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Session 1: Disclosure and transparency: what is at stake?

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OECD STANDARD IV. "DISCLOSURE AND TRANSPARENCY" WITHIN THE LEGAL SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

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It has long been said that information is "the most expensive and demanded commodity". This statement is probably valid for all areas of human activity, but it is certainly most pronounced in the securities market. The History has shown that information or disinformation has caused such confusion in stock exchanges that entire economies have suffered long-term consequences. In respect of the role that accurate and timely information plays in maintaining financial market stability, national and international organizations continue to emphasize transparency, financial reporting and disclosure of information as keystones of effective market regulation. Complete, accurate and timely disclosure of financial status and information on business operations enables the shareholders to make informed investment decisions; it increases protection of investors and advances the general level of understanding of the structure of corporate management.

The subject of this paper is the analysis of the incorporation of OECD Standard IV into the legal system of the Federation of Bosnia and Herzegovina regarding the new regulation of the Securities Commission of the Federation of Bosnia and Herzegovina (hereinafter: the Commission): the Book of Regulations on the Content, Methods and Standards of Disclosure of Financial Reports and Other Information on Business Operations of Joint Stock Companies (the document has not yet been published in the "Official Gazette of the Federation of Bosnia and Herzegovina" by the moment of delivery of the text to the OECD). Therefore, this text shall not deal with specific qualities and additional demands for transparency and disclosure information that are primarily relevant to privatization investment funds and fund management companies. This document was created so that the OECD Standard, and its Principles, are cited at the beginning of the chapter (the bold italicized text). Subsequently, the paper provides an analysis of the OECD Standard's incorporation into the legal standards of the Federation of Bosnia and Herzegovina.

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.

¹ The Securities Commission of the Federation of Bosnia and Herzegovina, in accordance with its Ethic Rules, denies liability for any publication of its employees. All the opinions expressed in this paper are exclusively the author's own and do not have to respond to the opinions of the Commission as an institution, individual members of the Commission or the staff of the Commission.

Financial reporting and disclosure of information is regulated within the Federation of Bosnia and Herzegovina through a set of five laws that regulate the securities market², and subsequent by-laws (Book of Regulations) developed and adopted by the Commission.

From the point of view of frequency and continuity, disclosure of information can be categorized in two basic groups:

- Regular or periodical disclosure (annual or semi-annual reports on business operations)
- Disclosure under special circumstances (the prospectus and extraordinary events material to the financial business operations of a company).

Apart from the above-mentioned laws and the Book of Regulations that is the subject of this paper, reporting and disclosure is also regulated by the Commission's Standards of Corporate Governance ("Official Gazette of the Federation of Bosnia and Herzegovina", No. 32/01). Standard 2, "Acting in the Best Interest of the Company", for the members of the Supervisory Board, particularly emphasizes the principle of disclosure in case of the conflict of interests and the principle of transparency of remuneration.

Disclosure under special circumstance has been regulated in sufficient detail by the Law on Securities, the Book of Regulations (on Issuance of Securities through Private Placement) and the Contents of the Abbreviated Prospectus ("Official Gazette of the Federation of Bosnia and Herzegovina", No. 52/00) which represents additional regulation by the Commission.

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.

In relation to the information on the business operations of a company, the annual report must contain the following data:

- Financial reports made in accordance with the Law on Accounting, the Code of Accounting Principles of the Federation of Bosnia and Herzegovina, Accounting Standards of the Federation of Bosnia and Herzegovina - Accounting Standard 1 and International Accounting Standard 1 - the Presentation of financial reports and the Guidelines of 8th EU directive. The set of financial reports is composed of:
 - balance sheet,
 - income statement,
 - statement of cash-flow,
 - statement of shareholders capital,
 - statement of changes in shareholders capital and
 - accounting policies and commentary with the financial reports.

² - Law on the Securities Commission ("Official Gazette of the federation of Bosnia and Herzegovina", No. 39/98 and 36/99),

- Law on Securities ("Official Gazette of the federation of Bosnia and Herzegovina", No. 39/98 and 36/99),
- Law on the Registrar of Securities ("Official Gazette of the federation of Bosnia and Herzegovina", No. 39/98 and 36/99),
- Law on Fund Management Companies and Investment Funds ("Official Gazette of the federation of Bosnia and Herzegovina", No. 41/98, 36/99 and 36/00),
- Law on Business Companies ("Official Gazette of the federation of Bosnia and Herzegovina", No. 23/99 and 45/00).

- Information on the subjects who have a superior or dependant relation to the issuer or who are connected in the sense of Accounting Standard 28, and the information on the nature and scope of the participation in the relation;
- Statement on all the transactions between the connected parties in the sense of Accounting Standard 24, in the reporting period, or on a planned transaction or a series of transactions if their value exceeds 2.000 KM. If the transaction or a series of transactions have been done within the regular business operations of the company, under conditions available to the general public, only those transactions whose value exceeds 500.000 KM are included. For every transaction it is necessary to:
 - identify every involved person,
 - describe the nature of his interest in the transaction,
 - briefly state the conditions of the transaction,
 - identify the individual of the body that approved the transaction.
- The amount, the method of creating and the use of the reserve fund during the past three years.

2. Company objectives.

The annual report of a joint stock company should contain, among other things, a description of the history and the nature of the issuer's business operations. A general analysis of current events in the company's business operations and its plans for the future should be given in a separate chapter, including an overview of all major investments that are in progress, as well as a description of major geographical markets for the company's products (services), the importance of every market to the company's income and its competition in those markets, and the activity of the company in the field of research and development.

3. Major share ownership and voting rights.

One of basic rights of investors is to be informed about the ownership structure of the company and the participation of individual major shareholders in the total number of votes. Therefore, in the annual report on business operations of the company, all the persons that have a significant control over the company's policy must be named, including:

- persons who directly or indirectly have 5% or more votes in the company's assembly,
- other persons who have "control" or "significant influence" in the sense of Accounting Standard 24. This requires naming the individuals with essential or practical influence on decision-making, as well as identification of persons who act jointly with the intention to influence the issuer's policy.

4. Members of the board and key executives, and their remuneration

The company is obliged to provide in its annual report the data on the members of the Supervisory Board, the management, the Board of Auditors and their remuneration. For the members of the management and the Supervisory Board, the following should be stated:

- Age,
- Education,
- Present employment and employment during the previous three years,
- The person or the group of persons that suggested them for the position,
- Membership in supervisory boards of other companies,
- The total amount of remuneration in all forms during the reporting period and expected remuneration for the following financial year.

5. Material foreseeable risk factors.

It is logical that different business activities are accompanied by different types of risk, and, therefore, can be difficult to generalize. However, the minimum of data that needs to be disclosed by every business company in its annual report is the data from which conclusions on eventual risks can be drawn, such as:

- Existing or expected claims or disputes that are material to the financial status of the company.
- The data on:
 - the percentage of income from every buyer that participates with more than 10% in the total income of the company,
 - the percentage of liabilities for every supplier that participates with more than 10% in the total liabilities to suppliers,
 - the percentage of liabilities for every creditor that participates with more than 10% in the total credit commitments.
- Name all the licenses, patents, and other intellectual property on which the issuer's business operations depend.
- State every change higher than 10% in the assets, net profit or loss of the company stated in relation to the preceding period, together with the facts that influenced it.
- Explain all the transactions or series of transactions in the reporting period that represent 10% or more of the company's assets.
- If the company's liabilities relative to any security traded with in the public market are guaranteed in full or partially by another legal person, it is necessary to identify the security and the guarantor, and describe the guarantor's relation with the issuer.

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6. Material issues regarding employees and other stakeholders

A mandatory element of the annual report of a joint stock company is a commentary regarding employees, including their total number, inclusive of the employees of subsidiary companies, and a description of all important employment contracts or disputes arising from labor relations. It is particularly necessary to state the participation of employees' shares in the share capital of the company.

7. Governance structures and policies.

Application of this principle is represented by the company's obligations to provide a short description of its governance structure, including the number and a description of general meetings and the sessions of the Supervisory Board that have been held.

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

The Book of Regulations is based on high standards of disclosure of financial and non-financial information incorporated in:

- IOSCO objectives and principles,
- OECD standards and
- Accounting Standards of the Federation of Bosnia and Herzegovina³.

Mandatory elements of the annual report, the abbreviated annual report and the semi-annual report are an integral part of this Book of Regulations. They prescribe the mandatory form and the minimum contents and scope of information that have to be disclosed in every report.

C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Pursuant to the Book of Regulations, the financial reports as an integral part of the annual report on business operations, should be audited and signed by an independent auditor (a legal person licensed for auditing in accordance with the Law on Audit of the Federation of Bosnia and Herzegovina).

D. Channels for disseminating information should provide for fair, timely, and cost-efficient access to relevant information by users.

Channels for dissemination of information are almost as important as the content of the information itself. The Law on Securities prescribes that companies must publish the abbreviated annual report on business operations in at least one daily newspaper, and must deliver the complete report on business operations at the request of shareholders to their address, with the

³ The Accounting Standards of the Federation of Bosnia and Herzegovina are based on and harmonized with the international accounting standards adopted by IASC (International Accounting Standards Committee). In the Federation of Bosnia and Herzegovina the following standards are not yet in use:

- MRS 29 – Financial reporting in hyperinflation economy,
- MRS 39 – Financial instruments: admission and evaluation, and
- MRS 40 – investors' property.

It is probable that the Bureau of Accounting and Auditing of the Federation of Bosnia and Herzegovina will soon adopt and publish them.

actual costs of making and delivery of the report covered. In addition to that, the annual financial report, including the opinion of an independent auditor, must be made available at the company's notice board within seven days from the date of its adoption at the general meeting of shareholders.

A novelty in the Book of Regulations, which also represents a completely new practice in the Federation of Bosnia and Herzegovina, is electronic reporting, i.e. disclosing information in electronic format. Namely, the Commission has prescribed an obligation that certain information from the annual and semi-annual report is to be delivered to the Commission in the electronic format in special forms, so that it could make those reports available via its WEB site. So, the visitors of the Commission's WEB site: www.komvp.gov.ba will have an opportunity to quickly, simply and cheaply access the following information regarding the companies of their interest:

- Table A: General data on the company
- Table B: Income statement
- Table C: Balance sheet
- Table D: Statement of cash-flow
- Table E: Statement of shareholders capital
- Table F: Statement of changes in the shareholders capital
- Table G: Clarifications and the commentary by the management

Final points

The Commission has doubtless made significant progress in the transparency and publicity of the work of joint stock companies by passing the Book of Regulations, and created the legal basis for a wholly new approach for disclosing information on business operations. This approach is fully based on the best international practice and standards. However, for this concept to succeed, it is necessary to implement these rules and standards in practice. There will undoubtedly be great resistance to their implementation. There should be no illusion that habits created over decades will be easy to change. The past system left us the heirloom of the cult of keeping (hiding) information. Almost some kind of paranoia was created not to leak information, not to tell a business secret, a whole conspiracy theory was created with the aim of keeping information from the public. The management withheld from the public even the basic information on business operations, such as the total profit or income, or loss, not to mention more "delicate" information on governance structure etc.

Therefore, it will be necessary to act in concert, comprehensively and deliberately, on the promotion of the new principles. This spirit of cooperation applies to government bodies, the media, trade unions, civil associations and the general public. The Book of Regulations could be a powerful tool for shareholders and the public, a tool they can use to understand, and seek protection for, their rights. First, the shareholders and the public need to be aware of their rights and willing to use them. Without an active participation of at least prominent shareholders, timely and accurate and full disclosure have questionable practical use.