Corporate Governance in Eurasia:
A Comparative Overview

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FOREWORD

A good corporate governance framework and sound corporate practices are key prerequisites for companies and countries that wish to attract and retain the capital they need for investment and economic growth. Such frameworks and practices must be shown to be sustainable before positive results will be seen. This is true not only for developed countries but for transition economies too. Investors must have confidence in both the legal system and corporate governance practices if they are to put their money at risk.

In Eurasia, (including Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Ukraine and Uzbekistan), the legal framework and ownership structures are still evolving. This provides an important opportunity to develop good corporate governance and to change the present situation where foreign and domestic investors are often reluctant to invest.

This report provides an overview of corporate governance developments in Eurasia, and includes concrete recommendations on how governments, regulators and business associations can contribute to improved corporate governance in Eurasian countries. The recommendations call for implementing international standards for accounting and auditing, strengthening the capacity of regulators and the judiciary, ensuring the basic rights of shareholders, especially minority shareholders, increasing the capacity of board members, and having both banks and emerging institutional investors play a more constructive governance role.

The recommendations in this report flow from the Eurasian Corporate Governance Roundtable, which brings together senior policy-makers, regulators and representatives of business and civil society to support national strategies for improving the regulatory framework and corporate governance practices in the region.

The Eurasian Roundtable was established by the OECD in 2001 and is organised in co-operation with the World Bank Group and regional partners. I would like to express my sincere gratitude to all the participants in the Eurasian Roundtable and to the US Agency for International Development, the Japanese Government, the World Bank, the Global Corporate Governance Forum, the International Finance Corporation, the Canadian International Development Agency, and the Swiss State Secretariat for Economic Affairs for their valuable support. I look forward to continued co-operation and further achievements of the Roundtable as progress towards good corporate governance is pursued.

Yours sincerely,

Donald J. Johnston

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INTRODUCTION

After a decade of transition, most Eurasian countries have succeeded in introducing fundamental economic legislation and creating institutions that provide the basis for a market economy. Current efforts to improve corporate governance constitute an important aspect of the transition process, which could bring investor confidence and interest and more broadly, could significantly increase the prospects for sustainable economic growth in the region. It is therefore, important to maintain the momentum for reforms and put in place credible enforcement mechanisms.

The Eurasian Corporate Governance Roundtable was launched in 2000. Its main goal is to foster good corporate governance by providing a platform for sustained policy dialogue, involving public and private sector participants, labour union and civil society representatives, participants from professional associations, academics and other interested parties. Eurasian countries participating in the Roundtable include Armenia, Azerbaijan, Georgia, Moldova, Mongolia, Kazakhstan, Kyrgyzstan, Ukraine and Uzbekistan.

Roundtable meetings were carried out in co-operation with regional and national partners and hosts, who have extended invaluable support for their successful implementation. The Cabinet of Ministers of Ukraine co-hosted the first meeting of the Roundtable, which discussed the relevance of corporate governance to Eurasian economies and the main features of the corporate governance landscape in the region. The National Securities Commission of Georgia, the Georgian Stock Exchange and the Regional Federation of Accountants Eurasia supported the second Roundtable meeting, held in Tbilisi in 2001 to discuss transparency and disclosure. The third meeting, which examined shareholder rights and equitable treatment in Kyiv in 2002, was co-hosted by the Securities and Stock Market State Commission of Ukraine, the State Property Fund and the First Securities Trading System (PFTS). The Kyrgyz Centre for Corporate Development, the State Commission on Securities Markets and the Asian Development Bank co-hosted the fourth meeting of the Roundtable in Bishkek in 2003, which focused on boards of directors and stakeholders.

This paper is based on the outcomes of the discussions held in the framework of the Eurasian Roundtable. It also relies on presentations made by its members at the annual Roundtable meetings and on country papers analysing the respective corporate governance issues, prepared by Eurasian consultants. In addition, it draws on surveys[1] of *(i)* transparency and disclosure, *(ii)* shareholders rights and equitable treatment and *(iii)* boards and stakeholders in Eurasian countries. Outputs and research carried out in the framework of ongoing initiatives driven by local business and academic circles or international and bilateral donors, provided important factual and analytical support for this comparative overview.

This paper constitutes an outline and comparative analysis of the main elements of the corporate governance environment, framework and practices in the region. It also attempts to propose a set of

[1] They can be accessed on the OECD webpage, www.oecd.org/daf/corporate-affairs/, together with all papers and presentations discussed at the Roundtable meetings.

conclusions identifying main corporate governance reform priorities for the region. The substantive chapters of the paper correspond to the chapters of the OECD Corporate Governance Principles, which have been used as a benchmark in its preparation. In addition, the paper introduces the specific corporate governance issues of relevance to the transition economies of the region, while recognising that each jurisdiction needs to build on the existing systems, ownership structures and governance institutions. Naturally, while national conditions may determine how corporate governance aspirations should be fulfilled, these conditions do not excuse jurisdictions from not fulfilling them. Finally, tables comparing the legal framework of corporate governance in the countries of the region are proposed in an annex to the paper.

The paper will be distributed to key national policy-makers, securities regulators and representatives of stock exchanges, standard-setting bodies and relevant private sector institutions in Eurasia. It will also be submitted to multilateral organisations for consideration. Finally, the paper will be disseminated to the wide public and made available for consultation through the OECD corporate affairs website (www.oecd.org/daf/corporate-affairs/). It is our hope that the paper will serve as a useful tool for promoting and assisting progress in corporate governance in Eurasia, thereby helping to increase confidence and international credibility of related reforms.

CORPORATE GOVERNANCE REFORM PRIORITIES

Eurasian economies face a similar set of corporate governance policy challenges and key priority areas for reform. As discussed throughout this paper, the countries from the region have made considerable progress in the wide-scale legal and institutional reforms they have undertook over the last years, including in regard to corporate governance. Some of the foundations for establishing sound corporate governance systems in the region exist, however the magnitude of challenges ahead is still significant. Therefore, the objective of the national agencies with responsibility for the way in which corporations are governed – whether the Eurasian businesses themselves, the authorities which regulate them, or those who provide them with funds – should be to focus on key priorities for reform and encourage their firm implementation.

The priorities of reform discussed below need to be seen as objectives and the concrete measures to implement these priorities should be designed with special attention to national circumstances. The subsequent chapters of this paper offer guidance on implementation, which can be adapted to respond to current trends and challenges in the countries from the region.

Moreover, the governance framework also changes shape and develops through time. Therefore, future regional and sub-regional work in Eurasia would add value in focusing on the nature of changes in specific corporate governance areas and on how their direction may be influenced through policy design and implementation.

In assessing the strengths and weaknesses of Eurasian corporate governance today, it is recommended that top priority should be given to facilitating the emergence of a strong private sector with an effective ownership and control structure.

It is important for the authorities in Eurasia to focus on the development of a sound private sector complying with high corporate governance standards. It is in the interest of the countries to support and accelerate the emergence of a private sector with effective investors, capable of restructuring the enterprise sector and promoting sound corporate governance practices. This is critical for improving company performance and achieving sustained economic growth. A central element of such an effort is intensified privatisation, which includes a programme for improved corporate governance of large enterprises in which the state is likely to retain a stake in the foreseeable future. It is also important that public policy priorities are clearly defined in legislation and exercised via regulation rather than ownership.

Eurasian private sector development policies need to pay serious attention to corporate ownership structures, as they have a direct influence on the main corporate governance challenges Eurasian countries encounter. Large shareholders and related insiders are a prominent feature of ownership structures in the region. Moreover, ownership and control are likely to remain concentrated for the foreseeable future, together with the presence of a sizeable number of minority and individual shareholders that emerged as a result of the privatisation process. Improved corporate governance and continued capital market development will require transforming the ownership structures of many smaller joint stock companies. In order to facilitate ownership consolidation, regulation should provide for incentives for the controlling interests in listed companies to buy out dispersed shareholders through a fair and equitable process. The establishment of an independent authority to assist in consolidating claims may also constitute an element of such a process.

In the short and medium-term, pressure for restructuring and better corporate governance in Eurasia is likely to come from strategic investors with controlling or large blocks of shares. This is the case because of the still insufficient shareholder culture, underdeveloped markets for corporate control and illiquid equity markets prevailing in the countries of the region. Therefore, the role of large shareholders should not be underestimated. They are already an important aspect of the Eurasian corporate governance systems and need to become effective and law-abiding owners. Moreover, they can potentially counterbalance the weaknesses of the institutional and legal corporate governance framework and serve as a disciplining mechanism, provided adequate transparency and disclosure frameworks, and mechanisms for effective monitoring by minority shareholders are in place.

The authorities and the corporate sector in Eurasia should pay special attention to increasing transparency and disclosure.

The predominant role of controlling shareholders, including insiders in Eurasia, is associated with various risks. Improved transparency and disclosure are critical to prevent abuse and promote sound corporate governance, in the absence of developed corporate governance institutions. Moreover, it is recognised that this is one of the weakest areas of corporate governance in Eurasian jurisdictions. To this effect, the legislator and the regulators in Eurasia need to ensure that ownership structures are transparent. The corporate governance framework and practices should also guarantee transparency regarding major decisions and actions of managers and controlling investors. For such an approach to be effective, adequate legal means to eliminate self-dealing and to monitor controlling shareholders also need to be put in place.

Furthermore, convergence with international standards and practices for accounting, audit and non-financial disclosure should continue to be a top priority, especially regarding ownership and control in Eurasian companies. This is particularly important to increase the liquidity of shares and lower the cost of capital in order to attract additional investment, including foreign investment. The potential benefits are likely to outweigh the cost of greater transparency, including the costs incurred by fighting resistance from insiders.

Governments need to perform their duties in licensing and regulating the audit process and overseeing the accounting and audit profession in a more credible and efficient manner. The accounting and audit profession, its self-regulatory bodies, and the reporting companies also have an important role to play in improving transparency and disclosure.

The legislative effort in Eurasian jurisdictions should be matched by progress in its implementation and enforcement, as the credibility of the corporate governance framework depends on its enforceability.

Weak enforcement and, in general, weak rule of law in Eurasia are also part of the legacy of central planning and transition. Over the past ten years, most Eurasian jurisdictions have introduced or substantially amended their laws, regulations and other formal corporate governance normative acts. Sustained political commitment at the highest levels is needed for enforcement to be successful and in order to instil public confidence in reforms.

The credibility of enforcement in Eurasia will also depend on an enhanced mandate and capacities of the regulatory authorities, especially those of securities regulators. Experience in transition economies has shown that regulators are the main line of defence for shareholders. The capacity of the regulators should be significantly improved in terms of financial and human resources, including through adequate training. The criteria for selection and appointment of members of the regulatory bodies need to be based on professional merit and integrity. Moreover, national regulators must strengthen their role in ensuring that stock exchanges and other relevant self-regulatory bodies observe high ethical and professional standards. Conversely, remedies used by Eurasian regulators need to be extended, from mostly suspending trading and de-listing of company stocks, which hurt small investors, to increased recourse to civil remedies, such as fines. Where appropriate, the regulators should have the capacity to enforce sanctions without their decisions being subject to automatic appeal through the judicial system.

The judiciary constitutes the backbone of a strong enforcement system. The following areas require special focus in Eurasia: increasing the independence of the judiciary; enhancing the knowledge and capacity of judges in dealing with company, securities and bankruptcy law cases; and encouraging the specialisation of the judiciary. Conversely, judges have to receive adequate compensation to ensure that the individuals attracted by the profession possess the necessary education, experience and integrity. Moreover, court written opinions should be made public to increase awareness, facilitate interpretation of the law and enhance the accountability of the legal system.

Improved shareholder rights are an important prerequisite for the emergence of effective owners, capable to engage in corporate restructuring and development.

With effective ownership and strengthened shareholder rights, company management will have incentives to restructure the companies, improve operations, and look for profitable opportunities to take the company forward and attract investors. Until now, it has not been feasible for most Eurasian small shareholders to sell their shares to owners, who can effectively exercise their rights as shareholders. Conversely, large and controlling shareholders encounter numerous obstacles to the consolidation of their stakes and generally to their participation in the corporate governance process of the companies they own. Weak shareholder rights have been among the major impediments to the development of the market for corporate control in the region.

Therefore, the right to sell can be among the most powerful tools for the protection of shareholders who cannot be effective owners. This also requires facilitating the effective owner's ability, and sometimes, obligation to buy. To this effect, buy out procedures should be developed that can be initiated by the company or shareholders, during control transactions or when the fraction of shares held by minority investors falls below a certain threshold. Under these procedures, the controlling shareholder buy-outs of minority shareholders at a price set through a fair and independent appraisal of the share's value. These sorts of procedures may be the only way for minority shareholders to be able to sell their shares for a fair price in Eurasia's highly illiquid capital markets.

In addition to the framework for changes in control, basic shareholder rights in Eurasia and their enforcement require serious attention. The need for improving the provisions related to general shareholder meetings, including on convening and voting procedures are recognised as among the most important areas requiring action. The clarifications of provisions on share registration and payment of dividends are also urgent issues to address.

The legal framework in Eurasian countries does not make a distinction between the rights of the state as a shareholder and the rights of other shareholders. However, evidence shows that the state does not act as an efficient owner in Eurasia and the scope for improvement is vast. The state should behave as prescribed by the existing legal framework and state representatives should refrain from intervention in day-to-day operations of businesses and from practices, which may be detrimental to other investors, especially minority shareholders.

Another important priority in all Eurasian jurisdictions should be to strengthen the legal framework for minority shareholder protection and ensure its proper application and enforcement.

As discussed above, turning controlling shareholders into effective owners is important, but only provided adequate safeguards for minority shareholders are in place. In the absence of well functioning laws, managers with or without shares can effectively expropriate minority owners, who acquired their stakes by default through mass-privatisation or employee ownership schemes.

Important steps in this respect should include strengthening disclosure requirements of decision-making mechanisms and related party transactions, as well as forbidding self-dealing, and insider trading. Regulators should have the capacity to monitor compliance with such requirements and to impose sanctions for misconduct. The fiduciary duty of directors to act in the interest of the company and all its shareholders needs to be clarified and strengthened. Last but not least, shareholders who have suffered abuse of their rights and / or financial losses need to be provided with private and collective rights of action against controlling shareholders and directors.

In addition to the lack of an equity culture, the small stakes held by individual shareholders are another disincentive for them to play a greater role in corporate governance. Thus, educational and public awareness programmes need to be carried out in order to allow for a better understanding of corporate governance issues by the numerous individual shareholders of countries in Eurasia. The emerging institutional investors, including foreign should also be encouraged to formulate and publicise their ownership policies.

Boards of directors should improve their role in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders.

Present problems with the exploitation of minority shareholders in Eurasia have called into question the independence and diligence of the region's boards. To address this challenge, In Eurasian companies, the functions of the board are not clearly distinguished from that of management. Moreover, board members often lack independence from insiders or major shareholders. These shortcomings have led to persistent problems with the abuse of minority shareholders throughout the region.

In addressing these challenges, boards would benefit from special director training programmes. Adoption and promotion of voluntary codes of conduct provide another opportunity for improving Eurasian boards. Director standards need to also be tightened in terms of independence and by making directors liable for their actions, by imposing adequate sanctions, especially for violations of the duties of loyalty and care, as well as by prohibiting self-dealing. Adequate remuneration and increased resources and authority *vis-à-vis* management will enable directors to fulfil their functions. To this effect, improved access to information is critical.

The development of banks and their role in imposing financial discipline and efficiently allocating capital should be given special attention. More concretely, governments should intensify their efforts to improve the regulation and corporate governance of banks.

Eurasian corporations rely much more on internally generated funds and on banks than they do on capital markets. In the short-term, debt financing is likely to prevail as a source of external finance in Eurasia. When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth. However, an important feature of the financial development in Eurasian countries is the weakness of the banking sector, which sustains soft budget constraint for enterprises. On the other hand, the existence of a great number of large formerly state-owned enterprises has prompted governments, on many occasions, to refinance loss-making entities. Evidence shows that creditor protection is critical in improving financial discipline and in promoting sound lending practices. Therefore, national insolvency systems must develop in order to provide effective protection and enforcement of creditors' rights as well as to ensure efficient liquidation of debtors, which cannot be expeditiously re-structured into commercially viable enterprises.

In addition, low lending levels, unusually high collateral and high real interest rates are the norm for most countries from the region. Instead of simply monitoring compliance with prudential rules and avoiding risks, Eurasian banks should shift to more pro-active credit risk policies and management. Moreover, banks have a responsibility for the effectiveness and integrity with which the enterprises they are financing are being directed and controlled. As a result, bank credits should flow to companies with high corporate governance standards.

On the other hand, weak governance of banks reverberates throughout the economy with negative ramifications for economic development. Legal, regulatory, and supervisory policies, which ensure sound bank governance need to be put in place throughout the region. Special attention needs also to be paid to the ability and incentives of bank shareholders to exert governance over banks, while not engaging in abusive related lending.

More liquid and vibrant capital markets can have a strong positive impact on corporate governance. Appropriate policies need to be developed and put in place in order to support the development of national stock exchanges

Eurasian markets do not yet perform the key functions of providing an alternative to bank funds for debt and equity finance to the private sector and of offering a secondary market in ownership. Stock exchanges in the region remain underdeveloped, with low capitalisation and liquidity levels. They have been created as privatisation devices and still remain largely secondary markets dedicated to this function.

The introduction of modern technological advancements and sound legal frameworks is only one step in the development of sound capital markets. More needs to be done in order to transform the local exchanges into vibrant markets. The implementation of the existing legal framework by the stock exchanges and strengthened supervisory authorities is key in this respect. Moreover, based on the positive experience in OECD countries, specific policies need to be designed in order to effectively use privatisation and private sector development to accelerate the emergence of sound capital markets.

Governments should also actively facilitate the development of the institutional sector in Eurasian capital markets: pension funds (as part of the reform of the public pension system), insurance companies (including in health insurance) and investment funds. It may also be explored, where appropriate, to transform privatisation investment funds into unit funds or similar type of collective investment institutions. It is key, in this process, to ensure that an effective regulatory and supervisory framework and good governance mechanisms are in place for all these types of investment vehicles.

Information and awareness campaigns for individual investors and adequate incentive schemes can be helpful in increasing the retail base of capital markets. Finally, regional and international co-operation may be beneficial as it can provide possibilities for dual listings, as well as direct links between the exchanges to their respective databases and common trading platforms. Most importantly, such co-operation or consolidation may lead to harmonisation of rules and regulations and to the reduction of costs of cross-boarder trading.

Corporate governance reforms in Eurasia are a serious policy challenge. They require political will, long-term focus, resources and determination to overcome serious resistance from vested interest groups. To lay the foundations for their success, it is also important to ensure competition and pressure from suppliers, customers and creditors, as constituencies for better corporate governance. A strong emphasis should also be put on the direct commitment of the private sector to improve corporate governance practices and to develop a series of initiatives that enhance corporate governance culture and standards. Moreover, adherence to and implementation of widely recognised principles, including the OECD Corporate Governance Principles, is an important basis for the private sector as well as for policy development and implementation. It also sends a strong signal about the commitment of governments and corporations to reform.

CORPORATE GOVERNANCE AND ITS RELEVANCE TO EURASIAN TRANSITION COUNTRIES

This chapter will examine the relevance of corporate governance to transition countries. It will discuss corporate governance as a public policy and private sector concern and its importance for institution building, for the efficient allocation of capital and for the promotion of foreign investment in Eurasia.

1. Corporate governance from policy and private sector perspectives

Corporate governance reform is driven by a multitude of public and private efforts, from the adoption of legislation in the parliament and its implementation by the courts, to regulatory action, professional codes and requirements, as well as individual company policies. While good corporate governance cannot exist without an adequate level of public governance, it will never materialise unless the private sphere of the economy and its main players, the companies, become transparent, law–abiding corporate citizens. Awareness of this mutual interdependence is key for the success of any reform effort.

In OECD economies, building good corporate governance has been an integral part of the development of a sound private sector as a basis for economic growth. Policymakers and regulators play an important role in shaping corporate governance practices as they design the legal and regulatory framework in which individual companies operate. Furthermore, the institutionalisation and internationalisation of equity ownership provides new investment and financing opportunities for companies. However, for countries to reap the full benefits of these opportunities, governance arrangements must be credible and well-understood across borders.

In transition economies, corporate governance is part of the larger economic and social development processes. It contributes to the establishment of the rule of law and of well-functioning institutions in a market economy. Effective corporate governance mechanisms, starting from introducing the basic legislation for corporations to well-established corporate governance institutions and agents in the transition context are dependent on the overall approach to reforms and their implementation. As in OECD countries, the development of good corporate governance practices in transition economies needs appropriate public policy and adequate legal and regulatory framework. In most Eurasian countries such a framework is yet to be defined. For example, important parts of the legal framework underpinning corporate governance is not yet sufficiently developed or is constantly evolving, creating significant inconsistencies and uncertainties. In other countries, legal frameworks are quite advanced, however their enforcement remains weak.

Corporate governance arrangements and practices are important pre-requisites for the mobilisation of capital. It is critical to establish credible and enforceable provisions for property protection, secure methods of ownership registration and the opportunity to obtain effective legal redress. Moreover, reliable and transparent accounts are essential for making informed decisions about the allocation of financial resources among alternative uses. Proper procedures for internal corporate decision-making, the distribution of authority among company organs, proper incentives and established lines of accountability are important for effective monitoring. However, without strong institutions that can uphold the rule of law, companies, whether domestic or foreign, will have trouble with enforcing contracts, collecting debts, and resolving disputes.

While policymakers and regulators are responsible for the establishment of an adequate legal and regulatory framework, it is the business community that actually develops effective corporate governance practices. In a broad sense, the function of corporate governance is to co-ordinate the various interests of different constituencies related to a corporation. In Eurasian countries the corporate sector has still little experience in operating within a market economy and its often inadequate corporate governance practices have emerged as a serious obstacle to domestic and foreign investment (see table 7). Investment needs are being financed by corporations retained earnings and sustained government subsidies, as well as through accrued debts, which has increased overdue payables and receivables in the economy as a whole. Thus, except for a limited number of companies in the energy and telecommunication sectors, investment is scarce for enterprises in the region.

To fulfil their transition and economic development objectives, countries of the region need a greater access to domestic and international capital, both as a portfolio and direct investment. In the context of more integrated and global financial markets, establishing good corporate governance is essential in the competition for foreign capital. This is especially important for Eurasian transition economies where domestic savings remain relatively limited. Moreover, the developing regulatory and institutional infrastructure in the region makes corporate governance at the company level often the most important factor in establishing investor's confidence. Companies that adopt high governance standards on their own are better suited to attract investors even in a difficult context. Thus, in addition to government initiatives, private sector action for the emergence of good governance is of particular importance. For private sector action to take place, awareness of the importance of good corporate governance for the growth of the businesses needs to be enhanced through targeted information campaigns and education programmes.

Corporate Governance and Institution Building in a Market Economy

Without good corporate governance the corporations cannot function with maximum efficiency, both in terms of private and social welfare. This important tenet was often forgotten when transitional privatisation policies were being designed. Corporate governance was assumed to appear automatically, as a direct result of ownership transformation. In fact, experience in transition economies shows that privatisation is far from sufficient to ensure the development of a robust corporate sector. A key reason why transition countries have not been very successful in corporate restructuring is the lack of proper corporate governance. Companies cannot function efficiently without adequate governance rules and institutions to enforce them; and without building private capacity to support and develop a corporate governance culture among directors, managers, shareholders and stakeholders. In transition economies, the development of good corporate governance practices is not only about enhancing the efficiency of equity markets or "fine-tuning" corporate decision making processes; it is equally about creating the key institutions that will drive successful economic transformation to a market based economy, the private corporation.

In order to have good corporate governance, all related agents, in particular managers, board members and shareholders, need to recognise and perform their roles appropriately. Such a cultural shift takes time and it is not yet evident in most transition economies. Mass privatisation has created a number of private shareholders, who have not yet realised the role, rights and responsibilities they are expected to assume as corporate owners. Conversely, corporate managers do not seem to fully understand their role as the agents for shareholders and on many occasions seek personal benefits at the expense of shareholders, and often of the company as a whole. Change in this context will take time and will require an effective mix of structural incentives. In many cases, it will boil down to recognising that increasing the longer term value of the company is better than diverting its assets for a personal benefit.

On the other hand, the legal and regulatory framework for corporate governance in transition countries is still developing. Improving its coherence and enforceability is probably the most urgent current task of policy makers. All Eurasian countries have already enacted a company law that is the core of the corporate framework. However, in many cases, the law does not provide a sufficiently clear and complete set of rules and is not well implemented, due to the lack of a proper enforcement mechanism. Moreover, while company law is a key for the corporate governance framework, other laws and regulatory rules also have significant influence in shaping corporate behaviour. They include insolvency legislation and securities regulation, which have yet to be effectively implemented in the countries of the region.

From another perspective, corporate governance relies on the selection of corporate managers under a market mechanism. In an adequate corporate environment qualified managers can reward capital providers sufficiently and thus attract more investment to develop their business; while unqualified ones should face difficulties in raising funds for their operations and lose their businesses. This market-based selection of corporate managers is a central feature of a healthy institutional set-up. By ensuring managerial competence, it fuels the development of a robust corporate sector and hence, of the economy as a whole. This aspect of corporate governance is still largely missing in transition economies.

Finally, it should be pointed out that the improvement of corporate governance should have an important spill over effect on society as a whole. Unaccountable and opaque corporations are more than likely to undermine the rule of law and the effectiveness of government, creating and sustaining a vicious circle of corruption, bribery and mismanagement not only in the private sector but also in the public sector. The development of good corporate governance can be seen as key public institution-building ingredient for a transparent and accountable society.

Efficient allocation of capital

Corporate governance is closely related to corporate finance and investment. Under central planning, corporations depended entirely on the government for their investment needs. In contrast, in a market economy, they have to raise funds from the public directly or indirectly through financial institutions and/or generate enough earnings to fund their own development. The public and the financial institutions provide their money to corporations in expectation of sufficient financial returns. In seeking maximum returns, fund providers try to discipline corporate managers to work for their interests.

Good corporate governance is key for the development of equity markets in developing and transition countries, as for all other economies. In order to attract investors, traded shares need to generate sufficient financial returns. Conversely, if the value of shares cannot be evaluated appropriately due to unaccountable and opaque management of a corporation, it is also difficult to expect active trading of such shares. In other words, if a sufficient number of companies, run in a transparent fashion by accountable managers, provide reasonable returns, equity markets will grow and the corporate sector in its entirety will benefit from a lower cost of capital. In the opposite scenario, an overall market impression of "bad governance" will impose higher costs on the few good corporations and will drive them out of the market in search of other (usually foreign) listings. This is the so-called "adverse selection" effect.

Good corporate governance is also important for the sound development of the banking sector. Banks channel public savings to the corporate sector. If banks are not in a position to assess the viability of debtor companies, they risk to accumulate non-performing loans and be forced into direct or indirect re-nationalisation in order to avoid systemic risk. Another common "disease" of the banking sector in unstable transition environments is banking capture by corporations. This capture often occurs with the help of the government, pointing to the importance of another aspect of governance, the governance of banks.

The establishment of proper corporate governance is especially important to transition economies for the efficient allocation of capital. In these economies, domestic savings are scarce and should be used most efficiently for the development of the economy. This means that the financial resources need to be allocated to the most profitable companies with the highest growth potential. This cannot be achieved if the fund providers cannot get adequate information and cannot ensure adequate monitoring through corporate governance mechanisms. Hence, corporate governance directly impacts on the efficient allocation of scarce savings.

A rules-based corporate governance mechanism is crucial for transition economies, because market imperfections and failures that hinder direct capital and product market disciplines are not expected to work effectively. These disciplines will thus not be sufficient to police corporate managers. In advanced market economies, when shareholders are not satisfied with the performance of a company, they may shift their investments by selling shares in the market, which decreases the share's price. The company would subsequently have difficulties in raising funds either by issuing new shares or corporate bonds due to the eventual downgrading of its rating. Banks would, in principle, be less willing to provide loans to such a company. The managers could also encounter the real threat of take-over as the share price goes down. In developing and transition countries, this mechanism of market discipline hardly works because of insufficiently developed securities markets and banking sectors. Take-overs may be possible but are still hard to carry out when no organised markets exist and no reliable corporate information is available. Therefore, in order to ensure efficient management of corporations in those countries, direct rules that create a governance mechanism through which shareholders and sometimes also creditors can discipline corporate managers are required.

Overall, the policy makers' effort in this area should be to promote the emergence of a virtuous cycle. Good corporate governance is an important factor in the establishment of a well-functioning financial market which leads to the efficient allocation of financial resources, and is key for economic growth. In its turn, an efficient financial market should promote better practices in corporate governance by increasing market discipline on corporate management

Promotion of Foreign Investment

In the last few decades, international financial markets have dramatically changed. One of the prominent changes is their globalisation. Vast amounts of capital are now transferred from one country to another on a daily basis. The number of investment funds and other asset management vehicles is increasing throughout the world, and their role in corporate governance of firms is consequently becoming more important[2]. They are looking for a spread of risk and reward and in making their investment decisions, standards of corporate governance have a measurable part to play.

[2] Stijn Claessens, *Corporate Governance and Development,* World Bank – OECD Global Corporate Governance Forum, Washington D.C., 2003. It is worth noting that the role of institutional investors in corporate

The globalisation of capital markets has an impact on emerging economies. Although recent financial crises have highlighted the risks brought about by global markets, it remains true that foreign investment played a role in the remarkable economic growth in some of these economies before the crisis. Foreign capital is particularly important for emerging and transition economies, because of the relative scarcity of domestic savings. Conversely, the establishment of proper corporate governance has become increasingly important in this context, as the growing foreign investment trend is largely irreversible, because excessive savings in advanced market countries seek new investment opportunities in developing countries that lack sufficient domestic savings.

Conversely, corporate governance is particularly important to large-scale institutional investors, as many of them, especially pension funds and life insurance companies, have a long-term investment perspective to match the long maturities of their liabilities. Instead of voting with their feet whenever returns do not match expectations, such investors thus focus on good corporate governance and in particular transparency and proper protection of minority shareholders to ensure sufficient long-term value growth. In order to attract these long-term foreign investors, it is of urgent necessity for transition economies to establish good corporate governance.

Foreign direct investment (FDI) is another important facilitator of rapid transition to a market economy. It does not only consist of a transfer of funds but also of skills, market access, technology and know-how. Indeed, direct investors assume control in order to function without external constraints. In practice, however, they are quite concerned about the corporate governance framework. As most of them function under transparency and accountability standards set globally, they might find themselves severely disadvantaged in an environment where local companies can externalise these costs through corruption, hidden subsidies and opacity. Direct investors need a sound company law framework as much as portfolio investors as they will often have to deal with minority shareholders and creditors in environments lacking in rule of law. In transition economies, one is not surprised to find direct investors having the state, local government or voucher recipients in the capital of the companies they control. If the corporate governance rules are not clear, these situations can create (and have in the past created) serious constraints and uncertainties.

2. Corporate Governance: the Eurasian landscape

Reflecting different social, political, economic and legal legacy, corporate governance patterns vary among countries from the region. In Eurasia as in other transition countries, economic reforms were widely expected to lead to substantial reallocation of resources, rectifying the distortions inherited from central planning and underpinning sustainable recovery. However, even though market reforms have been going on since the beginning of the 1990's in the region, there is still little restructuring and a persistent lack of investment in the corporate sector. This section will analyse some important features of the Eurasian economic environment, and their implications for corporate behaviour and governance.

The Eurasian Transition to a Market Economy

Eurasian countries experienced an economic shock following the break-up of the former Soviet Union, and the adjustment of transition from central planning to a market economy. They initially faced major macroeconomic instability and sharp decline in GDP, with recovery and growth resuming,

governance is complex and in some countries, they play a less prominent role in corporate governance as it is considered to bear a fiduciary risk.

for most of them, in the second half of the 1990s. However, the history of persistent macroeconomic instability, high inflation and inconsistent fiscal and monetary policies has undermined confidence in the economy. The difficulties of operating in an uncertain environment shorten business horizons and negatively affect the private sector. Exchange rate depreciation and volatility, as well as occasional backtracking in trade liberalisation in Central Asia have increased uncertainty for many enterprises in the region. Moreover, while economic growth has resumed throughout the region, poverty and increased inequality remain a serious problem.

Market oriented reforms in Eurasia were limited and have shown mixed results. Consequently, Eurasian countries lag behind leading reformers from Central Europe and the Baltic countries. Since the mid-1990s, economic reforms have progressed more rapidly, although with significant variations across countries. Market institution and capacity building advanced slowly throughout the region and fundamental weaknesses remain in many areas, especially in the regulatory and judicial systems, and control of corruption. At the same time, progress with the creation of democratic institutions has been limited.

Important incentive distortions have their origins in the tax system. In this respect some Eurasian countries introduced comprehensive tax legislation, although enforcement is still sometimes arbitrary. In contrast, other countries still maintain fiscal policies that result in punitive effective tax rates for enterprises. This creates incentives for managers to adopt double book keeping and divert assets from companies.

Weak competitive pressures have caused companies to remain inflexible to developments in output markets. The pervasive presence of the state in the economy continues in many countries through extensive direct and indirect subsidies. Extensive licensing requirements also hamper the development of competition; in some countries of the region, companies are reportedly required to obtain up to 100 licenses to carry out their activities. It is not sufficient to transform state-owned enterprises into shareholding companies and transfer them into private hands, while on many occasions business decisions to set prices, output, and investment are not based on market criteria, nor within the purview of business. In such an environment, managers are free to pursue their own objectives with little regard for the firm's overall efficiency and profitability.

Exposure to bank lending of Eurasian corporations is low and many enterprises are known to run up significant levels of wage, inter-enterprise and bank indebtedness. This is a common future for the transition period, however, it was addressed at a faster pace by most Central and South Eastern economies. Continuing arrears in Eurasia make the imposition of discipline in external payments more complicated, with a potential for illiquidity to contaminate a great part of the corporate sector. At the same time it renders the latter more opaque: the real situation of individual enterprises becomes more difficult to assess.

Insolvency systems have not been effective in Eurasia, neither as a disciplinary mechanism, nor as a mechanism to re-allocate resources. Liquidation of enterprises has been postponed for many years. As it can be seen from table 8, the corresponding transition indicators show that progress in this area has been even more modest than with privatisation. In some cases, the bankruptcy legislation, did not apply to state companies and remained vague in many respects, such as for example financial restructuring during bankruptcy. Thus, many cases flooded the court system, however only a limited number of proceedings were initiated and led to concrete results for the debtor company. Other countries in the region have been dotted with relatively advanced insolvency legislation, which has, however, remained largely non-enforced.

The development of the private sector is essential for sustaining market oriented reforms and economic development, in general. The private sector's share of GDP varies significantly among countries starting from 45 and reaching 70 per cent, and is generally lower than in the Central European transition economies. The private sector share in industrial production is even more limited. The state owns or effectively controls major utilities, and many of the largest firms. This contrasts quite sharply with the Central European transition economies, the three Baltic States, as well as Russia.

Privatisation is only one pillar of the reform package, which should be in place in order to develop the real sector. All countries had to confront the challenges of introducing and protecting competition, and imposing market discipline, in order to provide enterprises with incentives to restructure and compete in the post-COMECON world. However, following privatisation to insiders and the lack of subsequent investment, a large proportion of Eurasian enterprises remains un-restructured and thus, prospects for growth are seriously hampered. Moreover, reformers had difficulties in promoting the creation of new enterprises, while at the same time removing barriers to entry and gradually decreasing sources of soft financing.

The emergence of a vibrant enterprise sector, able to release resources and undertake new investment should remain a central priority for Eurasian economies. To achieve this, legal and regulatory institutions for corporate governance need to be developed and the contribution of the private sector to the economy should further increase by accelerating privatisation and promoting small and medium sized enterprise creation and development. Last but not least, management and governance of assets, which will remain in state hands in the foreseeable future needs also to be improved.

Slow and Ineffective Privatisation

With the beginning of market-oriented reforms in many transition economies, privatising inefficient state-owned companies became the symbol of change. Privatisation seemed to promise an end to the inefficiencies of central, to free resources and lift living standards. The transformation that occurred in most Eurasian countries was unprecedented as it changed their economies from an almost 100 per cent state-ownership to predominantly private ownership. However, privatisation has produced much more limited results as a driver of restructuring as initially expected, mainly due to a pervasive set of negative incentives driving corporate behaviour. Moreover, while small and medium-sized enterprises have almost all been privatised**,** a high proportion of economic activity still remains in state hands, in most Eurasian countries. Generally, throughout the region, privatisation resulted in insider ownership and domination, resistance to external investors, and weak protection for minority shareholders.

Eurasian countries have adopted a wide variety of privatisation methods. However, privatisation was approached with a main focus on equitable distribution of property by implementing programmes based on mass privatisation or management / employee schemes (see box 1). The simplicity and distributional fairness of voucher privatisation makes it politically and administratively quite attractive. However, the resulting dispersed ownership structure leads to weak corporate governance pressure from shareholders and delayed restructuring, leaving control in the hands of loosely monitored incumbent managers.

These problems have been partly addressed by pooling vouchers in investment or mutual funds, established during the mass privatisation process in order to collect privatisation certificates from citizens. In many countries the mass privatisation programme created many hundred thousands of shareholders, a proportion of which are shareholders of investment funds. In practice, voucher funds have not lived up to their assigned role as corporate governance principals. They were often captured by managers or other politically well connected parties. In some cases, they co-operated with insiders to strip assets off companies.

Box 1. The Legacy of Mass Privatisation

In less then a decade, wide-scale privatisation in Eurasian economies has reduced the state's share of output from almost 100% to less than 50%. While privatisation is not as advanced as in some other transition economies—many countries in Eurasia have 40% of GDP produced by the state controlled sector versus 20% in Hungary and the Czech Republic—this nonetheless represents a monumental achievement after 70 years of central planning.

There has been another consequence of privatisation: the creation of a very large number of open joint stock companies (See Table 1). This is due to *mass privatisation*, where enterprises were converted to joint stock companies, then distributed to the employees and managers of these companies, to the public at large through a voucher scheme, or some combination or variation thereof. The result is that large fractions of the adult populations in these countries are shareholders, and that each of these companies may have thousands of dispersed owners. While authorities generally only privatised the largest 2% or so of enterprises in this way, the resulting number of companies with a relatively high numbers of shareholders is large by any standard.

In Eurasia, shareholders in the great majority of these unlisted, open companies are essentially stranded, with no way out of their shares, and in many cases no real rights as owners. One response has been to create active secondary markets to facilitate the consolidation of shareholdings. In Mongolia for example, privatisation was conducted through the stock exchange, and nearly five hundred companies became "listed". The Mongolian Stock Exchange has allowed dozens of companies to be taken private successfully. In many Eurasian countries, active over the counter markets have generated liquidity and allowed ownership consolidation in a number of companies.

Yet no more than 200-300 stocks will make up the typical active over the counter market, and sometimes significantly less. Thousands of companies privatised through mass privatisation remain widely held, and their stocks are not traded on or off the stock market. It is recognised that these companies need to be taken private, but in a way that does not harm their minority shareholders, who normally own most of these companies' equity. In addition, Roundtable participants also pointed out that many of these companies are effectively insolvent--whether due to insider machinations or the great changes in the economy during the transition--and that this is an issue of creditor rights, not shareholder rights. However, some of these companies do retain value, and taking them private while providing minority shareholders with some compensation remains a significant challenge.

Table 1. The impact of privatisation in Eurasia

Country	Traded companies meeting listing requirements*	Companies with dispersed owners (Estimate)
Armenia	18	1,156
Azerbaijan	48	3,400
Georgia	2	1,500
Kazakhstan	14	1,500+
Kyrgyz Republic	63	1,212
Moldova	13	985
Mongolia	20	400
Ukraine	72	9,000+
Uzbekistan	6	1268

Source: OECD Estimates *Listed on the main exchange, meet minimum listing requirements, and have had some trading in their shares, generally at least once a month.

The powerful position of managers, in the region as in Russia, gives to management/employee schemes the twin advantages of feasibility and political popularity. Nevertheless, experience shows that a large scale sell-off to insiders creates important obstacles to corporate restructuring, as insiders are unwilling to meet the conditions for attracting external finance, especially through better corporate governance.

Only recently the countries from the region have made consistent efforts to implement trade sale methods and attract foreign investors to some of their biggest enterprises. The countries which have introduced such methods earlier have, as a result, benefited from more substantial foreign investment and show a more concentrated ownership structures. However trade sales lacked transparency and many large companies were not brought to the market in a competitive and open fashion. On the other hand, trade sales of larger firms were rather slow, while the companies remaining in state hands suffered rampant and bureaucratic interference in their management.

At the same time, asset consolidation underway in Eurasia develops often in grey markets. Managers with small minority ownership stakes in newly privatised firms or with the power to shift shares in state-owned firms try to gain greater control over company assets and shift them to new more closely held firms. In this regard, the nascent capital markets of the region are not used to raise funds, but much more to swap shares and redefine corporate ownership (see Box 1). This happens in insufficiently transparent and occasionally illegal ways. Moreover, in the presence of illiquid markets in the region, changes in ownership structures are difficult to occur. This is why, reliance on outside, mostly foreign investors is critical for revitalising the enterprise sector.

As experience elsewhere has shown, foreign investors can potentially contribute a lot in bringing additional financing, know-how and restructuring to the corporate sector. However, the privatisation methods implemented in Eurasia were not conducive to foreign investment, neither were the resulting ownership structures with ownership dominated by insiders unwilling to release control. Potential foreign investors often complained from being prevented to participate in the bids. Not surprisingly, foreign participation in privatisation as well as *de novo* foreign direct and portfolio investment to the region has been limited compared to other transition economies and has concentrated in resource rich countries.

Ownership structures resulting from privatisation

Shifts in corporate ownership and control structures, since reforms started in the Eurasian region, have been radical. As discussed above, managers have, at the first stages of privatisation, often acquired ownership of their companies through mass privatisation programmes that required little cash payments but good connections and buy-out techniques. Conversely, mass privatisation has led to extremely dispersed ownership.

Significant ownership by insiders, residual state ownership and the emergence of various forms of institutional investors are currently common characteristics of the ownership structures that have emerged from privatisation in Eurasia. Ownership structures in the region have been evolving and differences appear following differences in their approaches to privatisation. While some countries have relatively recently tried to shift exclusively to cash-based sales, after years of mass privatisation, other countries have introduced such an approach earlier (e.g. Kazakhstan). As a result, corporate ownership is more dispersed in the first group of countries, while more concentrated in countries where the privatisation method of trade sales led to more significant ownership by strategic investors.

The trend towards ownership concentration is a logical reaction to the initial excessive ownership dispersion and more fundamentally, to the great difficulty for minority shareholders to defend their rights. Parallel to this trend, many countries are experiencing the need to provide a framework and incentives for small and medium-sized companies to de-list. Indeed, it is not effective for these companies to bear the cost and burden of listing requirements and sophisticated mechanisms for shareholder right protection in order to access additional financing.

Box 2. Financial Markets and Development

While economists have debated for decades on whether financial development is a driver of economic growth, or responds passively to the demands of industry, there is now substantial evidence that the financial system does play a significant role in the development process[1]. Financial development is a good predictor of economic growth and investment, with more developed financial systems channeling resources to faster growing sectors and away from declining ones[2]. In turn, there is a strong link between financial development and corporate governance, in particular both shareholder and creditor protection. Both broad legal indicators as well as narrower measures of minority shareholder protection and disclosure are strongly correlated with measures of financial, and specifically equity and credit market, development[3]. This link is not surprising. Investors that face the potential for being misled and expropriated will keep their money to themselves, and the financial system will suffer.

Two measures of financial development are given in Table 2, market capitalisation relative to GDP, a measure of equity market development, and credit to the commercial sector, also as a portion of GDP. By both scores, Eurasia countries lag behind other emerging market economies with similar levels of per capita GDP, but are comparable to other transition economies. The low level of financial development implied by these figures indicates that economic performance will remain below potential in the region. However successful corporate governance reform, by credibly increasing investor confidence and encouraging the development of the financial system, could play an important role in enhancing economic growth and development in Eurasia over the years to come.

1. Ross Levine "Financial Development and Economic Growth: Views and Agendas", *Journal of Economic Literature*, Vol. 35, pp. 688-726 (1997).

2. Raghuram G Rajan and Luigi Zingales "Financial Dependence and Growth", *American Economic Review,* Volume 88, Issue 3, pp. 559-568 (1998), Jeffrey Wurgler "Financial Markets and the Allocation of Capital", *Journal of Financial Markets,* Volume 58, pp. 187-214 (2000)

3. *ibid,* Rafael LaPorta, Florencio Lopez De-Silanes, Andrei Shleifer, and Robert W. Vishny "Legal Determinants of External Finance" *The Journal of Finance*, Volume 52, Issue 3, pp. 1131-1150 (1997), Ross Levine, Norman LFoayza, and Thorsten Beck "Financial Intermediation and Growth", *Journal of Monetary Economics,* Volume 46, pp. 31-77 Katharina Pistor, Martin Raiser, and Stanislaw Gelfer "Law and Finance in Transition", *Economics of Transition,* Volume 8, pp. 325-368 (2000)

Similarities in the ownership structures, which are developing in the region, pre-empt a common set of corporate governance issues and problems. The experience in Eurasia has shown that indeed monitoring by beneficial owners is weak and "fiduciary culture" is insufficient. Insider domination of companies is associated with risks of minority shareholder abuse, asset stripping and difficulties in handling conflicts of interests. Some external investors who had obtained shares (see box 3) in the mass privatisation programmes often complain that their rights are abused and most often their stake are being illegally diluted or eliminated. Moreover, retail investors realise that the shares they had acquired with their vouchers have little value.

On the other hand, remaining state ownership and control may lead to political interference in management and be an impediment to restructuring. The emergence of institutional investors, which currently play a rather modest role, can have a significant impact on corporate governance practices. They are often in a privileged position to influence corporate governance practices as they retain significant stakes in companies. However, to this effect, they have to ensure that their own governance standards are high.

The expectation that effective ownership structures and in general, corporate governance institutions and practices would develop overnight following a historic privatisation effort throughout the region, has proved unrealistic. Therefore, a significant and systematic effort by policy markers and corporations is required in order to improve the corporate governance framework and practices in Eurasia.

Table 2. Financial Development in Eurasia and other Emerging Market Economies

	Per Capita Income *Purchasing power parity gross national income per person in US dollars*	Market Capitalisation of Listed Companies *%GDP*	Credit to Commercial Sector *%GDP*
EURASIA			
Armenia	3,800	1.4	10.6
Azerbaijan	3,500	0.1	5.9
Georgia	3,100	2.9	8.8
Kazakhstan	6,300	7.3	11.2
Kyrgyz Republic	2,800	0.3	4.2
Moldova	2,500	3.2	12.7
Mongolia	1,840	3.5	8.1
Ukraine	4,500	6.0	11.2
Uzbekistan	2,500	0.4	n.a.
OTHER TRANSITION			
Russia	9,300	15.0	11.9
Bulgaria	6,600	4.9	11.9
FYR of Macedonia	5,000	0.2	17.8
Romania	7,400	2.8	7.2
OTHER EMERGING			
Bangladesh	1,700	2.5	24.7
China	4,400	53.8	124.6
Colombia	6,500	11.5	26.9
El Salvador	4,700	15.5	41.6
India	2,540	32.4	29.0
Indonesia	3,100	17.6	21.6
Pakistan	2,100	10.8	29.8
Peru	4,800	25.9	19.8
Philippines	4,200	69.0	44.5
Sri Lanka	3,700	6.6	28.9
Venezuela	5,500	6.7	12.0
Sample Average	4,265	13.5	22.8
Eurasia Average	3,426	3.1	9.0
Transition Average	4,549	4.1	10.1

Legal Framework

Weaknesses in the rule of law constitute a major shortcoming for the development of corporations in all countries of the region. Proper corporate governance and protection of shareholder rights require an adequate legal framework, and its effective enforcement. In Eurasian countries, however, both requirements are often not satisfied. In contrast to Central and Eastern European transition economies, the long period of central planning and recent statehood for the majority of Eurasian countries means a lack of a law-making or regulatory tradition.

According to the OECD surveys on CG in the region (summarised in Annex II to this overview) and to EBRD research, the legal framework varies among countries. In general, countries which have adopted the main legal acts shaping corporate governance more recently, tend to show higher levels of compliance vis-à-vis the OECD Corporate Governance Principles, which have been used as a benchmark in the preparation of the survey. Among the front runners are countries, which differ significantly from each other in terms of economic performance, achievements in building market institutions as well as in their corporate governance practices. Thus, in order to reap the full benefit of legal reforms, countries need to devote the necessary attention and resources in order to significantly improve enforcement.

For the rest of the countries from the region, the implementation gap would be even more difficult to fill, given that, at the same time, they need to address the most urgent shortcomings of the legal basis of corporate governance. This includes also special focus on eliminating inconsistencies among different legal and regulatory norms in the areas of company law, securities market legislation, accounting and auditing rules, insolvency provisions and the civil code (including labour law).

It is worth mentioning that some of these inconsistencies stem from technical assistance programmes provided by different donors and implemented without the necessary concern for continuity regarding previous donor and local efforts. Adherence to internationally recognised standards can help in solving such problems. Moreover, in some countries, the tradition of *ad-hoc* resolutions and decrees in addressing legal and regulatory gaps tends to exacerbate existing contradictions among laws and rules.

Additional important areas of focus for all the countries of the region, no matter the development of their corporate governance legal frameworks, include the independence and resources made available to the regulatory authorities, as well as the competence and integrity of the judiciary. Last but not least, special efforts to develop capital markets, raise the awareness of shareholders of their rights and of corporate governance issues in general, should constitute another important priority.

3. Corporate Governance in Eurasia: Implementation and Enforcement

Enforcement and more generally, the rule of law, seriously affect the credibility of the corporate governance framework in Eurasia and the prospects for diversifying access to capital. Evidence suggests[3] that law effectiveness and concrete actions taken in accordance with existing norms are more important in transition countries than the quality and extensiveness of the body of law (See Table 9 for country indicators on commercial law and financial regulations extensiveness and effectiveness). Ownership and control is unlikely to evolve under the conditions of poor commitment of the company to adhere to its obligations of transparency, equitable treatment of shareholders and in general respect for their rights. The related impact can be seen at the firm level, but also in terms of capital market development and economic growth. Not surprisingly, entrenched managers and ownership concentration remain a lasting feature of the countries in the region.

A developed enforcement system is based on public and private initiatives and mechanisms, which are often complementary to each other. For different countries, the optimal choice of enforcement mechanisms tends to be different depending on cost-benefit considerations, culture and tradition, institutional and legal development and the overall environment. From the point of view of efficiency and incentives, private enforcement mechanisms are a very important pillar of enforcement. Moreover, where public enforcement mechanisms and institutions are not well established and efficient, the role of private initiatives tends to be more important. It is also noteworthy, that general reforms and capacity building in enforcing institutions require time and it is important to focus on pragmatic measures in the short term, in order to achieve tangible results.

[3] K. Pistor, M. Raiser, S. Gelfer, "Law and Finance in Transition Economies", *European Bank for Reconstruction and Development Working Paper No. 48, 2000*

Public enforcement

Public enforcement depends greatly on the quality and enforceability of the body of legal norms, the efficiency and effectiveness of courts, as well as on independent, competent and adequately staffed regulators.

In Eurasia, the judicial system has difficulties in handling the rapid growth of commercial cases. Insufficient experience, lack of a body of case law, shortage of human and financial resources and limited training opportunities are a common feature of all countries in the region. Not surprisingly, this has resulted in delays and questionable judgements. In addition to the resources, capacity and the authority of the judicial system, a special effort needs to be made in ensuring its integrity and in fighting corruption.

Important avenues for further reforms include: increasing the independence of the judiciary; enhancing the knowledge and capacity of judges in dealing with company, securities and bankruptcy law cases; encouraging the specialisation of the judiciary. Conversely, judges have to benefit from adequate compensation to ensure that the individuals attracted by the profession possess adequate education, experience and integrity. Moreover, court written opinions should be made public to increase public awareness, facilitate interpretation of the law and enhance the accountability of the legal system.

In most transition economies, including in Eurasia, the financial markets regulator is the main line of defence of shareholder rights. The resources available to Eurasian regulators are notoriously low; regulators sometimes suffer from unclear mandates and a lack of transparency and accountability. Enforcement will be significantly improved in the region though reinforced capacity of the regulators in terms of financial and human resources, including through adequate training. The criteria for selection and appointment of members of the regulatory bodies need to be based on professional merit and respectability. Their removal should take place within a strictly defined framework.

National regulators also play an important role in overseeing self-regulatory organisations, such as stock exchanges, which also contribute greatly to shareholder right protection and better corporate governance. The regulators need to ensure that stock exchanges and other relevant self-regulatory bodies observe high ethical and professional standards. Remedies used by Eurasian regulators also require special attention, as they have mostly included suspending trading and de-listing of company stocks. Additional measures, such as fines or public notice, could also be explored, especially because suspensions penalise primarily market participants.

Private enforcement

Private enforcement efforts may start unilaterally through reputation building, which can be lost in case of violation of agreements, commitments or standards. Evidence from transition economies suggests that unilateral corporate actions to improve corporate governance can have substantial effects on their value. Conversely, foreign investors with higher corporate governance standards can also have a positive impact on invested companies and also by putting pressure on local companies to improve.

Among the most important private arrangements are the multilateral ones. These include, for example, trade associations adopting their own codes of conduct or their own institutions for dispute resolution. Broker associations, in charge of licensing or oversight of their members, or rating agencies monitoring, collecting and disseminating data can also play a role in enforcing better corporate governance. A particularly important role in corporate governance play obviously stock exchanges developing listing requirements, as well as private arbitration bodies through their multilateral enforcement mechanisms.

Stock exchanges can provide professional arbitration mechanisms to settle disputes between companies and shareholders. Most importantly, stock exchange listings requirements play a critical role as a private enforcement mechanism. In some emerging countries, adherence to higher corporate governance standards in a new market or a specific market tier increase compliance and enforcement of rules, provided this can improve the access and the cost of financing.

Experience has shown that deficiencies in regulatory and judicial enforcement have made private arbitration of company law disputes quite important method of dispute resolution for private equity investors in many key emerging markets. Arbitration bodies are currently being put in place in Eurasia. Consistency of rules and practices for arbitration increase their creditability and potential for promoting corporate governance and shareholder right protection. Reliance on tools, such as the New York Convention that makes international arbitration binding in the local context can be particularly effective. Development of such an alternative dispute resolution mechanism needs to go hand in hand with overall reforms of the enforcement institutions and environment, as it relies on the existing options for implementation of decisions and appeal.

Private initiative in instigating private suits also plays a primary role in the enforcement of public legal norms and regulations. Improving the legal redress mechanism for shareholders could also include allowing low cost collective action through shareholder associations or other collective institutions and allowing the Securities Commission to file lawsuits on behalf of shareholders. Sufficient resources need to be made available so that this mechanism can function properly. The role of the judiciary and the court system, other governmental or semi-governmental agencies (for example for issuing various types of licenses) is fundamental. On the other hand, the public authorities grant many self-regulatory bodies, such as stock exchanges, the power to regulate financial market activities. Private enforcement may be particularly effective in countries with weak courts, as well as in the area of securities regulation, in which incentives play an important role.

Corporate governance and other voluntary standards can be developed and implemented independently from the judicial and legislative process. Their potential is great if they are used by investors to change the behaviour of corporations. The enforcement power of such self-regulatory mechanisms can be significantly increased by stock exchanges, which can use codes as part of their listing requirements on a “comply or explain” basis.   Indirectly, codes and the practices which can develop on their basis may prompt improvement of the existing legal framework.

Framework conditions for improved enforcement in Eurasia

In Eurasian economies, with large controlling shareholders, formal corporate governance mechanisms may not be very effective for enforcement (see Table 3). They are important, but they have inherent limitations in the short term. For example, private litigation is likely to help in the development of standards and a body of case law, however, in the region its effectiveness is limited by the imperfections of the court system and public enforcement. The boards in firms with controlling shareholders are likely to be susceptible to influence by the owners who have appointed them. However, in the longer term, boards can contribute in building corporate governance culture and tradition of compliance with rules and regulations.

Enforcement and implementation can be greatly improved by progress in corporate governance and market reforms in general. For example, improved transparency and disclosure can be instrumental in promoting a culture of compliance and enforcement, as it exposes directors, managers and controlling owners to the scrutiny of minority shareholders and the general public. Accountants and auditors provide information on the financial fundamentals of corporations and some aspects of their corporate governance. In order to improve enforcement, accounting and auditing reforms and professional capacity building will be of great value.

Conversely, capital market development and strengthening the banking sector may assist in developing a constituency for rule of law enforcement. Moreover, privatisation and other reforms, such as in the pension system, increase the number of retail investors and with the development of their culture and awareness, they can become another advocate for greater enforcement. The continuous efforts to develop a functioning market economy and in particular allow more competition and other external pressures can help improve the enforcement environment.

Political will is a key prerequisite for effective enforcement of the legal and regulatory framework of corporate governance. Moreover, improving market institutions and capacity building require a long-term focus, commitment and adequate resources. Enforcement is often competing with other reform priorities, however, it is important to acknowledge the enormous potential gains of improved compliance and implementation and ensure that enforcement enjoys strong political support.

SHAREHOLDERS RIGHTS AND EQUITABLE TREATMENT

In Eurasia company law and securities regulation do not establish sufficient legal rights for shareholders. Company practices, as well as weak enforcement mechanisms and inadequate remedies against violations of shareholder rights, further undermine effective shareholder rights. This is not only costly for shareholders; access to capital is essential for company development and growth and shareholders can be important providers of capital as well as the owners of a corporation.

In return for the risk they assume as residual owners, shareholders are entitled to certain basic rights. These include rights to secure ownership, to transfer shares, to share residual profits and to participate in certain strategic corporate decisions.

In addition to protection of shareholder rights, fair and equitable treatment of all shareholders is one of the key principles of effective corporate governance. Protection of minority shareholders is generally weak under Eurasian law. The interests of minority shareholders are often neglected by corporate managers and controlling shareholders, which do not hesitate to seek their own interests at the expense of minority owners. For example, related party transactions are generally not disclosed although it could effectively deter abuses of power by managers and major owners in pursuit of their personal interests at the expense of other shareholders. A fundamental problem lies in the fact that minority shareholders are often not fully aware of their rights or willing to exercise them.

Mass privatisation programmes have contributed to certain weaknesses of the Eurasian corporate governance landscape. People became shareholders without realising the related implications and without a clear understanding of their rights. In addition to the lack of an equity culture, the small stakes held by individual shareholders are another disincentive for them to play a greater role in corporate governance. Thus, educational and public awareness programmes need to be carried out in order to allow for a better understanding of corporate governance issues by the numerous individual shareholders of countries in Eurasia. The emerging institutional investors, including pension funds and foreign institutional investors, should also be encouraged to formulate and publicise their ownership policies.

Enhancing the framework and practices of shareholder rights and equitable treatment in Eurasia should be a priority. A consistent effort to improve the existing legislation and enforcement are necessary. The need for improving the provisions related to the general shareholder meetings, including on convening and voting procedures, is recognised as among the most important areas requiring action. The establishment or the clarifications of provisions on major corporate transactions, together with the explicit prohibition of insider trading, and abusive self-dealing are also urgent issues to address. Enhanced transparency and access to information, including improved disclosure of material interest, also require serious attention in most jurisdictions. Most importantly, enforcement needs to be improved through a systematic effort to increase the institutional capacities of regulators, of all market institutions and the judicial system.

1. Share Registration

Share registration allows interested parties, most importantly other shareholders, to identify registered security holders, as well as the type, nominal value and amount of securities they own. Only after such information has been entered in the register, can shareholders fully secure their rights and control circulation of company shares, including information as to particular shareholders building majority or controlling stakes.

Legislation in Eurasian countries requires registration kept by the issuer or by independent registers under an agreement with the issuer. Registers are either state-owned or privately-owned and subject to state licensing. Entries, made most often in hard-copy format[4], must meet mandatory requirements set forth by the securities and joint stock company legislation. The monitoring of registration falls under the jurisdiction of the securities commissions.

In practice, information on the composition of shareholders is not easily accessible. This is due, in part, to the fact that registrar and depository services have been established only recently. In spite of the fact that access of registered persons to information held in the registration system is formally granted, in practice, applications face delays and on many occasions no response. The administrative practices of registers vary among countries and districts within a country. It sometimes takes months or even years to register a change in the share ownership, which casts a doubt in the accuracy of the registration. Registry personnel frequently misinterpret confidentiality rules to deny rightful access to information, while at other times granting requests to those who are not entitled to access.

In this respect, it appears that government officials often abuse their position and obtain information from the registration systems without being entitled to access. Furthermore, the registration systems reportedly suffer from some of the weaknesses characteristic of the court system, including insufficient funding for ongoing operations. Finally, some companies may not transfer their registries to the central registry or depository; in Armenia, companies have refused to register shares of minority shareholders.

[4] In Kazakhstan, the registers exist in the form of book entries, as well as in electronic format.

Reliable registration systems are essential for effective protection of shareholders rights. Unencumbered access to shareholder registration information is also key for ownership consolidation in companies where ownership has been dispersed due to the privatisation process. The share registry should be open to any shareholder of the company, which is often not the case in Eurasia. This is, for example, the only practical way for shareholders to prepare a proxy fight to dislodge board members.

The above shortcomings, together with persistent cases of manipulation and fraud in company registers, jeopardise effective ownership transfers. They also affect the confidence of investors and their ability to make informed investment decisions. When they understand the problems of registries, shareholders have expressed great concern over the security of their shares: following information campaigns held by the National Securities Commission of Georgia, 72 % of attendees have requested verification of their shares in the share registers.

The registration system makes clear the need for effective institutional support to ensure legal protection of shareholders. Consistent efforts by stock exchanges and securities commissions to monitor and enforce registration and compliance by share registrars, are fundamental for the effective protection of shareholder's ownership rights. Conversely, companies have a critical role to play by monitoring their ownership and control structures, in co-operation with significant shareholders and registers, and by consistently making this information accessible to authorised parties.

2. Shareholder Rights

Both in companies with dispersed ownership and in companies with controlling owners, shareholder meetings have a role to play as a mechanism for informing all shareholders and enabling them to participate in the deliberations and voting on agenda items. This is a basic right for shareholders as providers of equity capital. The involvement of the shareholders at large in the discussion and vote of relevant resolutions also makes it more difficult for insiders to engage in abusive transactions and forces them to be more transparent in their intentions. The importance of the meeting requires that agendas are carefully prepared, meetings are properly conducted and that shareholders have ample opportunity to raise issues and ask questions at meetings and that boards respond to comments and questions seriously.

Unfortunately shareholders do not regularly attend meetings. This is frequently explained by the fact that most retail investors in the region became shareholders as a result of mass privatisation and thus lack the required interest, culture or will to follow company matters. However, evidence suggests that such practice does not simply reflect this premise or a rational apathy of investors, holding too small a portion of company shares to attend general meetings. Rather, this situation is due to poor protection of shareholder rights.

The legal framework governing shareholder meetings in Eurasia formally recognises the rights of shareholders to participate and vote and contains other provisions regulating relevant issues. However it appears that rules and actual practice fail to provide shareholders with a reasonable degree of certainty that they will be in a position to exercise such rights. In Georgia, for example, it is reported that in 2001, one third of the publicly traded (or tradable) companies fail the legal requirements for conducting shareholder meetings. More concretely, one of the most frequent shareholder rights violations in the majority of the countries of the region is the failure to give adequate notice of annual or extraordinary shareholder meetings. In this respect, in 2003, the inspection of 35 companies by the Armenian Securities Commission showed that the violation of the notification process constituted 37% of the total number of the detected corporate governance violations.

Moreover, notices of the general shareholder meeting are not made available through means enabling that reach the largest number of shareholders; the location is not always easily accessible or tends to be modified shortly before the actual meeting date without further notice. Failure to notify shareholders does not necessarily result in invalidation of the general shareholder meeting. The Securities Commissions in the region should be more active in ensuring that the terms and procedures for holding shareholder meetings are respected.

Legal changes may also be necessary. The minimum notification periods contained in company law are often inadequate to provide shareholders with a reasonable opportunity to receive the notification, to review the relevant information and to register for the meeting. These deadlines need to be of at least 30 days or longer. Where existing laws do not include meeting agendas as elements of the notification, it might be useful to amend the relevant provisions. Another option would be to change the practices voluntarily by either including in the notifications the agenda itself or a reference to a place where it can be easily obtained.

The information relating to the items of the agenda should also be sent to the shareholders or otherwise be easily accessible. For annual general meetings, this includes at least the annual report and accounts. However, all items of the agenda need to be properly explained and communicated through a specific means of communication. The same goes for the minutes of the meeting and other related results. In this respect, it is important to use appropriate means for dissemination of information, such as widely circulated newspapers or security commissions' web-sites.

To secure the shareholder right to discuss issues and take decisions without a proposal from the board of directors, Eurasian legislation in most countries contain procedures enabling shareholders to include items on the agenda. These provisions should, however, be subject to reasonable limitations, as set out in the OECD Principles, and thus should relate to issues within the mandate of the shareholder meetings, should not interfere with the management of the company and should be put on the agenda by owners holding a certain minimum of shares.

The legal framework in many countries also allows the shareholders to convene an extraordinary meeting. They can be convened on the initiative of the board of directors, executive body, audit committee or the shareholders. The aggregate thresholds enabling shareholders to convene extraordinary meetings vary from 5% (Kazakhstan) to 25% (Moldova) of the outstanding voting shares. In some jurisdictions, the failure of the executive board to comply with such a requirement after a specified period of time (e.g. for Ukraine the term is 20 days), triggers the implementation of a special procedure for convening an extraordinary meeting.

3. Voting Rights

Voting rights are a fundamental mechanism protecting the interests of investors, including minority shareholders. Evidence suggests that the latter tend to be passive and may prefer to exit the company by liquidating their holdings if they are not satisfied with its management or performance, rather then to exercise their voice rights. However, the strong correlation between minority voting rights and capital market development suggests that adequate frameworks for voting by minority shareholders are an important condition encouraging them to acquire minority stakes.

The principle of one share of common stock one vote is applicable everywhere in Eurasia. There is a wide variety of types of shares in existence, with ordinary and preferences shares used in all of the countries and non-voting shares also widely used. Changes in voting rights in most jurisdictions are subject to approval at the shareholder meeting. Eurasian company laws also contain provisions on the persons entitled to vote and on the relevant procedures. All holders of common shares have the right to participate and vote in shareholder meetings. Conversely, holders of non-voting preferred shares may attend the general meeting and only take part in the discussion of the issues on the agenda.

In all countries of the region, shareholders are permitted to vote in person and through proxies. In some countries, voting *in abstentia* (by mail) is also provided for. Electronic voting is not allowed by the current legislation. The legal framework in some countries fails to define the procedures for proxy voting in sufficient detail. This results in numerous violations, potentially leading to invalidation of proxies, which in turn may affect the meeting quorum and result in the cancellation of resolutions passed. Proxies are established on the basis of a properly issued power of attorney. Other shareholders and third parties may act as proxies. In the era of globalisation, it is increasingly important that structures are in place to ensure meaningful voting *in abstentia* and that such votes are given equal effect with votes cast in person. The exercise of voting rights if shares are held by custodians or nominees is allowed in most countries. Custodians receive meeting notifications and hand them over to the beneficial owners. However, in some jurisdictions (e. g. Georgia), there are no legal requirements that votes by custodians or nominees be made in agreements with the beneficial owners.

Substantial employee share ownership is characteristic of Eurasia and it may be necessary for the law to include procedures to ensure that the employees can vote and sell their shares freely, without management coercion. For example, the law might forbid a company's managers from receiving a power of attorney from shareholders to vote their shares. This is the case, for example in Kazakhstan. The law may also prevent company officers from establishing trust management of employee shares which would have the effect of preventing employees from selling or voting shares.

Voting takes place at meetings, and it is the responsibility of the board that it takes place in a orderly and consistent manner. Appropriate records should be kept of the votes cast and of the results of the voting and be made available to shareholders upon request. Shareholders should have right to record meetings with handheld electronic devices.

A legal provision on mandatory cumulative voting for members of the board of directors in companies with a large number of shareholders exists in some Eurasian countries. Cumulative voting enables a larger minority shareholder to obtain representation on the board of directors, or a group of small shareholders to put an "outsider" not connected to the majority or the management on the board. This can serve as a check on majority directors, providing some protection for minority shareholders.

The apparent intention of the legislators in Eurasia is to delegate the power to the shareholder meeting. However the powers of the general shareholder meeting may not be defined that expansively. On some cases, major decisions are not under the exclusive competence of the meeting, such as the appointment and removal of directors or external auditors. On other cases, some exceptions to general rules are also provided for, such as decisions regarding the issuance of new shares, which can be delegated to the boards of directors by the general shareholder meeting.

For major company decisions some Eurasian countries have supermajority voting requirements that ensure majority shareholders cannot simply push their views through at the shareholder meeting. It is important to stress that such provisions are instrumental only if the minority shareholders vote at the meeting, which requires sound voting procedures. Conversely, these provisions are not always successful in ensuring the protection of minority shareholders. Such rules need to be used with caution as they may render the adoption of resolutions more difficult. Additional protections in addition to supermajority requirements, for example, in the area of mandatory bids and squeeze-out rights, might also need to be explored.

4. Dividends

In many countries in Eurasia, the decision to distribute dividends is in the competence of the general shareholder meeting. The procedure for their disbursement is either determined by the charter or by the general shareholder meeting. Experience shows that dividends are rarely distributed in Eurasia and if so, their amount is low, often reflecting poor company performance. In practice, dividend payment not completed in a timely fashion is particularly detrimental to shareholders in periods of high inflation. On other occasions, general shareholder meetings simply declare the distribution of dividends, without establishing a clear deadline and procedure for payment.

In some jurisdictions, (e.g. Ukraine), the form of payment is not clearly regulated, and some companies pay in-kind. Another legal pitfall observed in the region concerns the incomplete list of restrictions on the payment of dividends, especially regarding companies showing signs of insolvency or impending bankruptcy, or if such signs would appear after the announcement of dividend payments. Such shortcomings might considerably increase creditor risk, especially in an environment of acute information asymmetries that characterise transition

The legislation of different countries appears to have generally secured a right to redress of shareholders in cases of delays or refusal of dividend payments, by authorising shareholders to file a complaint with the securities regulator and also to seek legal redress for damages through the court system. However, the implementation of these rights seems limited.

5. Shareholder Awareness

Equity culture in Eurasia is underdeveloped and shareholders are generally ill informed of their rights. Experience shows that the efforts of bilateral and multilateral donors, together with securities commissions and market professionals, bring results and shareholder awareness has slightly improved in countries in which specific programmes have been put in place.

Shareholder associations exists in Armenia and Ukraine, while other countries such as Georgia, the Kyrgyz Republic and Mongolia are envisaging the creation of such associations. In other countries, there have been numerous unsuccessful attempts in this direction.

Under such circumstances, the role of institutional investors in corporate governance in general and in particular in shareholder expression is even more important. It is reported that they are perceived as the most active shareholders in the region. However, on occasions, they may infringe upon the right of minority shareholders. Their role will become more important in countries including Kazakhstan and Ukraine that are introducing mandatory pensions that can invest in private securities.

6. Related Party Transactions and Insider Trading

To enhance the investment climate in Eurasia, policy makers need to focus on ensuring market integrity and credible investor protection. Abuses can be particularly harmful in the absence of well-developed legal and enforcement frameworks and especially in the context of major corporate transactions. In this respect, the focus should be on the equitable treatment of shareholders and on the establishment of control mechanisms to prevent abusive related party transactions.

The legal framework in Eurasian countries varies significantly in the definition of related/interested parties. Most often they include the company officers and significant shareholders, owning at least 5% (Kazakhstan[5]), 10% (Armenia), 20% (Mongolia) or 25% (Moldova) of the shares. In some countries, they also include family members of the latter interested parties. The current corporate legislation in Ukraine does not define the term, whereas the taxation and banking legislation do. In Georgia, related party transactions are hardly mentioned at all, and only in the context of large shareholders, not directors, supervisory board members or company officers.

The company law framework in many countries limits the right of related parties to vote on transactions in which they participate. The resolutions to enter into related party transactions are adopted by the boards of directors (by the members who do not have an interest in such a transaction) or on certain cases, by the general shareholder meeting.

In some jurisdictions, shareholders do not have recourse to challenge or invalidate related party transactions, or in general, they are not in a position to take legal action against the managerial body or an official of the company (e.g. in Ukraine[6]). In other jurisdictions, shareholders my apply to the Securities commissions or to courts. In Armenia, any shareholder may initiate legal proceedings, in Mongolia, a shareholder having at least 1% of the companies shares may do so. The legislation of Kazakhstan, for example, stipulates that related party transactions concluded in violation of the legal requirements are void and the interested entity is liable to the company for the losses caused. Some jurisdictions define only financial and administrative liabilities for interested parties engaging in related party transactions, unless they have acted in good faith. Insider trading[7] and abusive self-dealing[8] do not always constitute violations of the criminal code (e. g. they are not considered as such in the case of Georgia).

Restrictions to insider trading vary among countries. However, it is recognised that transactions among insiders are widespread. In Ukraine and Kazakhstan, the legislation does not have restrictions on insider trading. In other countries, such restrictions exist in the company law framework and the stock exchange rules. Such rules also target professional participants in the securities markets and explicitly prohibit share manipulation. In Georgia, restrictions include, in addition, the disclosure of insider information and recommendations for acquisitions of shares based on insider information. Examples of concrete legal action preventing insider trading are rare; for example, it was reported that in the Kyrgyz Republic, the licence of one brokerage firm was suspended in relation to insider trading.

7. Changes in Control

Eurasian company and securities legislation on important transactions, including mergers, acquisitions, tenders and take-overs needs further development. In some countries, there are no provisions on disclosure of substantial acquisitions of shares. Anti-take-over devices are neither provided for nor forbidden by the legislation. One common anti-take-over mechanisms in the region is the purchases and redistribution of shares among "loyal" shareholders, usually the management.

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5 For public companies or 10% for the remaining joint-stock companies.

6 However, having compensated shareholders for losses, the company may initiate legal procedures against the shareholder / official responsible for the losses incurred. A problem of proof arises in this regard, as the company must wait for damages/losses to occur.

7 Insider dealing includes buying or selling of a security (or tipping others) by insiders possessing material non-public information about the security.

8 Abusive self-dealing is a financial dealing that is not at arm's length, for example borrowing from or lending to a company by a controlling individual, primarily to the individual's own advantage.

Barriers to participation in the general shareholders meeting can also act as de facto anti-takeover defences[9].

Mandatory bid requirements during changes in control, as a tool intended to protect the interest of minority shareholders, are missing from the legal framework of the Eurasian countries with the notable exception of Kazakhstan, were the threshold triggering a mandatory bid in the legislation is 30% of shares, and Armenia, were it is 75%. These sorts of buy-out provisions are particularly important given the need to consolidate ownership in a number of Eurasian companies privatised via vouchers or to their employees. In addition to a trigger threshold, which can range anywhere from 30-90%, provisions should also be made for a "fair price" for minority shareholders, for example in Russia a sixth month average of the share price is used. Given the very limited number of shares actively traded in Eurasia, a means of evaluating shares through independent assessments should be considered.

8. Pre-emptive Rights

In order to maintain their proportional ownership stake in the company if it issues additional shares, shareholders should generally have a right of first refusal. Such pre-emptive rights can deter share issuance at an unfairly low price to selected buyers at the expense of other shareholders. The need for such a shareholder protection tool is especially strong in Eurasian economies, where outside controls over abuses by majority shareholders and management during stock issuance require extensive additional development.

The underlying framework appears to be adequately established in the region, through provisions of the securities legislation and company bylaws. Enforcement of relevant rules is reported as problematic and in practice, shares from additional issuances are often allocated among insiders. Low equity culture, on the other hand, leads to a low rate of exercising pre-emptive rights. Procedural weaknesses are also an issue, which needs to be addressed in Eurasia. The unreasonable short term of validity of the right of first refusal has often been used in order to deprive shareholders of the opportunity of pre-emption. Effective compliance with the existing rules will benefit from stronger monitoring and from the introduction and application of adequate sanctions.

Box 3. Case Study on Share Dilution

The case described below is a hypothetical one, which, however, is based on authentic share dilution cases that a law firm has handled for various clients in the course of the last several years. For convenience, the international client whose shares were diluted will be referred to as "**the Investor**", the Ukrainian company in which the Investor owned the shares in question will be referred to as "**the Company**", the Offshore intermediary that sold these shares to the Investor will be referred to as "the **Offshore Intermediary**" and the two outside Registrars that consecutively held the Company Shareholders Registry will be referred to, in chronological order, as "**Registrar 1**" and "**Registrar 2** ".

A few years back, the Investor bought from the Offshore Intermediary 25% shares (we will use the %age of the Authorised Fund rather than the actual number of shares for convenience) of the Company in two installments: a 15% Installment and a 10% Installment. The shares were issued in a non-documentary form. The Investor carried out all necessary paperwork and formalisation procedures and separately registered each Installment in the Company Shareholders Registry, which at that time was held by Registrar 1.

The Investor missed the first General Shareholders Meeting ("GSM") it was entitled to participate in, but

[9] In some countries, restrictions to corporate control changes exist in accordance with the provisions of the anti-monopoly legislation and require a permit by the respective state agency

came to the next one. At this GSM the Investor found out that the number of its shares recorded in the GSM documents was not 25%, but 15%. The Company management and Registrar 1 assured the Investor that it was a purely technical mistake, which would be corrected next time. The Investor believed them and did not undertake any formal measures.

When the Investor came for the next GSM, the number of its shares recorded in the GSM documents was not even 15%, but 5%. The Company management again was extremely apologetic and assured the Investor that it was a purely technical mistake, which would be corrected next time. The Investor again did not undertake any immediate formal measures because it had a good relationship with the management (which, the Investor believed, did a very good job in developing the Company) and did not want to ruin this relationship.

It should be also noted that the Investor had not received any dividends from the Company profits since it purchased Company shares, which the Investor believed was normal since the Company was growing and claimed that all its profits were reinvested in the Company.

However, sometime after the second GSM, the Investor grew suspicious and contacted a law firm. The Investor still believed that nothing wrong really happened, but just wanted to double-check the status of its shares. By the time the law firm got involved, Registrar 1 had been liquidated (meaning that there was no legal successor) and the Company had hired a new Registrar 2. It should be noted that, although there was no legal connection between Registrar 1 and Registrar 2, apparently Registrar 2 was owned and managed directly or indirectly by the same individuals as Registrar 1. It also had the same employees.

The first thing the law firm did was to request from Registrar 2 the excerpts from the Investor's individual account in the Company Shareholders Registry to see what the current status of the Investor's shares was. After many delays and appeals to the Registrar and the Company Management, we received a response and documents certifying that the Investor owned only 5%. Registrar 2 alleged that:

1) In the first 15% Instalment the Investor actually bought 5% and not 15%. To this end, Registrar 2 provided what seemed to be an original of the transfer order, signed by the Investor's representative that indicated only 5%. This "original" later was certified by the Ukrainian Forensic Institute as a fake document, with both the Investor representative's signature and its corporate seal having been forged. The Investor, on the other hand, had in its possession a real original of the same document indicating 15%.

2) As to the second 10% Instalment, Registrar 2 alleged that the Investor actually sold all of its 10% back to the Offshore Intermediary. To this end, Registrar 2 provided a copy of the share-purchase contract, which had been signed on behalf of the Investor by an individual who was totally unknown to the Investor and for this obvious reason had never been authorised by the Investor to perform any activities with the Investor's shares. There were a number of other features in the contract indicating that it had been forged. The same individual who signed the Contract later recorded this Contract with Registrar 1, on the basis of which the respective entries were made in the Company Shareholders Registry. It should be noted that these documents were accepted by Registrar 1 despite the fact that they were submitted by an unauthorised individual, while the authorised representative was on the record with Registrar 1.

When we requested a number of other documents from Registrar 2, we received a letter stating that all other documents had probably been lost by Registrar 1 and that Registrar 2 had no responsibility whatsoever in this case since it was not a legal successor to Registrar 1.

At the same time, the Investor learned that the Authorised Capital of the Company had been increased, which further diluted the Investor's shares from 5% to 2%, and that sometime later a consolidated majority packet of the Company's shares (owned by various shareholders) had been offered for sale to a single buyer.

In resolving this case, we used a combination of remedies, described in section 2 (Available Remedies) below, and eventually, after two years of successful litigation in and outside Ukraine, and other legal and political remedies, this case was settled to the Investor's full satisfaction. The practical lessons from this case are described in section 3 below.

Source: Dr. Irina Paliashvnili. Case Study on Share Dilution. Presented at Third Meeting of the OECD Eurasian Corporate Governance Roundtable.. 17- 18 April, Kiev. Full text available at http://www.oecd.org/pdf/M00030000/M00030021.pdf

9. Legal Redress and Enforcement

The most frequent abuses of shareholders in Eurasia, particularly minority shareholders, are violations of the procedures for convening and holding shareholder meetings. A second set of widespread violations include asset stripping, self-dealing and related party transactions. The non-payment of declared dividends comes third among the most frequent shareholder rights violations in the region.

Other violations of shareholder rights are all too common in the region. For example, there are cases where shareholders are not provided with paper titles to shares (share certificates). Breaches of the rules related to share registration and the maintenance share registers are too frequent. Irregularities of information disclosure are another common problem for all countries. Most importantly, these include the violation of the right to receive information about the company's transactions. This often happens in relation to abuses by insiders. Finally, financial fraud is another problem, which severely affects shareholders.

Financial and administrative sanctions are provided for by securities regulation, company law and administrative procedures with a different degree of detail. It appears that important violations, such as insider trading and abusive self-dealing, do not always entail criminal sanctions. In many cases, legal provisions are considered as "imported" with little applicability in the case of the countries practices. In other cases, they are relevant, but the reluctance for compliance is widespread. Moreover, the sanctions imposed are insufficient, uncertain and erratically imposed, which seriously affects their credibility and power. On occasions, they simply entail costs too large to justify the benefits of compliance.

Most importantly, in addition to the far from perfect legal sanctions, enforcement is a serious problem. Shareholders can appeal for redress to securities commissions and courts. In some countries (e.g. Moldova), petitions may be filed also with the government, parliament or president. Shareholders may also do that in relation to violations regarding changes of corporate control. Arbitration procedures exist only in a few countries (for example, in Moldova and Mongolia), however, there is little or no history of dealing with shareholder cases and the legal framework of arbitration does not contain specific provisions to this effect. Self-regulatory enforcement is available for shareholders in case a member of a self-regulatory organisations, such as a stock exchange, a central depository, violates shareholder rights. Derivative (Armenia and Georgia) and class action lawsuits (Kyrgyz Republic and Moldova) are provided for only in a limited number of countries. Introducing class actions will significantly reduce litigation costs for shareholders and could enhance the protection of minority shareholders rights.

The judicial system of the countries in the region has not developed sufficient capacity to address corporate governance cases. Settlement and enforcement of commercial disputes is largely inefficient. Specialised courts are being established very slowly and only in certain countries. Policy makers need to recognise and address the need for strengthening the judicial system. Training of lawyers and judges, adequate remuneration of judges and court personnel, publication of court written opinions and decisions are only a few of the urgent measures, which need to be put in place. Arbitration mechanisms and low cost collective action through shareholders associations or other collective institutions constitute alternative options of redress, which need to be developed.

The role of stock exchanges and securities regulators in preventing and sanctioning abuse and fraud is also very important. It appears that administrative enforcement is problematic in most countries of the region. Regulatory agencies lack the authority, resources and sometimes expertise necessary to fulfil their role. Lack of transparency of decisions, accountability and independence also impede on the capacity of the regulators to perform their tasks. There is a scope for private initiatives, such as codes for best practices, which are complementary to the legal and regulatory framework of corporate governance. Stock exchanges should also be more active in ensuring market integrity, shareholder right protection and equitable treatment.

10. The Role of the State as a Shareholder

In principle, the governance rules applicable to state-owned companies, at least those belonging to the competitive sector, should not be different from the ones applicable to any other company. In fact, the situation of the state vis-à-vis a company in which it holds significant interest is much more complex than that of a dominant private shareholder. Moreover, the state is still the largest shareholder in most of the countries in Eurasia and therefore it is important that its role in the governance of its assets is clearly defined.

The state's right as a shareholder in Eurasia is exercised by ministries, state property agencies, municipalities and other bodies vested with such authority. The state is still a significant shareholder in Eurasia, including publicly traded companies. Civil servants can be elected to boards of directors. In Ukraine, the chairman of the supervisory board of companies in which the state holds over 50 % of the shares is a state representative.

State representatives exercise the rights of the state as a shareholder by participating in shareholder meetings and in other instances as other shareholders. The legal framework in Eurasian countries does not make a distinction between the rights of the state as a shareholder and the rights of other shareholders. Moreover, state shares do not benefit from a special status. The state does not have the power to veto decisions by the majority shareholders in any way. In this respect, golden shares[10] as a specific control device used by the state, exist only in Mongolia.

However, evidence shows that the state does not act as an efficient owner in Eurasia and the scope for improvement is vast. The state should behave as prescribed by the existing legal framework and state representatives should refrain from intervention in day-to-day operation of businesses and be more transparent in influencing the corporate decisions making processes. It should not take advantage of its special status and engage in practices, which may be detrimental to other investors, especially minority shareholders. It is also important that the state recognises the primary importance of the business objectives of the companies in which it has stakes and keep at arms-length without pursuing the fulfilment of other objectives, if this risks distorting market mechanisms and incentive structures.

[10] Golden shares are legal arrangements, whereby governments retain an influence over privatised enterprises, regardless of the amount of their stakes, by exercising veto rights.

Box 4. Case Study: Impact of the State on Corporate Governance Practices at Ukrnafta

Ukrnafta is Ukraine's largest blue chip company and the local market's most liquid stock. The joint stock company Ukrnafta was established in February 1994 from the state production association Ukrnafta. Employing 26 400 people, the company includes 43 fully owned subsidiaries located in Poltava, Chernihiv, Ivano-Frankivsk and Lviv regions. Ukrnafta's minority shareholder group includes Alfa Nafta, Privatbank, Ukrsybbank and affiliated companies, such as Copland Industries S.A., Watford Petroleum Ukraine, Occidental Management Co. Ltd. and others.

Ukrnafta has been trading oil and gas at a huge discount to the Russian peers Lukoil, Yukos, Sibneft, Surgutneftegaz, Tatneft. When Ukrnafta was created in 1994, its share allocation plan envisaged retaining a 30% stake in the state hands and selling the rest to international and local investors. However, the state ended up controlling a 50% stake plus one share, which was transferred to the state oil and gas monopolist, Naftogaz Ukrainy. The decision to retain control over Ukrnafta was explained by the company's strategic importance to Ukraine.

Given Ukrnafta's important role in the oil market, Alfa Nafta and Privatbank collectively acquired about 30% of the company. What is more important, the minority group wanted to secure supplies of oil to their refineries and oil products to their retail networks. However, the minority shareholders did not acquire the power to influence the way the company was run. Thus the scene was set for a lasting conflict between the state as a controlling shareholder, and the minority group. At first, the minority shareholders expressed dissatisfaction with the newly elected supervisory board and blocked creation of Ukrnafta's subsidiary, Ukrinternafta

Following consolidation of the minority stakes to over 40%, the shareholder conflict at Ukrnafta became even more visible. The minority shareholders insisted on more transparent decision-making process, demanded that they be allocated 5 out of 11 seats on Ukrnafta's supervisory board and that the company's registrar be changed. Most lately, the minority group started inquiring about transparency of Ukrnafta's gas sales to Naftogaz Ukrainy after Naftogaz's debt to Ukrnafta for purchased gas increased dramatically last year.

A key issue is the 60% quorum for supervisory board meetings. This explains why the state is so reluctant to yield to the minority group's demand to have five seats on the supervisory board, as it amounts to giving the minority shareholders the right to invalidate the board's meetings.

The average price of natural gas in Ukraine totals USD 59/ths. cu. m., while Ukrnafta was selling its gas to Naftogaz Ukrainy at an average price of USD 24.6 per 1000 cubic meters in 2001 and expects to sell it at USD 22.3 per 1000 cubic meters in 2002. Since a sharp increase in Ukrnafta's gas price could unsettle the domestic energy balance , the minority shareholders accepted the current price on condition that all payments are made on time and in cash. However, by end-2001, Ukrnafta's receivables grew by 36 % year on year, to USD 124 million, with the state's debt for gas and oil accounting for about 90% of that sum.

The State Property Fund is another state representative in the company besides Naftogaz, with a 0.03% stake. This minuscule holding, however, gives the state more leverage. As this stake is considered not privatised under Ukraine's privatisation law, Ukrnafta is prohibited from the following operations: share capital increase, change of the company's structure via mergers and acquisitions or splitting. As a result, Ukrnafta is limited to borrowing on the domestic or external markets, which has been used by Russian and other Ukrainian oil companies as LiNOS.

As the dispute continues, Ukrnafta management is prevented from developing long-term strategies and negotiating foreign projects, which must be approved by a shareholder meeting. Thus, the conflict has virtually suspended Ukrnafta's foreign activities, particularly a planned JV with Libya's National Oil Corporation.

The shareholder conflict at Ukrnafta has adversely affected the company's international expansion plans and generally, its operations and ability to undertake important corporate decisions. Ukrnafta is the leading Ukrainian stock and its lasting problems are likely to have an adverse effect on the stock market as a whole.

Source: Bespyatov, Andrey. The Role of the State in Corporate Governance Practices in Ukraine. Paper presented at the OECD Eurasian Roundtable meeting held on 17-18 April 2002, in Kiev. The full text of the paper is available on http://www.oecd.org/pdf/M00030000/M00030005.pdf

TRANSPARENCY AND DISCLOSURE

Companies in Eurasia are far from transparent. Abusive controlling shareholders, a lack of knowledge and awareness about disclosure requirements and practices, and the lingering influence of the reporting system developed under central planning, have all contributed to the opacity of the corporate sector in each country in Eurasia. This opacity undermines corporate governance specifically, and financial development more generally.

Full, accurate, and timely disclosure is indispensable for good corporate governance. A strong disclosure regime is a central element of accountability, which can improve the way a business is managed and enhance its efficiency and growth. Reliable and timely information enables company governing bodies to make good business decisions and to enhance company effectiveness, growth and profitability. Fair disclosure provides boards of directors with an informed basis for reviewing company performance and strategy, as well as for preventing business misconduct.

Transparency is also important for decision–makers outside the company. Shareholders, investors and lenders must have accurate, relevant and timely information in order to decide where and at what risk to place their money. Good disclosure practices also reveal whether and to what extent corporations meet legal requirements. It helps public understanding of a company's activities, policies and performance, as well as its relationship with stakeholders and the communities where the company operates. Transparent information systems serve as a deterrent to fraud and corruption and allow companies to differentiate themselves for their good governance standards.

In Eurasia, disclosure is critical for attracting domestic and foreign investors. Insufficient disclosure is perceived as a significant risk by outside investors and can lead to higher capital costs for a company and/or reduced investment. In contrast, the enforcement of effective disclosure will make corporate insiders more exposed and responsive to external pressure and thereby enhance investor confidence, which is essential for the economic development of the region.

Moreover, corporate transparency goes hand in hand with public transparency. Reliable disclosure systems enable governments to conduct sustainable and stable economic policies. Enhanced public transparency in Eurasia can have a positive impact on the development of good corporate disclosure practices.

Unfortunately insufficient awareness of the importance of transparency and disclosure is perceived to be one of the main impediments to good disclosure in Eurasia. Attributed to a large extent to the legacy of central planning, the lack of awareness can be found at all levels, including among managers, local shareholders, and public officials.

Besides the lack of a transparency and disclosure culture, the costs and efforts to switch to a new reporting system and the burden of taxes are also considered major deterrents to fair disclosure and the enforcement of international disclosure standards. Examples show that 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. Minority shareholders in

Eurasia are 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. Once confidence is lost, it is difficult to regain it in the short to medium term.

Greater access to capital is generally perceived as the main incentive for companies to comply with disclosure rules in the Eurasian context. Yet, access to capital in the region depends, to a certain extent, on the development of well functioning banks and national capital markets, which in turn depends on adequate disclosure, or more broadly good corporate governance. The improvement of corporate governance should therefore be pursued hand in hand with the development of a sound banking sector and capital market institutions.

1. The Eurasian Context

Before the beginning of market economy reforms, accounting in Eurasia was designed to meet the needs of statistical and tax authorities. The main purpose of accounting was to record factual data, which was used to assess compliance with central planning requirements, rather than to assess the financial situation of a company. In its essence, accounting represented bookkeeping consisting of records on economic events. It did not rely on the application of standards to identify, measure and report these events together with their impact on the company. Accounting assumed an environment free from risks, an environment in which assets were never re-valued and doubtful accounts were written off only when they became definitely non-collectable and profitability was not a criterion for performance. Such a system was certainly not equipped to serve the needs of securities markets and company managers within a market economy. Its role for an effective enterprise taxation system was also limited, as for example, many production costs were not deductible for tax purposes. Auditing reflected the very rigid character of the accounting system. It consisted of the comparison between the final accounts to the bookkeeping records. With the exception of a limited number of large firms, auditing according to international standards of audit is rare for Eurasia.

It is important to note that legacy of central planning consisted of numerous and important challenges: lack of qualified public accountants and professional bodies, lack of reliable and publicly available financial information, lack of demand for such information by well-informed creditors and investors, lack of independent audits based on internationally recognised standards, lack of regulatory authorities overseeing financial authorities, such as securities exchange commissions. In their gradual approach to market reforms, Eurasian countries implemented progressive changes of accounting and financial reporting practices and arrangements. The Ministries of Finance in most countries were in charge of drafting the new legislative and regulatory framework and continue to exercise standard-setting functions. Notwithstanding the magnitude of expected reforms, the countries from Eurasia currently lag behind other transition economies.

The first professional associations of accountants and auditors were created at the beginning of the 1990s and at the same time, the first large-scale training programmes were put in place with the assistance of multilateral and bilateral donor institutions. The adoption of the accounting and audit legislation, together with the adoption of International Accounting Standards (IAS)[11] or IAS-based standards took more time in Eurasia, compared to other transition economies, thus prolonging the period of uncertainty for enterprises and investors. The professional infrastructure has also experienced the uncertainties, related to the evolving legal and institutional framework.

[11] IAS, drafted by the International Accounting Standards Board, are the result of the most prominent global effort to increase the compatibility of local accounting standards.

2. Standards of Accounting and Audit in Eurasia

As businesses become more international, it is increasingly important for financial results to be understood across national boundaries. Historically, accounting rules have been derived from company law and from pronouncements issued by national standard setters. However, the demand by investors for international stocks, and the desire of multinational companies for non-domestic capital, means that stock exchange regulators have a strong incentive towards global accounting harmonisation. Eurasian countries had very similar accounting and audit practices and regulations at the outset of the transition to a market economy, all depending on comparable if not the same normative documents. Although the pace of reforms is different among countries, efforts are being made throughout the region to bring accounting and audit in line with international standards.

In most Eurasian countries, accounting reform was slow to start and was not implemented in a streamlined and pragmatic fashion. In Kyrgyzstan, for example, new national standards were developed in stages, which included the development of several versions of principles. The process started in 1997 with the adoption of a simplified version of the old standards used under the central planning system, replaced at a later stage by an improved version and finally by national standards based on IAS. The adoption of a law on accounting followed the adoption of the standards. It is perceived that implementation of new standards and enhanced disclosure and transparency need to be accelerated.

In two countries of the region – Armenia and Georgia – international accounting standards (IAS) have been adopted in full and accounting is developing on the basis of self-regulation. Companies are required to provide financial reports in accordance with the international accounting principles at the legislative level. The regulation of private sector accounting is left to professional organisations. The remaining Eurasian countries have either adopted national accounting standards based on IAS or included modifications to their accounting standards, based on IAS. The State, in the face of the Ministry of Finance, normally regulates accounting. The certification process for accountants differs significantly from the requirements of the International Federation of Accountants (IFAC) and financial reporting, in most countries, is separated from tax reporting methodology.

The differences of national accounting standards in Eurasia and IAS are non-existent for Georgia, and insignificant for Armenia. In Kyrgyzstan, it appears that important differences exist in the content and at the level of application. For example, same or similar terms often have different meaning (e. g. profit or cash). In some countries, financial information under national standards is still geared towards the information needs of the tax authorities and as a result, companies tend to understate their operational expenses. In Ukraine, the national accounting standards are considered as more heavily regulated and leaving less scope for choice to companies, in comparison to IAS. Moreover, the accounting legislation states that national standards should not contradict IAS, however discrepancies and conflicts exist and are even more evident in their application. As the provisions of the new national standards are not complete, cases arise where a certain issue is not dealt with under the new rules. In such situations, companies use the old accounting standards, which are often in conflict with the IAS.

Thus, frequent deficiencies of national accounting standards include the existence of many gaps, as they are still being developed. There are, sometimes, contradictions between the accounting requirements set by the national standards and those required for tax purposes. Moreover, in practice, companies tend to follow the methodology mandated by the tax authorities. On some occasions, the mechanisms for conversion from the previous to the new standards were not fully adhered to and thus the books of many companies are not in compliance with either the national accounting standards or IAS.

In practice, some companies previously prepared IAS-consistent accounts but in many cases the conversion of joint stock companies and limited liability companies to new standards did not begin before 2000. Traditionally, companies exclusively reported to the State (i.e. the Tax Department). In some Eurasian countries the Ministry of Finance still requests companies to report in the traditional format, which compels companies to maintain a *de facto* costly double standard accounting system.

The proper application of disclosure standards requires clear guidelines, which are lacking throughout the region. In spite of current efforts, this is a major gap, which requires increased attention on behalf of governments and the multilateral and bilateral donors.

Another major issue is the need to secure qualified accountants and auditors in substantial numbers in order to successfully implement new reporting rules. Currently there is a critical lack of human resources throughout the region. Many countries in the region frequently urge donors to support effective accounting training programmes. Professionals also underscore that accounting is much more than just a bookkeeping formality. Thus, introducing new international standards can not be reduced to a change of format. The training of accountants should focus on the conceptual understanding of the international standards.

National standards based on internationally accepted ones are not only a priority in order to attract foreign capital and to enhance investment among countries from Eurasia. Domestic investors as well are interested in the application of principles, which privilege the substance over the form in order to have an informed basis for taking decisions, a meaningful framework for comparing information and obtaining a comprehensive view on results. Such a framework would enable national investors to have their companies audited by international firms, to enhance their access to national and foreign lending, and equity capital. Rapid adoption of standards based on internationally accepted principles by Eurasian companies would decrease the workload of their financial managers some of which still have to report according to the new and old standards and/or using separate guidelines for tax purposes.

However, it is acknowledged that this requires a change in the mindset of information users and information providers, together with political will to accelerate the implementation of the reform and sustained education programmes. Awareness of managers is very important in this respect, as good accounting standards provide them with a fair description of the financial situation of the enterprise and enables them to take the right decisions. The development of chartered accountancy in Eurasian countries will further complete the existing body of regulations, will enforce its rules and keep the quality of disclosure and reporting requirements on a level playing field.

3. Disclosure of Material Information in Eurasia

The concept of materiality, referring to information whose omission or misstatement could influence economic decisions, is used by many countries in order to determine a minimum standard for disclosure. In order for shareholders, creditors and other stakeholders to effectively monitor a company and its management and allow potential investors to gauge a company's prospects and compare different investment possibilities, all material information regarding the company should be fully and accurately disclosed on a timely basis.

The legal framework of Eurasian countries requires companies to disclose information to a specific range of users. Most frequently, specific requirements are set for disclosure to shareholders, the securities regulator and public disclosure. Provisions exist on what needs to be disclosed and when. In different countries, the deadlines of disclosure vary significantly, however the information concerned is similarly defined. It includes, most often: documents to be disclosed to shareholders prior to the assembly general meeting; annual reports and notices of shareholder meetings; information regarding extraordinary developments affecting company operation; submission of quarterly reports, etc. It appears that in practice, most frequent violations concern the information disclosed to shareholders, such as meeting notices, meeting documents, annual reports or *ad-hoc* requests for information by shareholders.

As noted earlier, disclosure to regulators and government bodies is usually adhered to and there are more violations with respect to disclosure to shareholders and other interested parties on request. Some of these violations are reportedly due to cumbersome and costly information dissemination. Modern communication tools, including the Internet, need to be used more often in Eurasia, as they provide an important opportunity for complying with the requirements of the disclosure legislation and the needs of various types of information users.

Financial Disclosure

Regular financial reporting enables investors to obtain an update on a company's progress, to evaluate the growth of returns and put it in the perspective of price. The legislation in Eurasia defines the companies, which are required to publish financial statements, specifies the documents and information to be disclosed, the frequency and timing, as well as the means for disclosure. On most occasions, companies are required to file financial statements by different regulations and with different bodies, such as the securities commissions and the fiscal authorities. It is reported, that this leads sometimes to conflicting requirements, which undermines good disclosure practices and requires a serious harmonisation effort.

Eurasian companies are required to prepare annual or more frequent financial statements, showing their financial performance and situation. Generally, annual financial statements are required to be audited prior to their presentation at the assembly general meetings. In spite of the existing provisions on civil and administrative liability for non compliance, it appears that annual financial reporting is not always applied in practice. Regular annual reporting of quality information is of primary importance for good disclosure and transparency. Therefore, the responsible authorities in the region need to take coherent enforcement measures in order to ensure compliance.

Consolidated reporting[12] is a central area in financial reporting. Consolidated statements allow users to gauge the financial position of an entire group and this is of particular importance when inter-group transactions are common and siphoning off of resources to group companies may take place. According to available information, consolidated reporting is required in at least four countries of the region**.** Companies with subsidiaries are thus required to prepare consolidated financial statements, in addition to the standard financial statements they prepare for each corporate entity. Annual consolidated financial statements are audited and must be filed with and disclosed to the same parties as standard corporate financial statements. Compliance in this area is difficult to estimate, especially because in some countries this requirement is relatively new.

[12] Consolidated financial statements provide information on the assets and liabilities, financial position and results of operations of a group as a single economic entity and the changes from year to the next.

Non-financial Disclosure

Non-financial information is valuable to assess a company's governance and is particularly relevant in the Eurasian context to understand changing ownership and control arrangements. The marked reluctance to disclose information considered as private by insiders in Eurasia has perpetuated problems with the implementation of disclosure standards at the company level and jeopardised the confidence of investors.

Corporate annual reports should clearly outline corporate missions and mandate, short and long-term corporate goals and how they will be achieved. The regulatory regime in some countries does not set provisions on the content of annual reports. In other countries, however, it does not set an obligation on companies to specify their goals and strategy in their annual report. In spite of this regulatory lacuna, some companies disclose this information; however, it is reported to be usually too general and brief, hence, not enabling shareholders and potential investors to objectively evaluate company strategy and planned activities.

Disclosure of major share ownership and voting rights in annual reports aims to promote transparency in favour of investors. Only if information is available on the identity of major shareholders (including on director and key executive ownership interest in company shares) is it possible to achieve market transparency and prevent the misuse of insider information. In Eurasia, companies are required to disclose ownership information above a certain threshold. For example, in Kyrgyzstan, Moldova and Ukraine, annual reports should include the list of shareholders who own 5 and more % of company shares, whereas in Armenia this threshold is of 10 %, and in Azerbaijan all shareholders should be listed, indicating those with more than 25 % of the shares. There is no indication of problems arising in this respect in the region. In Ukraine, for example, there is a perception that compliance with this requirement is quite high. This is to a great extent explained by the vigilance of the securities commission, which claims not to accept annual reports lacking such information.

In Eurasia, the regulatory system does not explicitly target disclosure of governance structures and policies by Eurasian companies. They are not required to report on how they apply corporate governance principles in practice, nor are they disclosing their governance structures and policies. Examples of voluntary disclosure of such issues are not available.

Related Party Transactions

Related party relationships are a standard feature of business practice. For example, enterprises frequently carry on activities through subsidiary or affiliated enterprises and acquire interests in other enterprises for investment or trading purposes. A related party relationship could have an effect on the financial position and operating results of the reporting enterprise. Therefore, in OECD countries particular attention is paid to disclosure of transactions with company directors, because of the fiduciary nature of their relationship with the enterprise, as well as of transactions with related companies and other interested parties.

In order to avoid conflicts of interest, the existing rules in most countries of the region define interested parties, set the modalities of disclosure if company officers or other related parties have financial interest in a transaction. However, according to reports to the Eurasian Corporate

Governance Roundtable, the current legislation of Ukraine[13] does not require disclosure of related party transactions, and related party transactions are hardly addressed at all in Georgian legislation. It is also reported that the legal framework in Kyrgyzstan needs significant improvement on this particular issue. Compliance in this area is notoriously weak throughout the region and enforcement may be considered as one of the main corporate governance problems in Eurasia. Progress on enforcement should be particularly important for countries (such as Uzbekistan) in which no sanctions are foreseen for the breach of related party disclosures.

Information on Directors and Key Executives

Information on individual board members and key executives enables investors to evaluate their competence and assess the potential conflicts of interest, which might affect their decisions. Companies are generally expected to disclose key information regarding directors, such as academic background and professional qualifications, shareholding in the company and its subsidiaries, board committees served on, directorships or chairmanships in other listed companies and other major appointments. Eurasian companies are most frequently required to disclose only the identity of board members and key executive officers. Ukraine and Armenia are the notable exceptions. In Armenia the legislation stipulates that annual reports, in their part on "Basic Company Information", should disclose additional information on the CEO, chairman, members of the management and supervisory boards, members of the audit committee and the chief accountant. Such information includes educational background, managerial experience and positions held in other enterprises. Annual reports in Armenia require disclosure of similar information.

In addition, companies' annual disclosure is expected to contain sufficient information on the remuneration of board members and key executives. There is very little information available on this issue for Eurasia. For example, in Ukraine, the law requires the annual report to disclose information on the collective remuneration of all employees. There is no requirement of individual remuneration disclosure. It is also reported to the Roundtable, that in Kyrgyzstan, shareholders may receive information on remuneration of company officers upon request. It is essential for the countries of the region to focus on improved disclosure of board and executive compensation. In line with current trends, disclosure of individual compensation should be an important goal.

Information on director and key executive ownership interest in company shares is also important for market transparency. This is usually the case as per the current legislation in most countries from Eurasia. Compliance is reportedly higher in financial reporting to the securities regulatory bodies, compared to disclosure of such information in annual reports. It is noteworthy that under the provisions of the Ukrainian Company Law, holding company shares is a precondition for becoming a member of the Supervisory Board and of the audit board.

Management Disclosure and Analysis

Reasonably foreseeable risks, which could adversely affect company business, assets, liquidity and capital resources, are also important for users of financial information. Therefore, effective disclosure mechanisms include the description of significant material risk factors, as well as risk

[13] The Ukrainian Civil Code, effective since 1 January 2004, provides a definition of a dependent company, as one in which another company owns over 20 % of the capital / shares of the former. The Business Code, also in effect since 1 January 2004, defines "associated" company. Companies engaged in such relationships need to comply with disclosure requirements.

management objectives and policies. This particular aspect of disclosure does not seem to have received sufficient attention in the regulatory regimes and practices in Eurasia.

However, in Ukraine for example, companies are required to provide information on the level of risk anticipated by the following risk factors: political, financial and economic, related to production, as well as technological, social and environmental risk factors. They are also compelled to indicate wither the level of risk is high, medium, or low and provide a brief description. In Kyrgyzstan, the regulatory regime requires issuers to specify such information in the prospectus of securities issue, intended for public placement; in Armenia financial statements are required to contain information on risk factors. In Uzbekistan, the legal framework does not explicitly require reporting of foreseeable risk factors. However, an Order of the Centre for Co-ordination and Control of the Securities Markets, adopting the relevant Regulation on disclosure of information by securities markets participants, contains a requirement for reporting foreseeable risks.

Companies are also encouraged to include in annual reports details on material issues regarding employees and other stakeholders. For example, details of employee share schemes enable their shareholders to assess the benefits and potential cost to companies. Conversely, certain key social, environmental and ethical matters can materially affect the performance of the company and become an important business issue with an impact on its risk factors. In Eurasia, the regulatory systems do not explicitly target reporting on such issues. In theory, such reporting might take place at the discretion of specific companies, if required by their internal documents.

Major company developments can affect share prices and need to be disclosed in a timely fashion. Examples of extraordinary developments affecting the company include, key management changes, major transactions, losses of major customers, significant changes in the company's economic environment, major litigation, insider trading of shares, default on debt, insolvency filing, etc. The regulatory framework of Kyrgyzstan, Ukraine and Uzbekistan sets forth the reporting obligations of companies with regard to such developments. In Ukraine, in practice, closed joint stock companies do not provide such information, as the relevant regulations only apply to open joint stock companies. In addition, they are unclear as to where a company should publish information on such events, thus reducing information users to track data in the periodicals of each one of the seven stock exchanges of the country. The relevant legislation in Kyrgyzstan, Ukraine and Uzbekistan also sets the modalities for disclosure of major company developments. However, it appears that timely reporting in this respect is a serious problem in all three countries.

4. Auditing Practices and Auditor Independence

Auditing of annual accounts aims to obtain reasonable assurance about whether the annual accounts are free of material misstatement. The audit includes examining evidence supporting the amounts and disclosures in the annual statements and ensures that the annual accounts give a true and fair view of the financial position of a company. According to information discussed at the Eurasian Corporate Governance Roundtable meetings, the legal frameworks in the region generally require hiring an independent auditor to confirm the accuracy of a company's annual financial statements. In addition to annual independent audit, financial statements may, at any time, be verified by an auditor upon demand of a shareholder holding shares above a certain threshold. Audit is conducted as specified by the national accounting, audit and securities legislation. Stock exchange rules also mandate listed companies to provide financial statements certified by an independent auditor.

In practice, however, not all companies comply with these requirements. Some are, reportedly, not doing so because of lack of funds. In terms of enforcement, the legal framework is in place, yet it appears that securities commissions rarely take measures against companies, for not providing audited statements.

Further important measures include the introduction of board audit committees and an enhanced role of boards in the auditor selection process. In the aftermath of the recent corporate failures and scandals, auditor independence is a major concern for regulators, companies and the accounting and audit profession itself. The legal framework in Eurasian countries requires auditors to be independent and defines the modalities of their appointment. In Uzbekistan, on the contrary, there are no explicit provisions on the auditor's independence; however, this can be defined in the agreement concluded with the company for auditing its financial reports.

Different jurisdictions in the region define independence with a varying degree of detail. In the Ukraine, for example to be independent, an auditor should not have direct family relations to members of company management bodies; should not have a personal material interest in the company; should not be a member of management, company founders and shareholders; should not be a company employee; should not be an employee, co-owner of a subsidiary, branch or another affiliated entity of the company. However, Ukrainian legislation does not contain enforcement provisions, nor does it specify procedures on approving the selected auditors and their contracts with the company. In ensuring auditors independence, the legislator in Kyrgyzstan, has decided to ban auditors from engaging in any other type of business activity with the company, except the provision of audit related services. Usually, the assembly general meeting has the authority to approve the contracts with independent auditors. Shareholders (or groups of shareholders) owning shares above a certain threshold, are generally allowed to invite an independent auditor without the approval of the assembly general meeting.

The liability of auditors for negligence or other wrongdoing toward the client companies and other users of information is a part of most legal frameworks in the region. For improper fulfilment of their obligations, auditors may be subject to material fines, penalties in the form of suspension of the license or invalidation thereof as well as criminal liability. Some jurisdictions limit the respective provisions only to a statement of auditor liability or provide very little detail on relevant penalties.

Independent audits represent one of the greatest challenges to transparency and disclosure in the region. The objective of an audited financial statement is to enable the auditor to express an opinion on whether the financial statements are prepared in all material respect in accordance with an identified financial reporting framework. The auditor, thus, assesses the risks attached to the company's business and the risk that the financial statements will be misstated, the auditor then designs audit tests to address those risks, the audit evidence is collected from a number of sources and finally the auditor reviews the evidence obtained and reaches an opinion. Thus, the audit opinion is the end result of a sophisticated process.

Audit needs to be conducted objectively and independently and the auditor needs to be able to demonstrate independence. Thus, auditors should not get involved in decision making and should be free of influence by company officials that might impair on their objectivity. There are also codes of ethics that could be developed by professional associations, possibly modelled on the IFAC code of ethics, in order to address the practical problems faced in this region.

The profession has to be in place to do high quality audits, but also there are other external issues that greatly affect the extent to which auditors are able to do the job effectively. There needs to be a stable regulatory environment, so that companies and auditors know what is expected of them and that their expectations are consistent. Regulatory and governmental agencies need to be clear and consistent in the rules they are developing and enforcing. By directly adopting IAS or international standards on auditing, regulators can not only achieve clarity and consistency, but they also make it easier for international investors to analyse market information on a comparable basis. Another area, which needs to be properly understood is the respect of responsibilities of management and the auditors. Auditors must not substitute themselves for management by taking responsibility for decisions on key accounting policy and financial reporting matters. One challenge faced in Eurasia is the lack of sufficient expertise within companies needing to prepare IAS financial statements and therefore they tend to rely heavily on auditors in this exercise. In such an environment, particular attention needs to be paid on safeguarding independence. This underlines one very important part of the main problems of transparency and disclosure, namely the lack of informed companies, knowing what the financial results have to look like and interested in maintaining proper information systems.

In this respect, many of the responsibilities for financial reporting or overseeing internal control can be delegated to an audit committee. Good practice for board committees in handling sensitive and complex issues, such as financial reporting, board nomination and compensation is to include independent directors. In this way, shareholders will have greater confidence regarding financial disclosures by companies, which would ultimately have a positive impact on capital inflows and on the capacity of businesses to create wealth.

5. The Profession: Enhancing Competence

Adequate qualifications and professional experience are of the essence if accountants are to meet their responsibilities to employers and to the public. The legislation in only a few Eurasian countries, such as Uzbekistan for example, contains provisions on the qualifications, educational background and experience of accountants; however, existing rules in most countries specify the qualifications or recognition criteria of auditors. The professional accountants and auditors associations are responsible for the certification of accountants and auditors. It is recognised throughout the region that existing training facilities are insufficient. There is widely perceived need for more training on IAS. In all countries, it is acknowledged that local auditors are not sufficiently familiarised with the International Standards for Audit (ISA) or are practically unfamiliar with them. Various institutions play a role in this respect, including Ministries of Finance, securities regulators and professional organisations, together with consultancy companies and bilateral and multilateral donor institutions. Training activity was booming in periods corresponding to the introduction of national or international accounting standards; its quality was not uniform and continuity was not always ensured.

Accounting and audit reform has emerged as a focal point of efforts by international organisations and other institutions involved in the reform process to assist transition countries in improving their financial architecture. Reform initiatives could benefit greatly from closer and more structured co-operation in order to promote dialogue, exchange experience and share expertise between the international community and the main public and private sector players in the regions. The establishment of a platform for regional dialogue, structured around an agenda with broad public and private sector support, in addition to international expertise, will greatly support the regional and country efforts to effect reforms.

Eurasian companies used to have dedicated accounting departments and currently most joint-stock companies keep such departments (with the exception of Mongolia) under the supervision of the CEO, the chief financial officer or the chief accountant. Companies may also choose to use the services of external accountants or accounting firms to prepare their financial statements. There are usually no requirements that such accountants be certified, although there is a certification process for accountants in most countries. Uniformly, companies in all countries of the region, lack well trained accountants or resources to prepare annual accounts according to IAS.

6. Channels for Dissemination of Information

Shareholders, investors, market professionals and other information users need to take their decisions on the grounds of timely and material information, but first of all, they need to enjoy equitable and cost-efficient access to information. To this end, channels for disseminating information are very important for effective disclosure to take place. Adequate legal frameworks are only an initial step in this direction. In Eurasia, the press is the primary channel for information dissemination, according to the legislation in place. Certain types of information are to be disseminated in a selected number of newspapers, other types of mass media or though direct responses to interested parties. Regulators and stock exchanges also are important recipients of information, as mandated by law, and are often required to publish it or post it on their web-sites. The company and securities laws of the countries in the region contain specific provisions on how information is disclosed and disseminated. Some countries are currently introducing new electronic means of reporting, as well as measures allowing to process and publicise information using modern information technology.

Internal accounting information systems are also important for the timely and reliable financial reporting and its dissemination. Modern software adapted to the specific needs of different users and compatible with the existing accounting standards is important for effective financial reporting. An important pre-condition is the computerisation of company financial information systems. Introduction of new technological developments in existing disclosure regimes, such as electronic filing of reports need to be considered in order to improve cost-efficient access to information.

7. The Role of Corporations

The primary responsibility for good corporate governance, including for effective transparency and disclosure lies with the board of directors. Ensuring the integrity of financial reporting and independent audit are key functions of company directors. The board is also chiefly responsible for putting in place effective internal controls over the safeguarding of assets, the maintenance of proper accounting records and the reliability of financial information used within the business or for publication. In many OECD countries, directors are, in particular, encouraged to review and report on all aspects of internal control, including controls to ensure proper risk management and compliance with the law.

In Eurasia, the legal requirements contain limited provisions on the role of the boards of directors in ensuring the accuracy of financial statements. The responsibilities of the boards are defined in little detail and concern the examination of annual financial statements before they are presented to the assembly general meeting and/or the approval/signature of annual financial statements by board members. In some countries, such as Moldova, Ukraine, and Uzbekistan, the law does not stipulate any explicit responsibilities of boards in ensuring proper financial reporting.

If a corporation is to be transparent to shareholders, it must be transparent to board members. Changes in board structures and procedures might be required in order for boards to better fulfil their obligations. Audit committees may, for example, be established with responsibilities for selecting the external auditor, approving its report and communicating the results to shareholders. They may also be responsible for alerting the executive of irregularities in systems of control. Priority should be attached to the education of independent board members. Experienced foreign institutions and institutional investors could be invited to designate board members in order to foster good board practices.

The rules defining the role of management in disclosing information do not seem to be much more explicit. In the cases of Kyrgyzstan and Uzbekistan, the legislation merely stipulates that the publication of financial information and annual reports is the responsibility of the executive directors. There is no information on the existence of sanctions for no-compliance or for fraudulent practices. In the case of Ukraine the company law sets the obligations for the company, and the management board, in disclosing financial and non-financial information, including: publishing financial information and annual reports, providing shareholders with the minutes of meetings of executive directors (management board), notifying shareholders regarding shareholders meetings, granting access to shareholders to the documents of the assembly general meeting, providing shareholders with the minutes of assembly general meetings. The securities legislation contains additional provisions on disclosure; however, neither the company nor the securities laws contain any specific obligations on the role of management regarding financial and non-financial disclosure. One exception is Armenia, where both the responsibilities and liabilities of particular company officers with respect to disclosure are specified.

Companies in Eurasia need to improve their compliance with basic disclosure requirements; e.g. in 2003, of the 456 companies required to file annual reports in Georgia only 274 bothered to file, in Armenia, in 2003, inspections by the Armenian Securities Commission showed that disclosure requirements violations constituted a significant percentage of the total number of detected violations. Beyond this, they should take a more proactive stance in communicating with shareholders. Better communication with investors can be established through websites with relevant information or by creating investor relation divisions. Promotion and compliance with corporate governance codes, foreign listings and other voluntary means to reduce opacity need to go hand in hand with a systemic effort to implement high standards. The role of stakeholders and the media, should not be underestimated in promoting transparency and disclosure.

8. Enforcement

Legal frameworks for corporate activities and disclosure practices are being established throughout the region. However, the major challenge in improving transparency and disclosure in Eurasia undoubtedly lies with implementation, monitoring and enforcement.

A fundamental difficulty for Eurasian economies stems from the fact that most enterprises went public through a mass privatisation process and not following an independent decision based on company strategies for development. Therefore, there is a greater scope for Eurasian regulators to focus on stricter enforcement of rules, including imposition of sanctions. Experience shows that too often regulators and exchanges are not instrumental in enforcing disclosure requirements and may be undermined by their institutional capacity or by gaps in the legal framework. In some countries, penalties for breaches of disclosure requirements may be low; the use of accounting standards may be seen as “voluntary” in the absence of civil or criminal penalties for improper accounting. Holding board members or executives accountable for gross violations of reporting requirements may be another important challenge for regulators and stock exchanges.

Violations of disclosure requirements are rather similar across the region. Rather often companies do not publish annual reports and financial reports; do not hire independent auditors to verify the accuracy of annual financial statements; fail to disclose extraordinary events which could affect the company. Most shareholders suffer from insufficient access to information, especially in cases of specific shareholder requests for information and/or regarding annual reports, balance sheets and minutes of meetings.

In Ukraine, only in 2000, approximately 7,500 out of 11,850 open joint-stock companies failed to file annual reports with the securities regulator, whereas disclosure violations comprise some 24 % of all violations committed by issuers in this country. For 2000, the Ukrainian securities commission imposed fines and penalties totalling approximately UAH 3 961 155 (approximately US$ 7 150). Disclosure needs to be equitable and provide a level playing field for compliance. This goal requires all companies, violating the existing rules to bear the cost of sanctions.

Regulatory and professional bodies as well as stock exchanges increasingly require high standards of disclosure. These institutions can play an important role in raising awareness and in monitoring compliance with disclosure standards and improving channels for disclosure. In many countries, stock exchanges are actively seeking ways to create incentives for companies to improve disclosure through their listing requirements[14].

Box 5. International Federation of Accountants and Auditors in Eurasia

In June 1999, the OECD, in co-operation with USAID, helped constitute a regional federation of NIS accounting and audit associations: The Regional Federation of Accountants and Auditors - Eurasia. The "Eurasian Federation" has as its principle objectives to:

- develop and strengthen the accounting and audit profession through their respective associations;
- integrate the profession into and create linkages with the international community; and
- develop sustainable self-regulatory organisations in the region.

In support of these broader objectives, the Eurasian Federation is to help translate, distribute and implement international standards on accounting, audit and ethics; develop model training, education and certification programmes based on international benchmarks; and serve as an "information clearing house". It encourages the development of an independent profession able to meet its public interest responsibilities.

Participating countries include Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The Eurasian Federation's activities have already begun to produce concrete and relevant results. The Eurasian Federation is currently participating in the translation, publication and dissemination of IFAC's International Standards on Auditing (ISAs), including its Code of Ethics, and IASC's 2000 update of the International Accounting Standards (IAS), in co-operation with IASC and the International Centre for Accounting Reform (ICAR). The Eurasian Federation's Secretariat is operational and has organised Council and Committee meetings, published a newsletter on recent CIS developments in accountancy reform and is establishing an Internet presence.

Five standing Committees have been established on (i) accounting standards, (ii) auditing standards, (iii) professional education, training and certification, (iv) legal reform and (v) membership and ethics. Committee activities are to focus on the drafting of gap-analysis papers, development of model codes and guidelines, and

[14] For example, the Armenian Stock Exchange (Armex) has the authority to receive and review the registration statements for shares to be listed or admitted for trading on the Exchange, and approve them in the absence of the Commission's objection.

promotion of harmonised professional training and education programmes. Finally, the Eurasian Federation is assisting its Member Bodies to meet IFAC membership criteria.

December 2002 saw the completion of this OECD accounting and audit initiative to support the accounting and audit professions in transition countries. At their meeting in May 2002, IRFAA discussed a strategic plan for 2002-2003, including steps to achieve self-sustainability of the Federation. Following the successful constitution of this body, the OECD is no longer directly involved in the work of this organisation.

For a full list of permanent and associated members, committees and their respective programmes, see the Eurasian Federation's website: http://www.irfaa-eurasia.org/index.phtml

BOARDS AND STAKEHOLDERS

1. The Responsibilities of the Board

1. The board should play a central role in developing the strategy of the company and overseeing its management. However, boards in Eurasia seem to play a limited role at best in corporate governance. This reflects the factors that have dominated other aspects of governance in the region: a still developing legal framework, other institutional weaknesses, and the resulting dominance of companies by their controlling shareholders.

2. Most companies in Eurasia have both supervisory and management boards, as well as statutory auditors that are sometimes considered another board tier. Hence none of these countries have a simple unitary board structure. On the other hand, Eurasian companies make very little use, if any, of specialised committees such as remuneration committees.

3. It is widely accepted that board members have duties of care and loyalty, and in particular should act in the interests of all shareholders. The company law of some countries in Eurasia explicitly mandates that board members act in the interest of shareholders. In other countries, it mandates that board members act in the interest of the company, but under the authority of the general meeting of shareholders. The duty of care, or an equivalent is found in most, but not all, Eurasian company law.

4. Globally, listing requirements, securities regulation and company law are all mandating greater use of independent directors. In all Eurasian countries there are limitations on executives serving on supervisory boards. However in most countries there are few additional requirements related to independence, and controlling shareholders generally have free reign to place their associates on the boards of companies they control.

5. Other provisions to protect minority shareholders are also limited. Cumulative voting, which can normally allow minority shareholders to pick a certain fraction of the board, is required in Armenia, Georgia, Kazakhstan Moldova, and Mongolia, but does not seem to be used elsewhere. More importantly, the legal requirements for board members with respect to related party transactions are minimal in most Eurasian countries.

6. Overall, the legal framework retains substantial gaps in a number of countries. Supervisory boards frequently receive only minimal coverage in company law, and the presence of supervisory boards may have dissuaded countries from implementing stronger requirements for independence and the treatment of related party transactions. While board member duties are present in company law, it is not clear that they are explicit enough, given the current capacities of the legal systems in these countries. Even administrative duties of board members may not be detailed enough.

7. Beyond these legal gaps however is the de facto status of boards in Eurasia. Companies are very much dominated by their controlling shareholders, which is still the state in many companies.

Boards seem to have little power or inclination to challenge the controlling shareholder when actions are taken that is not in the interest of the company. One measure of their limited importance is compensation: supervisory board members in Eurasia are frequently only reimbursed for meeting expenses and do not receive a salary.

2. Board Structures and Functions

All company boards, including supervisory boards and boards of directors in unitary board systems, have broad powers that are similar. They are supposed to oversee the management of the company. They must be engaged, albeit to varying degrees, in company strategy. They play a critical role in determining their own compensation and that of management, have the power to hire and fire executives or members of the management board, and can greatly influence nomination and election of individual board members. They must ensure the company complies with its various obligations, including financial reporting and other disclosure requirements. And most importantly, they must fulfil their legal duties to protect the interest of the company and shareholders.

Specific competencies will not be the same. In companies with a formal management or executive "body,"—which includes almost all Eurasian joint stock companies—whether it is a board or committee, significant aspects of management and strategy may be delegated, with the (supervisory) board playing an oversight role. In other countries, the single unitary board is for all practical purposes the executive body, and will be heavily engaged in strategy and management. Normally boards do have wide powers of delegation, and their involvement in strategy and management will also vary across companies as well as across countries.

A key variable for the board is size: boards should be "big enough", but not too big. Boards should be big enough to have a range of skills and specific financial, legal, and industrial knowledge, and enough independent non-executive board members to avoid conflicts of interest. On the other hand, as boards begin to exceed a dozen members they will become unwieldy.

Company law in most Eurasian countries require boards to have least 3-5 board members, with Mongolia requiring a relatively large 9 members. Georgia caps the maximum size of the board at 21 members, other countries do not have limits. Eurasian companies normally have 6-9 members, though a number seem to have too few board members, especially ones capable of exercising informed, objective, judgement.

Table 3. Board Structures

Country	Board Structure
Armenia	Board of Directors and Audit Board, Supervisory Board optional
Azerbaijan	Supervisory Board, Board of Directors and Audit Board
Georgia	Supervisory Board and Board of Directors
Kazakhstan	Board of Directors and Audit Board, Supervisory Board optional
Kyrgyz Republic	Supervisory Board, Board of Directors and Audit Board
Moldova	Supervisory Board, Board of Directors and Audit Board
Mongolia	Board of Directors and Audit Board
Ukraine	Supervisory Board, Board of Directors and Audit Board
Uzbekistan	Supervisory Board, Board of Directors and Audit Board
Germany	Supervisory Board and Board of Directors
Japan	Board of Directors and Audit Board
Russia	Board of Directors and Audit Board, Supervisory Board optional
United States	Board of Directors

Board Tiers and Committees

Companies in Azerbaijan, Georgia, and Ukraine, and companies with more than 50 shareholders in Moldova, have dual board structures with both supervisory boards and management boards. In Kazakhstan, companies can opt for a dual structure. In addition, open joint stock companies in all of these countries but Georgia have an audit commission or audit board consisting of statutory auditors (Table 3). In Mongolia the “supervisory board” has the powers comparable to audit boards in other countries.

The management board is an executive grouping overseen by the supervisory board. Members are generally called “directors”. In Armenia and Kazakhstan, company law dictates that companies may have a one person chief executive, or a collective executive, in this latter case these companies are also considered to have a management board. Generally there are limitations on members of the management board serving on the supervisory board—in most Eurasian countries there can be no overlap, in Kazakhstan at least half of the supervisory cannot be members of, or related to, the management board.

Specialised committees, such as nomination and remuneration committees, allow non-executive board members to play a leading role in determining company policy in an area where conflicts of interest are likely, e.g. nominating board members and paying executives, and can be a useful source of objective advice. In Eurasia, the issue of conflicts of interest in this respect is less pronounced, due to the prevalence of two their board structures. Therefore, in such a setting, the emphasis needs to be put on the establishment of committees chaired or composed of independent directors, as such committees can provide objective advice to important areas of company activities. However these committees are not widely used in Eurasia.

Audit Boards and Audit Committees

The company law of a number of Eurasian countries requires companies to have audit boards made up of statutory auditors. Elected by the shareholders and frequently having legal duties similar to board members, the statutory auditors oversee the firm’s internal auditing and the preparation of financial reports and other information given to regulators and shareholders. They frequently oversee compliance with the law and shareholder resolutions. While they may attend meetings of the supervisory board, they do not vote. They may have other powers as well. However, given the prevailing lack of requirements for technical expertise of audit board members and the lack of budget to hire professional advisors, the role of such boards seems to be limited.

Instead of an audit board mandated by company law, boards in other countries increasingly are required to have an audit committee formed from members of the company’s main board. Audit committees generally oversee the company’s internal audit and reporting. In many cases, they may also have a role in overseeing compliance. In addition, they normally have a significant influence on the choice of external auditor; they may oversee the control and risk management systems of the company; and they normally provide opinions on related party transactions to the rest of the board or shareholders. In addition to somewhat distinct powers, the main difference between audit boards and audit committees is that members of the audit committee also serve on the company’s main board.

Audit committees made up of non-executive and preferably independent board members are a way for the board to develop expertise, and maintain independence, in some of its most important competencies. Audit boards on the other hand have performed poorly in many countries. Like other board tiers they have tended to fall under the influence of the controlling shareholder and other corporate insiders. They often lack the technical expertise increasingly necessary in the face of ever greater financial and operational complexity. Their relationship with external auditors is often unclear. Perhaps most importantly, by taking on certain functions, they may encourage a negligent attitude on the part of the supervisory board.

Important questions remain about how to make audit boards more effective. As audit committees become more common in countries that also have audit boards, the relationship between the two will have, at least, to be clarified. However, given the limited role of audit boards in Eurasia, it would be useful to consider their phasing out as companies establish audit committees of the board..

Box 6. Do Boards in Eurasia suffer from a "Soviet Mentality"

"To understand the role of the supervisory boards in Georgia today, one should realise that, like in many post-communist countries, people's mentality practically did not change. This is true for the general public, government officials, employees (which in many cases are shareholders at the same time) and for Directors and Supervisory Board members as well."

"If in Soviet time 'decision makers' were respective communist party officials now a dominant shareholder plays such a role. In Soviet times there also existed various employee committees, trade union committees, etc. "elected" by employees but strictly according to directors' or communist officials' "recommendations". Common understanding was that these committees were nominal and membership there was just a "honorary duty", without any real obligations or rights."

"Enterprises (including their staff and managers) are continuing their "routine" activities according to "routine" schemes notwithstanding fundamental changes in the legal, political and economic environment. Primarily this is caused by inertia of the people's mentality, which is most difficult to change. "

"Respectively, by this 'routine' mentality, to the post-communist supervisory boards are attributed formal 'honorary' functions of the above committees - without any effective rights or duties. And one should stress again, that this virtual picture is in the minds of all and every – directors, employees, shareholders and members of the supervisory board themselves!"

"Due to the described phenomenon, members of supervisory boards in Georgia could be classified in two groups. The first group are those members who are dominant shareholders themselves (or their fully authorised representatives - appointed in many cases informally). The second group are those appointed by the dominant shareholder formally, to meet some legal requirements e.g. on the necessary number of supervisory board members, or on some other matter. Such breakdown of supervisory board members fully reflects the above mentioned virtual role of the board. The first group is considered as a 'decision-maker' – but not due to their board membership but because they are the decision-makers (or directly associated with decision-makers). As for the second group – they are not taken seriously by anybody, thus stressing insignificance of the supervisory boards once again. In many cases companies are functioning in a way that the employees even have no idea about the existence of the supervisory boards (but of course, they know the directors and the dominant shareholders). "

Source: "Role of Boards and Board Culture in Georgia", by George Loladze, presented at the 4th meeting of the Eurasian Roundtable, October 2003. Edited by OECD

3. Board Member Accountability and Performance

Legal Duties of Board Members

Everywhere, board members should act in the interest of the company and *all* shareholders. This may either be explicitly mandated in the company law (more likely in a civil law country) or it may be based on case law (the case in most common law countries). In many cases, the explicit duty or responsibility is to the company, or the general meeting of shareholders, which in turn implies a duty to all shareholders.

Board members also normally have a duty of care. This generally requires the board member to approach the affairs of the company in the same way that a prudent and reasonable person would approach their own affairs. Like the duty of loyalty, the duty of care or a close equivalent can be found in most countries with open joint stock companies.

It is sometimes said that "board members must be accountable to shareholders and responsible to stakeholders". Board members generally have a requirement to ensure that the company complies with the law, honours its contractual commitments, and hence protects the legal rights of stakeholders. Relevant legislation may also specify that corporate officers, including board members, are responsible for particular actions of the company.

In addition to the fundamental duties of loyalty, care and ensuring legal compliance, board members have their own "governance and disclosure" duties. Company law and securities legislation place specific requirements on board members to follow certain administrative procedures and disclose certain information, for example specifying any relationship they may have with the company. Company law also generally requires board members to act honestly, and specifies penalties for wilful misinformation.

Law in Armenia, Moldova, and Ukraine[15] mandate that board members should act in the interest of shareholders, but only Armenia has an explicit equivalent to the duty of care. In Azerbaijan, Kazakhstan, and Mongolia board members are responsible to the general shareholders meeting, and board members in Mongolia are also required to act in the interest of the company, as are those in Georgia—all also have an equivalent to the duty of care. Most countries also list certain administrative duties and criminal actions that board members may be liable for. Overall however, in Eurasian legislation the duties of supervisory board members remain under-defined. While there has been recent change in some countries, for example clarifying various administrative duties, gaps remain. More importantly, in practice nominal board member duties and liabilities seem to have little motivating or deterring effect on board member behaviour.

Board Member Effectiveness

Basic qualifications for board members tend to be minimal in most countries, including those in Eurasia. Board members normally must be of a minimum age, usually the age of "majority" (18-21). Generally they cannot be convicted of certain crimes, including fraud, cannot be bankrupt, and in some cases cannot have served on the board of a company that went bankrupt. Some countries limit the number of boards that someone can serve on. In many countries, board members cannot serve on the boards of competing companies. Some countries require board members to be shareholders of the company, though in some cases having only one share may be sufficient. Some countries allow legal persons to be board members, some only allow natural persons, and some allow legal persons, but with a natural person as a "permanent representative". The by-laws of the company may specify additional requirements for board members.

Board members for banks often have additional requirements, including minimum levels of education. Some board committees and tiers, where they exist, may also have special requirements: for example one member of the audit committee or audit board may be required to be a certified accountant. Increasingly certain committees, and in some cases the board as a whole, must also have a minimum number of "independent" board members.

[15] Provided for in the Civil Code, according to which a Company

In Georgia someone can be prevented from serving as a board member for violation of fiduciary duties. In Moldova and Ukraine, a criminal background can be a source of disqualification. In Kazakhstan at least 70% of the board must be shareholders, in Moldova at least 50%. In Armenia, Azerbaijan and Moldova, board members of banks and insurance companies have additional qualifications. Finally, most countries have some restrictions on certain state officials serving on company boards, however, state officials still serve on a number of company boards.

Independent Board Members

Globally, laws, listing requirements and codes are calling for more independent boards and more independent board members. But what exactly is "independence" and are independent board members automatically better then other board members?

Boards in many countries have not only a high fraction of executive members, or recent executives, but also the non-executive relations and representatives of controlling shareholders. Frequently, an individual will serve on multiple boards in a business group controlled by a particular family. In each case, the board member may feel that their first loyalty lies with the controlling shareholder. Increasing the number of independent board members may have the potential to reduce the dominance of the controlling shareholder, and increase the capability of the board to act in the interest of the company and the shareholders as a whole.

What constitutes a non-executive, outside or "independent board" member often depends on the relevant legislation or code. Generally it excludes all managers and executives. Increasingly, securities regulation and listing requirements have gone further in defining independence. Relatives of management and other board members, recent employees, and officers in related companies may be excluded.

Most importantly, "independent" increasingly means independence from significant, and especially controlling, shareholders. Securities regulation and listing requirements in a number of countries now all require some degree of separation from significant shareholders for independent board members, and voluntary codes encourage this in a number of other countries.

However simply having no connections to the company does not guarantee that a board member will act in the interest of all shareholders, be responsible to stakeholders, or exercise adequate care in their decision making. As experience with non-executive board members has accumulated, it has become clear that board members with no special connection to the company can be as deferential to management or the controlling shareholder as any executive, and may have little incentive to devote much time or effort to their duties.

The *OECD Principles of Corporate Governance* emphasise a "positive" definition of independence somewhat different from the "negative" definitions that are so widely used. The ability of a board member to exercise objective judgement, and provide informed opinions independent of the dictates or desires of particular shareholders or corporate insiders, is a positive indicator of independence. Board members with this sort of independence are in a stronger position to contribute to the strategy of the company, oversee management, and fulfil their duties to all shareholders. This "independence of thought" should also allow them to evaluate stakeholder issues more objectively.

The supervisory boards mandated for most Eurasian companies generally only have non-executives as members. In Armenia and Kazakhstan, where companies can have unitary boards, the number of executive board members are limited. Certain state officials that may be involved in overseeing the company, and in some very limited cases those directly employed by the company, may also not be allowed to serve as board members in Eurasian countries, in Mongolia no civil servant may serve on a company board. However board members in Eurasian companies generally don't have requirements to be independent from management, controlling shareholders or to be able to act in an informed and objective manner. Each country in the region, through listing requirements and or company law, should begin to require boards for widely held companies to have at least a few independent members, using a suitably broad definition of independence.

Developing Board Professionalism

It is not enough to mandate greater use of independent board members, qualified individuals that can serve as independent board members must be available. With the goal of developing new and better board members, institutes devoted to board member training and professionalism have been established in a number of countries outside of Eurasia, many in the last 5 years. Frequently modelled on the British Institute of Directors (IoD), these institutes seek to improve the performance of primarily non-executive board members. Effective training often builds on the "learning by doing" process that new, or newly active, board members normally experience, with more of an emphasis on active learning rather than lectures. Multilateral agencies and donors including the Global Corporate Governance Forum (GCGF), have developed "training the trainers" workshops and other programmes to assist these institutes and encourage new ones. The GCGF has also developed a "tool kit" for creating and running an IoD.

Institutes for training board members and increasing board member professionalism are notable for their absence in Eurasia. However, there is definitely an interest in establishing these institutes. Given local interest, the next step is finding resources, an area where foreign donors should play a significant role.

Voting

Another way to reduce the dependence of the board on the controlling shareholder is to create mechanisms that allow other shareholders to choose some board members. In practice minority shareholders may have little choice in who actually sits on the board, with the controlling shareholder in a position to choose all board members. This is most likely to be the case when companies use simple majority voting for each board member. However controlling shareholders frequently have less then 50% of the company's voting rights, and one way to increase the influence of other shareholders is to make the general meeting more accessible. This would include reducing barriers to participation erected by the controlling shareholder and other corporate insiders.

Some countries have introduced specific mechanisms to reduce the dominant position of the controlling shareholder. The most popular is cumulative voting. A kind of proportional representation for the board, in a cumulative voting system shareholders do not vote separately for each board member, but assign votes across board members. 10-15% of the total vote is normally enough to select a board member. Under this system, the controlling shareholder would still choose most of the board, but other shareholders could elect some board members without the support of the controlling shareholder.

However, by its very nature, cumulative voting can encourage board members to think of themselves as representing particular blocks of shareholders, not the company and shareholders as a whole. The board members duty of loyalty to the company and all shareholders becomes more important, not less so, when cumulative voting or similar procedures are in place.

Cumulative voting is allowed for in Georgia, but not widely used, if used at all. It is required in Kazakhstan, Mongolia, and in Armenian companies with 500 or more shareholders. Board members in Moldova must be chosen by cumulative voting or by two thirds of shareholders. In Georgia shareholders having at least 20% of the shares can also directly choose a representative to the board, as can those holding 10% of the shares in Armenia.

State Appointed Board Members

In Eurasia many companies remain state controlled, and it is a standard practice for ministries to appoint board members in these companies. Like other controlling shareholders, the state is in a strong position to improve the governance of companies that it still controls or influences, and some OECD countries have taken significant steps to improve the governance of state owned enterprises. Unfortunately in Eurasia, the performance of state appointed board members has not been exemplary

Improving the governance of these companies generally requires a clear separation of the state's role as owner and regulator. Control should be transferred from ministries to professional boards with commercial objectives. The management culture of the company should also be transformed into that of a private commercial enterprise. Introducing performance-enhancing compensation combined with high standards for management can facilitate this.

The Board's Role in Major and Related Party Transactions

Company law normally requires individual board members to declare any potential conflict of interest to the rest of the board. Conflicted board members are also generally required to abstain from voting when they have a personal interest. Securities regulation and listing requirements in some countries also require reporting related party transactions and other potential conflicts of interest in the annual report, or immediately to the stock exchange, securities commission or the public at large.

Beyond disclosure, companies may require that certain transactions be approved by a super-majority of the board. They may also take the matter out of the board members' hands by requiring that certain major or related party transactions receive shareholder approval or, super-majority approval.

To determine if the terms of a transaction are fair to the company, or biased in favour of the other (related) party, shareholders in some countries may be able to demand an outside appraisal. Where audit committees are used, these committees—which normally have a minimum number of independent members—are frequently required to submit their opinion on the fairness of a particular transaction to the board and or shareholders. As part of this process they may also have the power to solicit an outside appraisal.

Most Eurasian countries require reporting related party transactions, and shareholder approval of certain major transactions. In Armenia, which has a unitary board structure, and Kazakhstan, where a dual board structure is optional, the role of board members in related party transactions in relatively well defined. However the role of supervisory boards in other countries, both in company law and in practice, in overseeing related party transactions is limited. Increasing the effectiveness of boards in

Eurasia requires them taking a much more active role in managing, and exploitation of conflicts of interest.

4. The Role of Stakeholders in Corporate Governance

46. With widespread employee ownership and the potential for bank credit as a source of external finance, employees and creditors as well as other stakeholders could play a constructive role in the governance of joint stock companies in Eurasia. However, based on the very limited evidence available, stakeholders play a limited role in Eurasian corporate governance.

47. Employee shareholders, who are numerous in the region as a result of mass privatisation, have faced significant challenges in exercising their rights as owners. They may be restricted from participating in the shareholders meeting, not be able to vote their shares, or have their shares voted for them by management. On the other hand, employees and their representatives may focus on their own interests and not those of the company. Outside of ownership, there may also be other mechanisms through which employees can constructively participate in the governance of the company. Unfortunately, information on role of employees in governance more generally, is extremely limited.

48. Information on the protection of creditor rights is also limited. The ratio of private credit to GDP in Eurasia ranges from 5-10%, which is low if compared to other emerging market economies (the average across the Roundtables is 36%, in many OECD countries it is well over 100%). This would imply that firms have little access to credit. Poor creditor protection is among the reasons for this restricted access.

49. Creditor protection in the region is not adequate, first because borrowers can take action to harm creditors that may not always lead to insolvency (e.g. borrowing against a property from multiple creditors for more than its value). A more fundamental problem is that in practice insolvency is generally avoided, and courts may not uphold creditor rights with respect to effectively insolvent borrowers.

5. The Role of Employees

Good employee relations can increase motivation, reduce turnover, and encourage workers to acquire skills that benefit the company. The governance mechanism at a minimum should ensure that the company honours its contracts with employees and relevant legislation. Beyond that, successful companies are ones that can constructively bring employees into the wealth creation process.

Unfortunately, companies in many countries do not even meet minimum requirements, breaking agreements, laws, and standards designed to protect employees. Employees often have limited redress to protect their rights when those laws, or contracts, are violated. This is part of more general problems with enforcement found in many emerging and transition economies, and also reflects a myopic attitude that some companies seem to have towards outside resource providers. Methods to improve enforcement in this area are similar to those for improving the enforcement of investor protection, including increasing the capability of the judiciary and regulators, and making greater use of alternative dispute resolution.

Employee Participation in the Governance of Joint Stock Companies

Different mechanisms through which employees can participate in the governance of the company include board representation, work councils, and share ownership. In Georgia, the company law allows for employees to elect one third of the board, however no company has chosen to exercise this option, and no other Eurasian country makes provisions for it.

Works councils are found in a number of countries, including all the members of the European Union and Russia. They are also required for companies in Georgia, Kazakhstan, the Kyrgyz Republic, and the Ukraine. Employees elect representatives to the council, which must be consulted by the board of the company on matters that affect employees. While the council has the power to negotiate with the company, the board retains ultimate decision-making authority.

Not only can consultation give voice to worker concerns, it can be an important source of information for the board, especially independent board members, and for shareholders. Employee representatives can provide the point of view from the "shop floor", which may differ substantially from the view presented by other corporate insiders. However the limited evidence indicates that works councils play a small role at best in most Eurasian companies that have them.

Employees as Shareholders

Privatisation in transition economies, including Eurasia, has made millions of employees shareholders in the companies they work for. Employee owners are in a strong position to improve the governance of their company. They have particular knowledge about the company that other shareholders might not have. Since the company is the source of their livelihood, they have strong incentives to ensure that it is successful. Being owners may also motivate employees to advocate corporate governance reform more generally.

In Eurasia and elsewhere, dominant controlling shareholders and weak boards diminish the potential advantages of having employees as shareholders. In many cases employees sell their shares as soon as possible. When they have held on to their shares, employee owners have faced barriers to full participation in corporate governance. Employees may be prevented from voting their shares, and may even have their shares voted by management. Employees, like other shareholders, may not have the necessary information to exercise their vote effectively. They may also not have access to independent advice, but may be heavily influenced by management or other corporate insiders.

These problems are similar to ones faced by other shareholders. In addition, employees also face the threat of retribution by management if they choose to vote in an independent manner: demotion, being fired, etc. These problems can be addressed by bringing employee owners into the general meeting as normal participants, and ensuring that the meeting itself meets adequate standards: voting should be secure, and results confirmed by an independent party; management should not be able to vote employee shares, or any shares they do not have; confidential voting should be encouraged, and is highly relevant for proxies acting on behalf of employees; and relevant information should be distributed to all shareholders in a timely manner before the meeting. Kazakhstan now forbids employers to act as proxies for their employees, and other countries in Eurasia should do the same. The wider use of cumulative voting would also allow employees and minority shareholders to choose some board members, even when the controlling shareholder and their allies have a majority of votes in the general shareholder meeting.

Whistle Blowers

Employees are usually the first ones to know about transactions and practices that violate the legal rights of shareholders and other stakeholders. "Whistleblowers" who reveal these abusive activities can be a critical source of information and are in many cases essential in bringing the appropriate civil and criminal action. The potential for employees to act as whistleblowers can be an important deterrent to abusive behaviour. Unfortunately, whistleblowers face unemployment, being "black-listed" by other potential employers and even subject to personal threats for revealing sensitive information. In some cases it may actually be considered a breach of duty for employees to reveal such information.

Countries in Eurasia should take action to protect whistleblowers, shielding them from liability, and in turn penalising employers who retaliate. Relevant authorities should also consider steps to protect the personal safety of whistleblowers. As part of wider efforts to improve both relations with employees and transparency and disclosure, companies should facilitate the internal flow of information through mechanisms like anonymous reporting by employees and creating an internal "ombudsman" to follow up on employee allegations of unethical behaviour.

6. The Role of Creditors

Bank loans, bonds, and other kinds of credit are normally the primary source of external funds for companies, and are a critical source of finance for private investment. In addition to providing loans, creditors can also develop long-term relationships with companies, providing long-term capital and perhaps acting as effective monitors of corporate governance in the process. However, in many countries, including most Eurasian ones, banks and other potential creditors seem less interested in lending to the private sector than in holding government bonds, and the "relationships" between creditors and companies when they exist are not always ideal.

Like shareholders, creditors can face "tunnelling" by companies they have provided funds to, and like shareholders, they often have difficulty to recover their debts or in obtaining redress when their rights are violated. The specific kinds of transactions that companies use to expropriate creditors are in many cases the same as those used to transfer funds from minority shareholders: when the net assets of a leveraged company are reduced through tunnelling, the potential for default increases, and the value of both its debt and equity are reduced. In addition, companies may make excessively risky investments when net assets, and equity, are low: a high return will go to the (major) shareholders, but creditors will absorb any loss.

These abuses come at a high cost: creditors are less willing to lend to companies, and this in turn limits financial development, increases reliance on internal cash flow, and reduces investment and growth in the process[16]. Table 4 gives some indication of how much private credit firms have access to in Eurasia, and a sample of other transition and emerging economies as well as some OECD countries. With the exception of a few countries in Asia, credit to the private sector and state controlled commercial enterprises is significantly higher in the developed economies listed on the table than in the developing and emerging market economies. Credit to companies in Eurasia is particularly low.

[16] An overview on the links between credit market development and economic performance is provided in Ross Levine, "Financial Development and Economic Growth: Views and Agendas" *Journal of Economic Literature*, Vol 35, pp. 688-726 (1997).

Table 4. Total Credit to the Commercial Sector in Eurasia and other Countries

Country	Credit to Private Sector and Commercial, State Controlled Enterprises (% of GDP) 2001
Eurasia	
Armenia	10
Azerbaijan	5
Georgia	8
Kazakhstan	11
Kyrgyz Republic	4
Moldova	12
Mongolia	8
Ukraine	11
Other Transition	
Bulgaria	11
China	124
Croatia	36
Romania	7
Russia	12
Vietnam	35
Emerging	
Argentina	23
Brazil	35
Chile	63
Thailand	108
OECD	
France	87
Germany	120
Japan	188
United Kingdom	135
United States	144

Source: World Bank

Protection of Creditors' Rights

The rights of creditors depend on the contracts they make with firms—loan agreements and bond covenants—specific restrictions on certain actions by the company, and the specific regime for corporate insolvency and creditor protection. Creditors should be able to write a range of different contracts with companies and expect to have them enforced. In practice, the same delays and other difficulties that shareholders, employees, and other stakeholders face in the courts also bedevil creditors. Even pressing claims to pledged collateral can be difficult in many countries, and more sophisticated agreements are in some cases completely unenforceable. This limited enforcement severely restricts the risk-sharing mechanisms the company can employ.

In the law, creditors frequently have rights that go beyond the enforcement of contracts. For example, in many countries a company may not be able to transfer a liability to a third party without the explicit approval of the relevant creditor. However companies sometimes have means to bypass these restrictions. Instead of moving liabilities, they will move assets, "hollowing out" the company and leaving creditors with the shell, to the detriment of both creditors and minority shareholders that unknowingly acquire the effective liabilities.

In some countries, courts may be able to block certain transactions or other actions if they are clearly intended to harm creditors. In some cases, they may also be able to "pierce the corporate veil" and hold controlling shareholders and corporate insiders accountable for transactions that were abusive to creditors. A related mechanism is "avoidance powers" that require funds tunnelled out of the company before insolvency to be returned to the company. Overall however, creditors have limited redress in the face of abusive transactions.

One important difference between creditors and shareholders is that companies do not always have to pay dividends, but they do have to pay interest, if they are solvent. For this reason it is normal that creditors have a limited role in the governance of the company. This changes as the company approaches insolvency. In almost all countries, though to varying degrees, creditors do become involved with the governance of the company, and will frequently become the new owners of the company, once it is insolvent and begins formal procedures for liquidation (or re-organisation, albeit it is exceptional in Eurasia).

On the other hand, rates of bankruptcy in emerging markets are a fraction, in some cases a very small fraction, of the rates of developed countries. Some transition economies have never had a major non-financial company actually complete insolvency proceedings. Given their limited institutional capacities, including for example very minimal social safety nets, there may be good reasons why these countries do not enforce insolvency legislation as aggressively as in more advanced economies. Nonetheless the rare use of these laws was is the principle weakness in protecting the rights of creditors.

One of the main reasons formal insolvency procedures are infrequently used are the costs associated with the courts enforcing them. Compared to other commercial disputes, bankruptcy cases seem particularly prone to delays and judicial indecision that almost always comes at the expense of creditors. This may in part be another aspect of the stigma involved in actually declaring a company insolvent, but also reflects the capacity of the judicial system to enforce insolvency legislation.

In Eurasia, creditor protection is particularly poor, and improving the enforcement of their rights through insolvency legislation should be a priority, as should be enforcement of simple debt recovery. Creditor protection would also be enhanced if abusive transactions were more effectively restricted, and the enforcement of loan agreements improved. The overall goal of reform should not only be to protect creditor rights after insolvency, but to facilitate risk management and ensure fair treatment of creditors before insolvency.

7. Ensuring Responsible Behaviour by the Company

Companies should ensure the legal rights of all their stakeholders, not just creditors and employees. Improving the treatment of stakeholders depends in part on changes at the national level. Increasing the general capabilities of courts and regulators is one way to improve enforcement and encourage better treatment. Ensuring greater clarity in the legal rights of stakeholders is a second: a range of potentially inconsistent and sometimes contradictory laws governs stakeholder relations in Eurasia. Making board members, managers, and controlling shareholders directly liable for abuses against stakeholders is a third. Engaging in any sort of fraudulent or misleading activity, or breaking specific laws designed to protect stakeholders, may be the basis of legal action against individuals, and not just the company.

This is not just an issue for legislators or judges. Companies must take steps to better comply with existing legislation and contracts. The board should be involved in major stakeholder issues, and understand the company's legal responsibilities and the significant liabilities and opportunities associated with relevant stakeholders. Along these lines, the company should also establish *compliance mechanisms*: internal systems for reporting, monitoring, and training that facilitate compliance with the law and are ultimately overseen by the board.

ANNEX I:

ECONOMIC STATISTICS AND INDICATORS FOR EURASIA

Table 5. Basic Statistics for Eurasia

	Armenia	Azerbaijan	Georgia	Kazakhstan	Kyrgyz Republic	Moldova	Mongolia	Ukraine	Uzbekistan
Surface area (thousand sq. km)	29.8	90.5	69.7	2,700	198.5	33.7	1,600	603.7	447.4
Population (million)	3.0	8.1	5.4	14.9	4.7	4.3	2.7	49.3	25.0
GDP (US$ billion)	2.4	6.1	3. 3	24.2	1.6	1.6	1.3	41.4	9.7
GDP (per capita, US$)	788.9	743	736	1,688	333.6	381	481	851	308.4
Monetary Unit	Dram	Manat	Lari	Tenge	Som	Lei	Togrog / Tugrik	Hryvnia	Som
Currency Units per US$	555.08	4,860	2.2	153.28	46.94	12.87	1,134	5.33	970

Source: GDP 2002, GDP per capita and population 2002 estimates, except Mongolia, which is 2003. Currency units per dollar 2001 averages for Armenia and Moldova, 2002 for others. Source: EBRD. Transition Report 2003, London, World Bank. Country Data Profiles. www.worldbank.org, EIU. CIA. World Factbook, www.cia.gov/cia/publications/factbook

Table 6. Growth in real GDP in Eurasia

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Estimated level of real GDP in 2001 (1989=100)
Armenia	-11.7	-41.8	-8.8	5.4	6.9	5.9	3.3	7.3	3.3	6.0	9.6	12.9	9.0	78
Azerbaijan	-0.7	-22.6	-23.1	-19.7-	11.8	1.3	5.8	10.0	7.4	11.1	9.9	10.6	9.4	64
Georgia	-20.6	-44.8	-25.4	-11.4	2.4	10.5	10.8	2.9	3.0	2.0	4.7	5.6	8.0	38
Kazakhstan	-11.0	-5.3	-9.3	-12.6	-8.2	0.5	1.7	-1.9	2.7	9.6	13.5	9.5	9.0	86
Kyrgyzstan	-5.0	-19.0	-16.0	-20.1	-5.4	7.1	9.9	2.1	3.7	5.1	5.3	-0.5	5.2	70
Moldova	-17.5	-29.1	-1.2	-31.2	-1.4	-5.9	1.6	-6.5	-3.4	2.1	6.1	7.2	5.5	39
Ukraine	-10.6	-9.7	-14.2	-22.9	-12.0	-10.0	-3.0	-1.9	-0.2	5.9	9.2	4.8	5.5	47
Uzbekistan	-0.5	-11.1	-2.3	-4.2	-0.9	1.6	2.5	4.4	4.1	4.0	4.2	4.2	.05	106
Eurasia	-9.7	-22.9	-12.5	-13.8	-0.8	1.3	4.0	2.0	2.5	5.7	7.8	6.7	6.45	66
South-eastern Europe	-14.8	-9.6	-2.4	3.0	6.2	3.2	-0.7	-0.8	-3.1	3.7	4.6	4.5	3.9	82
Central eastern Europe and the Baltic States	-10.3	-2.2	0.3	3.9	5.4	4.8	4.9	3.4	2.6	4.0	2.5	2.5	3.3	113

Source: EBRD. Transition Report 2003. London. Data for 2002 preliminary, for 2003 EBRD estimates. Data not available for Mongolia

Table 7. Foreign Direct Investment in Eurasia

	Cumulative inflows 1989-2002 in million US$	Cumulative inflows per capita 1989-2002 in US$	Inflows per capita in 2001	Inflows per capita in 2002	Inflows in 2001 in per cent of GDP	Inflows in 2002 n per cent of GDP
Armenia	730	243	22	37	3.3	4.6
Azerbaijan	5124	625	37	128	5.2	17.2
Georgia	969	210	22	28	3.1	3.9
Kazakhstan	13568	938	188	148	12.6	8.8
Kyrgyzstan	407	85	0	3	0	1.0
Moldova	849	199	37	25	10.0	6.6
Ukraine	4802	79	16	14	2.1	1.7
Uzbekistan	847	33	3	3	1.3	0.8
Eurasia	3412	301.5	40	48	4.7	5.5
South-eastern Europe	17739	358	79	54	4.9	3.1
Central eastern Europe and the Baltic States	119846	1761	239	358	5.1	6.1

Source: EBRD. Transition Report 2003. London. Data not available for Mongolia

Table 8. Progress in Transition

	Private sector share of GDP in % mid 2002	Governance and enterprise restructuring	Small-scale privatisation	Large-scale privatisation	Competition policy	Banking reform and interest rate liberalisation	Securities markets and non-banking financial institutions
Armenia	70	2+	4-	3+	2	2+	2+
Azerbaijan	60	2+↑	4-	2	2	2+	2-
Georgia	65	2	4	3+	2	2+	2-
Kazakhstan	65	2	4	3	2	3↑	2+
Kyrgyz Republic	65	2	4	3	2	2+	2
Moldova	50	2-↓	3+	3	2	2+	2
Ukraine	65	2	4↑	3	2+	2+	2
Uzbekistan	45	2-	3	3-	2-↓	2-	2
Russia	70	2+	4	3+	2+	2	3-
Bulgaria	75	3-	4-	4-	2+	3+	2+
Hungary	80	3+	4+	4	3	4	4-

Based on selected EBRD transition indicators, ranging from 1 to 4 with 4 meaning highest level of reform.

Source: EBRD. Transition Report 2003. London. Data not available for Mongolia.

Table 9. Legal transition indicators

	Commercial law			Financial regulations		
	Overall	**Extensiveness**	**Effectiveness**	**Overall**	**Extensiveness**	**Effectiveness**
Armenia	2+	3-	2	3	3+	3
Azerbaijan	2+	3	2	2	2	2
Georgia	3	3	3	3-	3	2+
Kazakhstan	4	4	4	3+	4	3
Moldova	4-	3+	4-	3+	4	3
Ukraine	3	3+	3	2+	2+	2+
Uzbekistan	3	3	3	2+	3-	2
Russia	3+	3	4-	3-	3-	2+
Bulgaria	4-	4	4-	3	3	3
Hungary	4-	4-	4-	4-	4-	4-

Based on selected EBRD transition indicators, ranging from 1 to 4 with 4 meaning highest level of reform. Commercial law includes pledge, bankruptcy and company law, while financial regulations include banking and capital markets law. The overall score is the average of the scores given for the two indicators, rounded up where the average did not fall exactly into the existing categories.

Source: EBRD. Transition Report 2001. London. Data not available for Kyrgyz Republic or Mongolia

ANNEX II:

QUICK REFERENCE TABLES ON THE CORPORATE GOVERNANCE FRAMEWORK IN EURASIA

Table 10. The Legal Framework for Corporate Governance in Eurasia

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
The Rights of Shareholders									
Does the law require maintenance of a central or company share register where the shareholding of investors is recorded?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law require that the relevant share register be maintained by an external and independent organisation?	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Yes
Under the law, does registration of shareholding in the central or company share register constitute proof of ownership?	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes
Under the law, can the purchaser (or, as the case may be, the seller) of shares require amendment of the register to record the change in shares' ownership?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law require that all the shares be fully paid before they can be transferred?	No	Yes	Yes	Yes	Yes	Yes	n.a.	No	No
Under the law, is the shareholders' meeting the only body authorised to elect/appoint members of the board?	No	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Is the shareholders' meeting the sole body legally authorised to dismiss members of the board?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law give the shareholders' meeting the power to:									
a) appoint auditors;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
b) approve the auditors' remuneration;	No	No	No	No	Yes	Yes	n.a.	Yes	Yes
c) request additional information regarding the auditors' report?	No	No	No	No	No	No	n.a.	Yes	Yes
Under the law, does the shareholders' meeting have the power to approve the company's audited annual report?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Does the law require that dividends be approved at the shareholders' meeting?	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Does the law give the shareholders' meeting the right to decide on the time frame within which approved dividends are paid out?	Yes	Yes	Yes	No	Yes	Yes	No	Yes	Yes
Does the law impose any conditions on a company to declare dividends?	Yes	Yes	No	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law require the distribution of dividends among holders of shares in proportion to their shareholding?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law require the distribution of liquidated proceeds among holders of shares in proportion to their shareholding?	Yes	Yes	Yes	Yes	No	Yes	n.a.	Yes	Yes
Does the law provide that shareholders should be notified of, and have the power to vote in respect of, the following corporate changes:									
a) Amendments to the company charter;	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
b) Issue of additional shares;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
c) Merger or reorganisation of the company;	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
d) Winding up or voluntary liquidation of the company;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
e) Amendment of the specific rights attached to any class of shares?	Yes	Yes	No	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law provide that existing shareholders have pre-emption rights to subscribe for newly issued shares in proportion to their relevant shareholding?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
a) Does the law allow restrictions to these pre-emption rights described in Question 2 above?	No	Yes, if specified by the charter	Yes	No	No	Yes	n.a.	No	Yes
b) If yes, is the only way to establish these restrictions through a super-majority vote of the shareholders (e.g. 75%)?	n.a.	n.a.	Yes	n.a.	n.a.	Yes	n.a.	n.a.	No

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Does the law enable a shareholder who voted against any of the corporate changes in the company as referred to in Question 1 above to sell its shares to the company for not less than a price determined by an independent valuation entity?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	No	Yes
Does the law require a shareholder meeting to be held annually, within a specified time frame (e.g., 6 months) of the end of the company's fiscal year?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law require that the annual shareholders' meeting be called by the chairman of the board of directors?	No	No, by the board of directors	No	No	No	Yes	n.a.	No	No
Does the law empower the following persons to request extraordinary shareholders' meetings:									
a) the chairman of the board of directors; or	No	No	No	No	No	No	n.a.	No	No
b) any 2 directors of the board of directors; or	No	Yes	No	No	No	No	n.a.	No	No
c) one or more shareholders whose aggregate shareholding represents at least 10% of the company's issued shares?	Yes	Yes	Yes	No	Yes	No	n.a.	Yes	Yes
Does the law enable shareholders to participate in the shareholders' meeting not only in person, but also by voting instructions in writing or by substitutes other than directors on the basis of a power of attorney?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law require a presence quorum for a shareholders' meeting be shares representing an aggregate of at least 50% + 1 of the company's issued and outstanding common and preferred shares?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Does the law require for the adoption of ordinary resolutions by an affirmative vote of a majority (of 50% + 1) of all of the company's issued and outstanding voting shares?	No	No	No	No	No	Yes	n.a.	No	Yes
Does the law require a super-majority vote of at least 75% of all the company's issued and outstanding voting shares regarding resolutions on the following matters:									
a) any amendment to the company's charter;	No	No	No	Yes	No	No	n.a.	No	Yes
b) any merger or reorganisation of the company;	No	No	No	Yes	No	No	n.a.	No	Yes
c) the winding up or voluntary liquidation of the company;	Yes	No	No	Yes	No	No	n.a.	No	Yes
d) a waiver of shareholders' tender rights in case of voluntary redemption; and	No	No	No	No	No	No	n.a.	No	No
e) any single transaction or series of transactions involving at least 25% of the company's assets?	Yes	No	No	No	No	Yes	n.a.	No	No
In the case of any proposed restriction on, or any amendment of, the specific rights attached to any class of shares, does the law require:									
a) the 50 % + 1 presence quorum and	Yes	Yes	No	Yes	No	Yes	n.a.	Yes	No
b) a super-majority vote of at least 75% of the company's issued and outstanding voting shares within each such class of shares which may be affected by the proposed restriction or amendment?	No	No	No	Yes	No	No	n.a.	No	No
Does the law provide for the right of shareholders to bring an action in order to set aside a shareholder's resolution in cases of violations of the rules relating to the holding of shareholders meetings?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law require that the company notifies the shareholders of the agenda for a shareholders' meeting at least 20 calendar days in advance of the scheduled shareholders' meeting?	No	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Does the law require a form for a power of attorney to vote on behalf of the shareholder to be sent out at the same time when the notice convening the meeting is sent out?	No	No	No	No	No	No	n.a.	No	No
In case of a proposed shareholders' meeting where any of the proposed resolutions require super-majority approval, does the law require that the company send a copy of the agenda, including any valuation reports and proposed resolutions and charter amendments to the shareholders as indicated?	No	Yes	No	Yes	No	Yes	n.a.	n.a.	Yes
Does the law require the agenda for a shareholders' meeting to be adopted by the board of directors?	Yes	Yes	No	Yes	Yes	Yes	n.a.	No	Yes
Does the law provide for additional items to be added to the agenda at the request of:									
a) The chairman of the board of directors;	No	No	No	No	No	No	n.a.	No	No
b) Any 2 directors; or	No	No	No	No	No	No	n.a.	No	No
c) Any one or more shareholders whose aggregate shareholding represents at least 10% of the company's issued and outstanding shares?	No	No	No	No	Yes	Yes	n.a.	Yes	Yes
Does the law allow shareholders to submit questions in advance of a shareholders' meeting and to obtain replies from management and board members at such shareholders' meeting?	No	Yes	Yes	Yes	No	Yes	n.a.	Yes	Yes
a) Does the law regulate cross-shareholdings (a cross-shareholding is where the company owns shares in another company which is also one of its own shareholders)?	No	No	Yes	Yes	Yes	Yes	n.a.	No	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
b) If so, is there a voting cap limiting the number of votes that a shareholder in which the company holds a cross-shareholding may exercise (for example a voting cap of 10%)?	n.a.	n.a.	Yes	Yes	Yes	No	n.a.	n.a.	Yes
Does the law impose restrictions on transactions involving shareholders with a conflict of interest regarding the transaction in order to avoid disadvantageous transaction terms for the company?	Yes	Yes	Yes	Yes	No	Yes	Yes	No	Yes
Does the law require notification to the company, the other shareholders, the securities commission, the stock exchange or anti-monopoly office if a shareholder builds up a significant shareholding in the company?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law impose any penalties for non-notification (e.g. the respective shareholder not being allowed to exercise the voting rights attached to the shares)?	Yes	No	Yes	Yes	No	Yes	n.a.	No	Yes
Does the law require an authorisation by a shareholders' resolution with a majority of 75% of the company's issued shares, before the board of directors is entitled to enter into any transaction other than for full and valid consideration as a measure to prevent a change of control in the company?	No	No	No	No	No	Yes	n.a.	No	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
The Equitable Treatment of Shareholders									
Does the law require that within any class of shareholders all shareholders have the same voting rights?	Yes	Yes	Yes	Yes	No	No	n.a.	Yes	Yes
Does the law require that all investors have access to information about the voting rights attached to all classes of shares before they purchase?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	No
Are there any laws in place which impose special restrictions on certain classes of shareholders of the company (in particular minority or foreign shareholders) regarding the voting rights and/or procedures at a shareholders meeting?	No	Yes	No	No	No	Yes	n.a.	No	Yes
Does the law require the company to disclose without delay company information which is likely to affect stock exchange prices (in order to prevent insider dealing of shares)?	No	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Are there any laws in place which prevent or punish the trading of shares where the seller or purchaser is using important information which has not been provided to the public?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	No
Under the law, if a shareholder, director, officer or employee of the company has conflicting interests in a deal between the company and another party, must such interests be revealed to the company?	Yes	Yes (for management board members)	No	Yes	Yes	Yes	Yes	No	Yes
Under the law, if the company plans to buy or sell assets or services from any shareholder, director, officer, employee, agent or representative and where the deal has a value of 5% or more of the total amount of shares of the company, at one	Yes	No	No	Yes	No	Yes	n.a.	No	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
time or over a period of time, must the board of directors ensure that the price to be paid by the company for such assets or services is fair?									
If the directors, officers or shareholders of the company who have conflicting interests to those of the company's in a deal, can they be legally prevented from voting at the meetings where the deal-related conflict of interests issues are to be discussed?	Yes	No	Yes	Yes	No	Yes	n.a.	Yes	Yes
a) Does the law allow the company to give persons including the company's directors, officers and employees the right to buy shares?	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
b) Are there any restrictions imposed on such act?	Yes	Yes	No	No	Yes	Yes	n.a.	No	Yes
Does the law require disclosure by the company of loans made to related parties (e.g. parent companies, subsidiaries, directors, employees, their spouses, children or relatives of the company or related companies)?	No	No	No[17]	Yes	No	Yes	n.a.	No	Yes
Under the law, can transactions made by companies, which are not based on fair market values, be made invalid and can action be taken against the relevant parties?	Yes	No	Yes	Yes	No	Yes	n.a.	No	Yes

[17] This is not required by law, but is required by International Accounting Standards, which all companies are supposed to adopt.

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Transparency and Disclosure									
Is the company required by law to:									
Prepare annual audited financial statements?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prepare quarterly financial reports?	Yes	No	No	Yes	Yes	Yes	n.a.	Yes	No
Prepare group accounts on consolidated basis?	Yes	No	Yes	Yes	No	Yes	n.a.	Yes	No
Disclose the employment history of individual board members and key executives?	Yes	No	Yes	Yes	Yes	No	Yes	Yes	Yes
Disclose board positions in other companies of individual board members and key executives?	Yes	No	Yes	Yes	Yes	Yes	n.a.	No	Yes
Disclose transactions with related parties of individual board members and key executives?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
Disclose information on the compensation of board members and key executives?	Yes	No	No	Yes	No	Yes	Yes	No	No
is the remuneration of the board determined by the shareholders?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Disclose to users of financial information and market participants information on reasonably foreseeable material risk	Yes	No	No	No	No	No	No	Yes	No
Disclose key issues relevant to employees and stakeholders that may materially affect the performance of the company (such as management/employee relations and relations with creditors suppliers and local communities)?	Yes	No	Yes	Yes	No	Yes	No	No	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Disclose (e.g. in its annual report or a similar document) its corporate governance structures and policies, such as providing information on the division of authority between shareholders, management and board members?	Yes	No	No	Yes	No	Yes	Yes	No	Yes
Prepare and disclose financial and operating data in accordance with internationally recognized accounting standards?	Yes	No	Yes	No	No	Yes	Yes	No	No
Have financial results audited annually by an independent auditor?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law provide a test to ensure that the auditor is truly independent from the influence of management?	Yes	Yes	No	No	Yes	No	Yes	Yes	No
How often is the company required by law to disseminate information to shareholders?	Annually , quarterly and on certain events	Annually and on certain events	Annually, semi-annualy and on certain events	Annually and on certain events	Annually and on certain events	Annually and on certain events	At least annually	Annually	Annually and on request
How often is the company required by law to disseminate information to the securities commission and the stock exchange?	Annually , quarterly and on certain events	Upon certain events	Anually, semi-annually and on certain events	Quarterly	Annually , quarterly and on certain events	Annually	n.a.	Annually	Annually, quarterly
Is the company required by law to make publicly available:									
a. Minutes of the shareholders meetings;	No	No	Yes	No	No	No	n.a.	No	No

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
b. Audited financial statements of the company, as approved by the shareholders' meeting;	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
c. Any amendments to the company charter or other constitutional documents of similar nature	Yes	Yes	Yes	Yes	Yes	No	n.a.	No	Yes
d. The names of any resigning or removed directors and of newly elected directors;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
e. The name of the statutory auditor;	N.a.	No	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
f. Information on bankruptcy proceedings?	No	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
Does the law require that documentation such as the following is made available for inspection by shareholder at the offices of the company.									
a. The company's charter or other constitutional documents of similar nature incorporating all amendments;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	No	Yes
b. Financial statements and statutory auditor reports;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	Yes	Yes
c. Any report of an independent evaluation expert prepared in connection with a shareholders' meeting;	Yes	Yes	Yes	Yes	Yes	Yes	n.a.	No	Yes
d. Minutes of each shareholder meeting and of each board meeting and any sub-committee;	Yes	No (with the exception of general	No	Yes	Yes	Yes	n.a.	Yes	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
		shareholder meetings)							
e. a list of shareholders owning 1% or more of the company's issued shares;	No	Yes	No	Yes	No	No	n.a.	No	No
f. a list of shareholders who have not fully paid for their shares and the amounts due?	No	No	No	No	No	No	n.a.	No	No
Is the company required by law to provide annual report and/or monthly/quarterly reports to third parties upon request?	Yes	No	No	Yes	Yes	Yes	n.a.	Yes	No
The Responsibilities of the Board									
Is the board legally required to act in the best interest of the company and its shareholders?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law provide for shareholders to bring actions in the name of the company against the board?	Yes	Yes	Yes	Yes	Yes	No	n.a.	No	Yes
In discharging their duties, do board members have personal liability for breaches of the law while they are in office?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Under the law, do the responsibilities of the board include[18]:									

[18] In Ukraine, the responsibilities of the board are not provided for in the law, but in the company charter. As a rule, the board is responsible for monitoring the management and protecting shareholder rights.

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Functions such as reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures?	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes
Functions such as selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning?	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes
Functions such as reviewing key executive and board remuneration, and ensuring a formal and transparent nomination process for board members?	No	No	No	No	No	No	Yes	No	Yes
Functions such as monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions?	Yes	Yes	No	Yes	Yes	Yes	n.a.	No	Yes
Functions such as ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law?	No	No	No	No	No	No	n.a.	No	Yes

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
Functions such as monitoring the effectiveness of the governance practices under which it operates and making changes as needed?	No	No	No	No	No	Yes	n.a.	No	No
Functions such as overseeing the process of disclosure and communications?	Yes	No	Yes	No	No	No	Yes	Possible	Yes
Is the board required by law to:									
Review the annual report prior to submission to the shareholders' meeting for final approval?	Yes	No	Yes	Yes	Yes	No	Yes	No	Yes
Make recommendation on issues to be voted on at the shareholders' meetings?	No	No	Yes	No	No	Yes	n.a.	No	No
Includes a sufficient number of non-executive and independent directors?	Yes	No[19]	No[21]	Yes	No[21]	No[21]	No	No[21]	No[21]
To have separate committees for dealing with financial reporting, executive and board remuneration and board nominations?	No	No	No	No	No	No	No	No	No
Does the law determine board independence?	Yes	Yes	Yes	Yes	Yes	No	No	No	Yes
Are there limitations imposed by law as to the number of board directorships that a director can hold?	Yes	Yes	No	Yes	Yes	No	No	No	No

[19] Members of the management board cannot serve on the supervisory board.

	Armenia	*Azerbaijan*	*Georgia*	*Kazakhstan*	*Kyrgyzstan*	*Moldova*	*Mongolia*	*Ukraine*	*Uzbekistan*
The Role of Stakeholders									
Does the law contain provisions for protecting the rights of employees as stakeholders?	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Does the law contain provisions for protecting the rights of suppliers as stakeholders?	Yes	No	No	Yes	Yes	Yes	n.a.	Yes	No
Do the laws contain provisions for protecting the rights of creditors as stakeholders?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law incorporate remedies for violation of stakeholder rights?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does the law permit stakeholder participation in decisions by employee representation on boards?	Yes	No	Yes	Yes	Yes	No	No	Yes	Yes
Does the law permit employee stock ownership plans or other profit sharing mechanisms?	Yes	Yes	Yes	Yes	Yes	No	No	Yes	Yes

Source: OECD, EBRD

ANNEXE III:

LIST OF EURASIAN CORPORATE GOVERNANCE ROUNDTABLE PARTICIPANTS

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