Law and Corporate Governance is also a good source of information on Russian legislation: <http://www.iclg.ru/>.

⁴ The term "board of directors" will be used throughout this paper to refer to the supervisory board in a two-tier board structure.

⁵ A number of terms are used to translate this Russian structure into English. It has been referred to as an audit commission, audit committee and revision commission. For the purposes of this paper the term "revision commission" is used to distinguish it clearly from an audit committee, which has distinct functions and responsibilities.

⁶ The terms "executive board" and "management board" are both used to refer to the executive part of the board under a two-tier board structure. The term "management board" is used for the purposes of this paper.

⁷ Source: Dimitry Vasiliev, Executive Director of the Institute of Corporate Law and Corporate Governance.

⁸ Gennady Kolesnikov, Deputy Chairman, Federal Commission for Russian Securities Market.

⁹ Excluding bank accounting standards, which are set by the Central Bank.

¹⁰ The Russian deadline of 2004 for convergence may appear ambitious since the European Union has set its deadline for 2005. A number of other convergence plans have been discussed, some envisioning transition periods of up to 10 years. Investors, on the other hand, would like to see immediate changes.

¹¹ For a full list of the differences see "GAAP 2001, A Survey of National Accounting Rules Benchmarked Against International Accounting Standards" at: http://www.ifad.net/content/ie/ie_f_gaap_frameset.htm.

¹² "GAAP Convergence 2002: A Survey of National Efforts to Promote and Achieve Convergence with International Financial Reporting Standards".

¹³ www.micex.com

¹⁴ www.rts.ru

¹⁵ RAO UES, LUKoil, Mosenergo and Sberbank.

¹⁶ RAO UES, LUKoil, Surgutneftegaz, Yukos, Mosenergo and MMC Norilsk Nickel.

¹⁷ See at www.corp-gov.ru/upload/file/Table_eng.doc for a list of companies surveyed by S&P and their disclosure rankings.

¹⁸ Similar structures may be found in other countries, for example Italy and Brazil.

¹⁹ Kirill Ratnikov, Partner, Coudert Brothers LLP, in interview with the Russian Institute of Directors.

²⁰ Igor Belikov, Director, Russian Institute of Directors.

²¹ As a result, Standard & Poor's downgraded their corporate governance score for the company.

²² Source: Resolutions of the 5th Council for Corporate Governance.

²³ Igor Belikov, Director, Russian Institute of Directors.

²⁴ Natalia Annikova and Igor Belikov, the Institute of Capital Market and Management.