



# **2nd Meeting of the Eurasian Corporate Governance Roundtable**

Sheraton Metechi Palace Hotel  
Tbilisi, Georgia  
7-8 June 2001



## *Transparency and Disclosure*

### **NOTES TO THE AGENDA**

hosted by

**The National Securities Commission of Georgia  
The Georgian Stock Exchange  
International Regional Federation of Accountants and Auditors Eurasia**

with the support of



**The Government of Japan  
The Global Corporate Governance Forum**

## **Background**

The OECD and the World Bank Group have agreed to co-operate in efforts to improve corporate governance in emerging and transition economies. One important outcome of this agreement is the establishment of Regional Corporate Governance Roundtables, in which the OECD has taken the lead. Regional Roundtables have been created in Asia, Eurasia, Latin America and Russia. The OECD and the World Bank Group decided to launch the Eurasian Corporate Governance Roundtable in response to the growing awareness of the impact of corporate governance among public and private decision-makers in the economies of the former Soviet Union and to encourage improvement both in the regulatory domain and in private practices. The first meeting of the Eurasian Corporate Governance Roundtable took place in Kiev, Ukraine on 19-20 October 2000 and was hosted by the Ukrainian Cabinet of Ministers.

This first meeting yielded important insights into the corporate governance framework in the region and acknowledged that:

- While the countries of the region have specific identities and perspectives due to their geographical, cultural and economical potential, they also face common problems due to the Soviet legacy and need to share their experience to overcome these problems.
- The enforcement of good corporate governance practices in the region is closely linked with corporate restructuring efforts.
- From a policy perspective, adequate laws and regulations need to be adopted and enforced, by strengthening the institutional capacity of the judiciary and regulatory authorities.
- From a private perspective, business culture needs to be improved by raising awareness of how good corporate governance can be beneficial at the enterprise level. Business rules and ethics also need to be developed in order for an accountable and transparent corporate sector to emerge.

## **The Second Eurasian Corporate Governance meeting**

The Second Eurasian Corporate Governance Meeting will allow participants and policy-makers of the region to examine in depth an important aspect of corporate governance: transparency and disclosure on all matters regarding the corporation.

The main objectives of this meeting on transparency and disclosure will be to:

- Explore the role of disclosure and its contribution to improving both the domestic and foreign investment climate;
- Consider impediments to the implementation of better disclosure practices in the Eurasian context and contribute to improve the understanding of disclosure practices;
- Serve as a central vehicle in the process of identifying key areas for improvement in the regulatory domain and in private practice.

Invited Eurasian countries include Ukraine, Moldova, Kazakhstan, Uzbekistan, Kyrgyzstan, Georgia, Armenia, Azerbaijan and Mongolia. While these countries are at different stages of economic development, they all share the same past and are going through a difficult transition period. All participating countries are currently undertaking steps to reform their corporate governance regimes and their legal and institutional frameworks in order to achieve long-term economic growth. In the field of transparency and disclosure, efforts have especially been made to introduce international accounting and audit standards although implementation and enforcement of these standards remain critical issues.

## **Structure of the meeting**

The Second Roundtable meeting is divided into five broad areas. The first session's objective is to set the context of transparency and disclosure by stressing the importance of good disclosure in attracting investors, although the impediments and deterrents to disclosure remain strong in the Eurasian context. The second session will provide an empirical overview of the pace of reform in Eurasia in introducing international standards of disclosure. The third session will discuss relevant financial and non-financial information that needs to be disclosed whereas the fourth session will be devoted to analysing the liabilities and responsibilities of the board and other parties in monitoring and overseeing disclosure. Before discussing regional corporate governance initiatives in the region and future works, the roundtable will debate ways to enforce disclosure standards in the region.

## **Procedure of the meeting**

After a brief introduction by the chairperson, each session will include two 15-20 minute presentations, followed by 10 minute commentaries by designated discussants. The floor will then be opened to general discussion, in which all participants are encouraged to take part. One of the objectives of the Roundtable is to create an open and active dialogue in a collegial atmosphere between the public and the private sector, as well as between Eurasian countries and the international community.

All participants are invited to take part in the lunch sessions as well as the welcome diner-cocktail on the first evening of the meeting.

## **Annotations and issues for discussion**

This section to the agenda provides a guideline to facilitate discussion.

### **Session I**

#### **Transparency and disclosure: Setting the context**

Transparency and disclosure are pivotal issues for corporate governance. Corporate governance is a mechanism of interactions between corporate insiders and outsiders, and when the latter cannot conduct themselves appropriately without sufficient information on the affairs of the company, the corporate governance mechanism will not function properly. Full, accurate, and timely information is indispensable for good corporate governance. Good disclosure is a powerful tool for influencing companies, protecting shareholders, and attracting domestic and foreign investment. The lack of sufficient disclosure is perceived as an increased risk by outside investors and therefore leads either or both to increase capital costs for a company and to reduce investment in it. In contrast, the enforcement of effective disclosure will make corporate insiders more exposed to external pressure and thereby enhance the effectiveness of corporate governance mechanism on one hand, and could strengthen investor confidence and develop capital markets on the other hand. Transparency and disclosure can therefore change the way a business is managed, bringing with it accountability as an engine to drive improvements in efficiency and growth.

In Eurasian countries, disclosure of company information is generally weak. Management, often in alliance with controlling shareholders, has superior access to information and can manipulate the decision making process of the company to the disadvantage of minority shareholders. The lack of a transparency and disclosure culture, the costs and efforts to switch to a new reporting system, the burden of taxes and the pride in contravening state rules constitute major deterrents to fair disclosure and the enforcement of international disclosure standards. This has perpetuated some problems with the implementation of standards at the company level and jeopardised the confidence of investors. Honest disclosure and compliance with tax laws are still considered weaknesses and/or attributes of naïve mismanagement. Minority shareholders are often the first victims of the lack of disclosure as management often finds ways to keep secret details of transactions and other operations from minority shareholders that have not teamed up with them.

**Issues:**

*What has been the traditional view of disclosure and transparency in the countries of the region? Has there been increasing acceptance and use of disclosure as a tool for enhancing corporate governance and protecting investors? Is the management of Eurasian companies generally reluctant to disclose information? If so, what are the main reasons? How could good disclosure practices be promoted?*

**Session II**

**Introducing international standards of disclosure: The pace of reforms in Eurasia**

The information that is disclosed to users is only as good as the standards under which it is prepared and presented. The OECD Principles of Corporate Governance call for material and relevant information about the company to be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

There is general agreement that disclosure standards need to be of sufficiently high quality to fully inform the investment community regarding their investment decisions. Investors, in particular, tend to agree that the use of international standards that allow for meaningful comparisons between companies of different countries is desirable in order to have access to make informed decisions about the acquisition, ownership and sale of shares. The use of internationally recognised standards also helps to improve public understanding of the structure, activities and policies of enterprises. At this international level, accounting standards are increasingly moving towards harmonisation.

In the area of accounting, national standards setters are generally responsible for developing accounting standards. Standards are typically developed in close collaboration with private sector experts and the self-regulatory organisations of the accounting and audit professions. Standards that are under development tend to be submitted to broad public exposure and commentary before they come into force. Compliance with accepted accounting standards is then usually required by law for listed companies. Audit standards, on the other hand, are rarely legislated, although the right to practice as an auditor may be regulated in order to ensure the independence of the auditor. Disclosure rules and requirements for non-financial disclosure are typically set by securities regulators and stock exchanges.

The public and private sectors have complementary responsibilities with respect to standards setting. National standards setting bodies (in many countries, key regulatory organisations) usually determine accounting standards while the accounting profession and companies must apply standards when preparing financial statements.

Although the pace of reform is different among countries of the region, efforts are being made in the Eurasian region to bring accounting and audit standards in line with international standards. Some companies previously prepared IAS -consistent accounts but the conversion of joint stock companies and limited liability companies to new standards really began in 2000. Implementation and enforcement to date remain slow.

**Issues:**

*Why are better accounting standards needed? How have the regulators and accounting profession responded to the introduction of international standards? To what extent are international accounting and audit standards of relevance and value in the Eurasian context? Are the current accounting and audit standards in the Eurasian countries comparable to the internationally accepted ones? To what extent are they effectively implemented? What have some of the problems been in implementing improved standards? Are there still gaps in accounting standards and their implementation that need to be filled? How can the quality of standards be improved and maintained? What are the respective roles of the public and private sectors?*

### **Session III**

#### **Timely disclosure of material information**

A strong disclosure regime is indispensable for the effective governance of enterprises. Full, accurate, and timely information enables shareholders, creditors, and other stakeholders to effectively monitor a firm and its management, allows potential investors to gauge a company's prospects and compare different investment possibilities, and permit regulators and self-regulatory organisations to monitor compliance with applicable rules and regulations. It also helps to improve the public's understanding of the structure, activities and policies of enterprises. Channels for disseminating information should provide for fair, timely, and cost-efficient access to relevant information by users.

Good disclosure requires the provision of material information. Material information is information whose omission or misstatement could influence the economic decisions made by the users of information. The question regarding what to disclose is important both for companies, who may be concerned about the costs of complying with disclosure requirements, and regulators, who want to ensure that the information they demand is genuinely useful for meeting their regulatory objectives. Applying the concept of materiality in developing disclosure requirements helps companies and regulators to decide what information is truly relevant.

#### Financial disclosure

Financial information is the bedrock of a disclosure regime and financial results are the key indicators of enterprise performance. At the heart of a disclosure regime is proper accounting and auditing. Accounting is the basic language of business and financial reporting. It is the primary means by which information on company performance is communicated to market participants. For many investors, the quality of financial disclosure has the most important impact on their investment decision.

In order to improve their transparency, companies throughout the region will need to establish adequate financial reporting systems. Traditionally, companies exclusively reported to the State (i.e. the Tax Department). As of today, in many Eurasian countries the Ministry of Finance still requests companies to report in the traditional format which obliges companies to maintain a de facto double standard accounting system. Furthermore, securing qualified accountants and auditors in substantial numbers is crucial to the successful implementation of new reporting rules. The proper application of disclosure standards requires sufficient training and expertise of accountants, and the existence of institutional structures that improve and maintain the quality of the profession.

#### **Issues:**

*What kinds of improvements are being made to ensure better quality reporting at the company level? What have been the incentives in introducing such changes, if any, to reporting practices in companies? What has been their impact? Can better quality reporting reduce non-cash payment? What are the enduring/remaining obstacles?*

#### Non-financial disclosure

Given that not all information relevant to the company can be captured by financial statements, comprehensive disclosure must also include disclosure of material non-financial information. In fact, some of the issues that are covered by non-financial disclosure are fundamental to understanding the opportunities and risks of investing in an enterprise. In Eurasia, the importance of non-financial information is not yet fully appreciated and there is a marked reticence to disclose information that some consider private. The lack of transparency and non-financial disclosure deters especially foreign investors.

Non-financial disclosure in corporate groups is particularly relevant to understand ownership and control arrangements. Additional disclosure of ownership structures, voting rights, the identity of management and the board of directors, the remuneration of management, the frequency and timing of disclosure, and other relevant issues provides users with valuable information to assess a company's governance. All of these matters are important in the Eurasian context.

The increased transparency provided by a strong disclosure regime may also help to deter the expropriation of minority shareholders by controlling shareholders and reduce likelihood of managers (who may also be shareholders) engaging in transactions, such as trading on material, non-public information and improper related-party transactions, that are detrimental to the company and its shareholders.

**Issues:**

*To what extent are disclosures made regarding capital structures, major ownership of companies and voting rights? To what extent is information on boards provided, in particular, data on directors and key executives and their remuneration? Do companies disclose sufficient information on affiliated parties and risks? Are there further areas that require consideration such as disclosure of company environmental and ethical policies or policies regarding stakeholders? What are the expectations from investors? What specific type of information is poorly reported? To what degree do the existing disclosure channels provide users with timely, accurate and relevant information? What areas require improvement, especially from the perspective of foreign investors?*

**Session IV**

**Monitoring and overseeing disclosure**

*The role of the board in overseeing disclosure*

It is increasingly felt that companies themselves should ensure that the information they provide to market participants gives a true and fair view of the enterprise. In some countries, the board of directors is considered to have the overall responsibility for disclosure. Many investors look to the board to provide assurances that monitoring systems are in place, that they function correctly and that appropriate accounting, audit and disclosure standards are applied. In Eurasia, major investors admit that in order to have the best access to information, they systematically insist on having a seat on company boards. In the future, changes in board structures and procedures (i.e. the establishment of audit committees and/or reconsideration of the relationship between the board and the internal and external auditors) may be required in order for boards to better fulfil their obligations. Audit committees may, for example, be established to be responsible for selecting the external auditor, receiving and approving the report of the auditor and communicating the results to shareholders. They may also be responsible for alerting the executive of irregularities in systems of control.

**Issues:**

*Who has traditionally been responsible for overseeing disclosure? Do boards progressively have the responsibility for overseeing disclosure in companies or is this responsibility primarily in the hands of the executive? Are perceptions changing with regard to the board's responsibility in this area? If so, what changes have been put into effect? In particular, have there been changes in the relationship between the board and external auditors?*

*Independent external auditing: assurance for investors*

As stated in the OECD Principles, 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.

Whatever the nature of the information, its value can be enhanced by an independent audit that provides greater assurances regarding the truthfulness of the statements that are made to users of information. The conduct of an independent audit is, in turn, subject to the observance of standards designed to protect its quality.

The auditor plays an important role in verifying accounting information and in providing some level of assurance to the investment community regarding the veracity of financial information. Audit practices vary across the Eurasian region. As a consequence the quality of the assurance that investors receive also varies.

Policy makers may specify the need to apply specific standards and/or may specify rules for ensuring auditor independence. The profession itself is understood to have a responsibility towards the public interest in the conduct of the audit. One of the key objectives of this session is to explore the extent to which the statutory audit provides needed assurances and the ways to improve the level of confidence in financial statements in the Eurasian context where auditors are still in many cases directly or indirectly dependent on management.

**Issues:**

*What is the level of auditing in Eurasian countries? What kinds of audit standards exist and how are they applied? What rules exist to ensure the independence of the auditor and the auditor's ethical conduct? How do these rules work in practice? Who appoints the auditor? What kinds of improvements are being made both in standards and in their implementation? To what extent are international audit standards of relevance and value in the region? What has been the approach to regulating the audit profession? Have changes been introduced, why and to what effect? What should the role of the public sector be in encouraging high quality audits, and what is the role of the profession?*

**Session V**

**Enforcing disclosure standards**

Increasingly, regulatory and professional bodies or stock exchanges in the Eurasian region require high standards of disclosure. These institutions can also play an important role in monitoring compliance with disclosure standards and improving the channels for disclosure. In many countries, stock exchanges are actively seeking ways to create incentives for companies to improve disclosure through their listing requirements. Other organisations such as accounting and audit federations are also attempting to disseminate and facilitate access to information. Yet, even where high quality standards exist, their implementation may prove difficult in practice. Introducing better disclosure requirements is only the first step in ensuring better disclosure practices and a strong disclosure regime requires a complex set of interactions between regulators, self-regulatory organisations, companies, investors and other stakeholders, and the press. If one or more elements of the system are weak or absent, the effectiveness of the disclosure regime will be diminished. In the Eurasian region securities commissions and stock exchanges tend to promote good governance practices and have taken the lead in introducing international standards of disclosure. However, their influence remains limited as the markets are still in their infancy and as the incentive for being listed is essentially prestige and not access to capital.

While better disclosure practices will not emerge overnight, all jurisdictions should endeavour to build a strong disclosure regime, as it remains a fundamental tool for improving corporate governance. This session will help identify efficient enforcement and incentive mechanisms as well as ways to ensure public adherence to established disclosure rules.

**Issues:**

*What are the respective roles of the public and private sectors in enforcing disclosure standards? What are the respective roles of stock exchanges and self-regulatory bodies in improving disclosure of financial and non-financial information? Are securities commissions embracing disclosure based or merit based regimes? How can these private institutions help improve the channels for disseminating relevant information to users in a timely and cost-efficient manner? What have been the major trends in the use of regulatory tools in enforcing disclosure? From guidance to sanctions: what powers for securities commissions? What are the stringent sanctions attached to misleading or inaccurate reporting? What is the role of the accounting/audit profession in this respect? What are the major challenges for the improvement of disclosure practices?*