

***EFFORTS BY THE CZECH SECURITIES COMMISSION TO IMPROVE DISCLOSURE***

Presentation on by

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<sup>1</sup> A large number of issuers of publicly tradable securities is one of the most remarkable results of the voucher privatisation programme completed in 1995 in the Czech Republic. Unfortunately the growth of the capital market in terms of quantity was not paralleled by the growth of corporate governance culture and especially by disclosure. Many investors both domestic and foreign have repeatedly criticized many Czech companies that they do not provide information although they are clearly obliged to do so following the Securities Act and indirectly criticized the Czech government as well that it is not able to enforce the law.

The Czech Securities Commission (SEC) established on April 1, 1998 has analysed the situation and concluded that the improvement of the disclosure duty observance by companies must be one of three major short term tasks to be tackled immediately (together with the review of licences issued in the past by the Ministry of Finance and the management of Investment Funds and Close-end Unit Trusts opening).

As the SEC has large powers to impose penalties up to 100 mil. CZK (2,8 mil USD) and to enforce corrective measures to entities under its jurisdiction including issuers of publicly tradable securities, it has decided to apply these powers after “last warning” announced via press release. While 52 % only of companies have complied with their duties to report on their semi-annual financial results in 1998, after the “penalties bombardment” by the SEC (0,8 mil. USD), 91 % of companies complied with their reporting duties for 1998 and 95 % for the first half - year 1999 which represents a jump of more than 40 % improvement.

In addition to that the SEC together with the Securities Centre (the central depository) and the Prague Stock Exchange have looked for a way to improve the ability of investors and potential investors to have a more comfortable and ready access to financial information provided by issuers. The issuers have been asked to start sending their annual and semi - annual reports in electronic form (on diskettes) instead in traditional paper form stored afterwards in premises of Securities Centre reading room. The financial information provided by issuers in a uniform structure is available since 1999 annual reports on [www.scp.cz](http://www.scp.cz). The Czech Securities Commission publishes the history of each company’s disclosure since 1997 on <http://www.sec.cz>.

Although the periodic (annual and semi-annual) compliance with disclosure requirements has significantly improved, the SEC is still not satisfied with the ongoing reporting by companies of price sensitive information which is essential for investors to make sound decisions. In order to improve this part of issuers’ disclosure the SEC has drafted a Consultation Paper on Ongoing Disclosure Obligations of Issuers since it has found that issuers do not know well what kind of events in companies lives are to be considered as price sensitive and therefore be reported. The following items should be immediately and separately disclosed as a minimum whenever they occur (i.e. not waiting for the annual report) as well as subsequently also being disclosed in the annual report:

- a) receivables past due date where this receivable is from an entity personally or financially tied to the issuer, regardless of the size of the receivable;

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

- b) creation of reserves for potentially bad receivable(s) or any unusual write-off of asset(s) (i.e. where they represent more than 5% of issuer's assets – where the figure represents less than 5% it only need be reported in the annual financial statement);
- c) use of a material (i.e. 5% or more) portion of issuers assets as a collateral, or its freeing as a collateral, together with the value of total collateralised assets. A figure less than 5% need only be specifically announced in the annual financial statement;
- d) an accounting item that is not included in the balance sheet and that would have a material (5%) impact on the issuers net asset value (such item should be fully explained in the annual results);
- e) issuer's new capital investments, divestments, or change in level of investments(s) in other entities, where such investments represent 5% or more of the issuer's capital. A figure of less than 5% must still be disclosed in the annual report;
- f) new changes in the fulfilment of contract(s), either by the issuer or the other parties where these represent 5% or more of the issuer's annual turnover. A figure less than 5% should still be stated in the annual report;
- g) receipt of all new material grants and subsidies and their cessation, where such monies represent 5% or more of the issuer's profits. A figure of less than 5% should still be included in the annual report;
- h) new patents or licenses, regardless of size;
- i) change of economical situation of entity, in which the issuer has a material investment regardless of size;
- j) closing of a contract where the issuer sells its property (or property of an entity controlled by the issuer) and the contractual price is materially different from the fair market value, regardless of size;
- k) the issue of any bonds together with the interest rate, interest and principal payments (amounts an payment dates) regardless of size. In the event of an anticipated default in respect of such bonds, the company should report this to the SEC at least 10 day prior to such default;
- l) any operation that has an impact on liquidity of issuer's assets (e.g. securities swap, etc.) where such operation represents 5% or more of the issuer's assets. A figure of less than 5% should still be included in the annual report;
- m) a payment past its due date, where the creditor is personally or financially connected to the issuer (e.g. leasing, payrolls, coupon payment default, unpaid fine arising from breaking issuer's contractual commitments etc.) regardless of the size;
- n) issuance of option(s) on issuer's common stock regardless of the size, and a statement as to whom the options have been granted;
- o) expected material change in the level of issuer's debt (e.g. acquiring of new asset, etc.) regardless of size;
- p) issuer's unsuccessful attempt to receive a loan from a financial institution, regardless of size;
- q) any loan to the issuer which has been called by the lender, or became callable automatically after the issuers default on its contractual commitment, regardless of size;
- r) if a creditor committee or similar formal or informal grouping of creditors was created to consider issuer's ability to pay off its debts, loan restructuring, etc., regardless of size;
- s) when the issuer's creditors sign an agreement to co-ordinate their loan recovery activities, or met to consider such an agreement, etc., regardless of size;
- t) an occurrence which resulted or may result in the establishment or cancellation of a reserve by the issuer, where such occurrence represents a 5% or more change in reserves. A figure of less than 5% should still be included in the annual report;
- u) a new contract of essential importance to the issuer's business, where it is expected that such new contract will represent a 5% or more change in the profits of the issuer. A figure of less than 5% should still be included in the annual report;

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- v) a fine or other sanction imposed by a state authority or a court which will affect issuer's assets, regardless of size;
- w) failure to comply with ruling issued against the issuer by the stock exchange (or other market organiser) where the issuer's security is registered, regardless of size;
- x) when issuer's net asset value is negative or issuer's liabilities (including potential liabilities) exceeded its net asset value, regardless of size;
- y) the issuer, or entity connected with the issuer personally or financially, enters into or is about to enter into bankruptcy and the termination of bankruptcy proceedings, regardless of whether such action has a likelihood of success;
- z) the decision to dissolve the company, regardless of whether such decision is ultimately carried out or not;
  - aa) the Court's rejection of bankruptcy due to lack of assets;
  - bb) the imposition of forced administration;
  - cc) the commencement of a financial crime investigation (regardless of whether it is likely to be successful or not) or a judgement (in such a crime) against a member of the company's statutory body or against any of its key executives;
  - dd) the liquidator should report to the SEC the date when the company was deleted in Business Register and specify the nature of assets division among the shareholders.

The SEC recognises that such disclosure requirements should not place unreasonable administrative or cost burdens on companies nor should they be expected to disclose information that may endanger their competitive position unless disclosure is necessary to fully inform the investment decision and to avoid misleading the investor.

The SEC considers that all information whose omission or misstatement could influence the economic decisions taken by users of information must be disclosed without delay.

In the event that an issuer is unclear as to whether particular information would be considered, as substantial SEC staff will always be prepared to provide an individual ruling, thus providing the issuer with a safe harbour. Issuers should remember that it is not a defence against failing to make appropriate disclosure merely because certain information does not have a substantial effect on a share price movement, the disclosure requirement is when it could lead to such a movement.

All the information provided when complying with the issuer's information duty should be presented in a simple form, clearly written, and arranged so it is readily understandable. SEC will require companies to send price sensitive information in electronic form in order to be able to provide the entire market with the information in one moment.

The SEC intends to vigorously enforce compliance with disclosure requirements and to ensure that issuers of publicly traded securities promptly provide all information about their business which would enable investors to make an informed judgement about the value of their securities. The strict observation of information disclosure principles is also a measure that helps to prevent abuses of confidential information, so called insider trading.

The SEC realises it is absolutely necessary that the International Accounting Standards (IAS) are adopted. It has therefore made the Prague Stock Exchange to require the companies listed on its Main and Secondary market to report following IAS from January 1, 2001. In the meantime IAS have been translated from English to Czech and the translation is waiting for a formal approval by the Ministry of Finance.