

SESSION VI: THE ROLE OF BOARDS OF DIRECTORS IN OVERSEEING DISCLOSURE

PRACTICAL DIFFICULTIES IN INTRODUCING AUDIT COMMITTEES IN A RUSSIAN COMPANY

Presentation on by

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¹ Russia's dynamic integration in the world economic community makes paramount the solution of the problem of compliance of the Russian enterprises to the norms of behavior accepted on the international market.

The public joint-stock company Gazprom is seeking optimal approaches to creating a system of corporate governance, accommodating both the requirements of the Russian legislation and the international investment community, and the interests of different participants of corporate relationships, in particular: shareholders, the board of the directors, the Board, auditors, the personnel, suppliers, creditors, the state, etc.

Current State of Affairs

A characteristic feature of the gas industry is its extreme capital intensity. Gazprom annually invests some 3 billion dollars in the maintenance of the existing extraction level and development of production. It is impossible to carry out any projects of a global scale without external financing.

Therefore the international requirements of disclosure of both financial and non-financial information on the company activity are not only well known in Gazprom, but are being successfully fulfilled.

The obtaining of the listing of Gazprom's American deposit receipts at the London Stock Market in 1996 has become a milestone in development of corporate government in the sphere of information disclosure.

Already 74% of all supplies of hydrocarbons controlled by Gazprom have been audited, and it is planned to complete the auditing of 100% of supplies by the end of 2001.

Since 1999, Gazprom, as a stock emitting company, has been issuing public reports, including, among other things, data on affiliated persons, in accordance with FKCB requirements.

At present, a pilot project of introducing an integrated managing system (based on SAP R/Z) is underway. The system opens up the opportunity for upgrading quantitative and qualitative characteristics of activity, which increases the trust of shareholders, investors, and the public.

Working Group for Improvement of OAO Gazprom Corporate Government

In the middle of the current year, a working group has been set up in Gazprom for the purposes of examining the state of corporate government in the Company and working out proposals for its improvement, as well as drafting a Corporate Government Code of OAO Gazprom.

¹ The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries. This paper is subject to further revision.

Members of the working group are also involved in the activity of the FKCB Coordinating Council for elaborating a Corporate Government Code for the Russian enterprises. We hope that our modest contribution to the work of the FKCB Coordinating Council will be useful.

Approach to Elaboration of a Corporate Governance Code

Gazprom's idea of the future structure of the Code consists in the following.

Corporate governance shall be regulated on two levels.

Level one is the Code (charter) proper. We suppose that any interested person should have access to the Code for familiarization, therefore the Code should be a rather compact document, simple for understanding. Consequently, the Code shall reflect the fundamental provisions on corporate management of the company: statement of the importance of maintaining favorable relations between the managers, shareholders, and other interested persons, and the company's willingness to improve them; description of the purposes of corporate governance, participants of corporate relations, and the basic principles of their interaction.

The second level consists of the company internal documents attached to the Code (or approved in accordance with it). These documents regulate in detail the mechanisms and procedures applied within the frames of corporate government (provisions on committees, regulations of their activity, the order of concluding deals, the provision on arbitration tribunal, the provision on information disclosure, etc.).

The reasonableness of this approach is confirmed by the practice of its employment by large corporations in the West (Royal Dutch/Shell, BP/Amoco, GM, Microsoft).

We suggest that a similar approach to elaboration of a Code should be applied by FKCB, with one particularity, however, that the documents of the second level should vary, depending on the scopes of joint-stock companies to which they will be applied: apparently, the problems of interaction with thousands of individual shareholders, of taking into consideration the positions of the state as a shareholder, etc., are not acute for small companies without state participation in the joint-stock capital.

Auditing Commission and Auditing Committee

In accordance with the Russian legislation, an Auditing Commission is operating in Gazprom, which is a standing body of the Company controlling the financial and economic activity of OAO Gazprom and its affiliates.

The existing practice of work of the Auditing Commission reflects the Russian realities and is rather effective.

Independence of Members of the Board of Directors' Auditing Committee

The issue of creating an Auditing Committee at Gazprom Board of Directors has been raised lately. However, the Russian companies forming an auditing Committee encounter a number of objective difficulties.

According to the Russian law, the notion of independent director – which most of the Auditing Committee members ought to be, in accordance with international principles – is defined only as applied to deals involving interest. (*A member of the Board of Directors is considered independent, if he is not a singular executive authority or a member of a collegial executive authority, and also a member of the*

Board of Directors whose spouse, children, parents, brothers or sisters are not members of the company managerial bodies.)

According to the Russian definition, only two members of Gazprom acting Board of Directors can be considered independent directors – Chairman of OAO Gazprom Board and First Deputy Chairman of OAO Gazprom Board.

The annotation to OECD principles defines an independent director as a person who is not on the company payroll and is not closely connected with the company or with its administration by any serious economic, family or other relations.

Proceeding from the OECD definition, all members of OAO Gazprom Board of Directors can be regarded as independent. A representative of minority shareholders, esteemed Board member B.G.Fedorov, who is at the same time a member of the Board of Directors of our major creditor – Sberbank, and RAO EES Russia – Gazprom’s largest debtor, may be considered an independent director.

In order to eliminate the aforementioned difficulties, it seems expedient to define in the Russian legislation the notion of “independent director” for purposes of forming an Auditing Committee and solving other corporate governance tasks.

Affiliated Persons

The gaps in the Russian legislation also cause the difficulties in disclosure of information on the company activity.

The legislation on joint-stock companies requires that the stock emitting entities publish the lists of affiliated persons. It also establishes the order of disclosure of information on affiliated persons in the joint-stock companies accounts. This is a fair demand.

However, the definitions of affiliated persons given by the Russian legislation are complicated and contradictory, and Gazprom encounters difficulties in preparation of the aforementioned lists, which, in our opinion, are also encountered by the other Russian companies.

Moreover, there is no legislative norm ascribing the affiliated persons themselves to present the initial information to the emitting entity.

As a result, the data on Gazprom affiliated persons, presented in the Quarterly Report of a stock emitting entity, are far from being exhaustive. They only include the information on members of the Board of Directors, the singular and collegial executive body of the company. The data on legal persons are restricted to the organizations where Gazprom has an over 20% share on the charter fund, and legal persons, which own more than 20% of OAO Gazprom charter fund. Nevertheless, the list includes over 130 organizations.

Auctioning Fund of Workers of the Gas Industry

The notion of corporate governance in a broad sense is a system of rules and stimuli, which are used as a basis for building relations between all sides interested in successful performance of the company.

In a narrow sense, corporate governance is a system of rules and stimuli, urging the managers to work in the interests of the company owners.

Gazprom considers its new project of creation of the Auctioning Fund of Workers of the Gas Industry as a component of the complex of corporate governance measures.

The functioning of the Fund will open up an opportunity to directly link the results of the company's work in the interests of shareholders with the size of compensation of employees, including the company managers. This will make it possible to secure economic stimuli for the company employees, urging them to act in the interests of proprietors.

Other Participants of Corporate Governance

Relations between participants of the management system also influence corporate governance. Shareholders of controlling parcels of stock, which may be natural persons, families, alliances or other corporations, acting through a holding company or through mutual ownership of shares, can exert a considerable influence on corporate behavior. Being a holder of stocks, institutional investors increasingly demand a vote in the corporations' management on some markets. Individual shareholders usually are not so eager to exercise their managerial rights, but they certainly are concerned whether the holders of a controlling parcel of shares and the administration guarantee them fair treatment.

Creditors play an important role in some management systems and have enough potential to exercise external control over the activity of corporations. The staff and other interested persons introduce an important contribution to attaining durable success and results of the corporations' activity, whereas the governments create general institutional and legal entities of corporate government.

The total number of OAO Gazprom shareholders is 570 thousand (Russian legal persons – 31.53%, Russian natural persons – 19.79%; foreign shareholders – 10.31%; the state – 38.37%), and there are currently about 300 thousand employees working within the OAO Gazprom system. A multitude of counteragents operating on economic agreements in all Russian regions, as well as a high social significance of stable performance of OAO Gazprom for the Russian economy, impart special importance to the question of using a “single standard” of determining relations with all the interested persons on the basis of a clearly formulated and persistent strategy of corporate governance.

Considering that OAO Gazprom has over 800 long-term investment objects (including the investment of its affiliated companies) in different industrial sectors and with different property structure, the improvement of corporate government of these companies, as well as the optimization of inner-group relations, would enable to increase the corporate cost of OAO Gazprom, the transparency of the group's performance, to use the experience of introduction of new managerial technologies within the frames of OAO Gazprom system.

Conclusions

The difficulties in introducing international principles of corporate governance on the Russian soil are caused by objective reasons, lying outside the competence of even such large companies as Gazprom.

Today, there is an evident mutual willingness of all participants of economic activity to improve the system of corporate government in the country. It is apparent that the solution of the problem would in fact make it possible to work out principles, acceptable for the Russian life and, nevertheless, based on commonly recognized international standards.