

## SESSION I: FINANCIAL REPORTING AND TRANSPERANCY

### *FINANCIAL TRANSPARENCY AND CORPORATE GOVERNANCE*

Presentation on by

**Mr. Andrey Sharonov**

Deputy Minister, Ministry of Economic Development and Trade  
Russia

<sup>1</sup> **Corporate governance is one of the priority directions of improvement of the investment and entrepreneurial climate in the country.** The Russian Ministry of Economic Development is beginning to pay increasing attention to issues of corporate governance. The problems accumulated in this sphere require a complex approach to development of legislation on joint-stock companies, the bankruptcy procedure, the stock market, the antimonopoly policy, labor legislation, specifically, the regulation of work of enterprise leaders.

**Why is corporate governance important for the state?** “Bad” corporate governance leads to depravity of enterprises’ behavior, in particular, their accountability, to the dominance of non-market motives in decision-making, and to be more exact, to the lowering of incentives towards an increase of effectiveness and competitiveness, to overt theft, decrease of investment attractiveness of companies, high investment risk, etc. All this is damaging to the efficiency on the micro-level and, in the long run, hampers the development of the economy as a whole.

At present, Russia **has developed a certain stable system of corporate government with its own principles and specifics of the market of corporate control.** The main specifics are known:

- A relatively higher share of managers at large enterprises(in comparison with the world practice);
- Russia has an extremely low share of banks and financial institutional investors (in comparison with the European model), particularly industrial enterprises, which does not inspire hope for enhancement of corporate governance on the part of this group of investors;
- Russia in fact lacks such class as the national institutional investor (pension funds, shareholders’ funds, etc.), which is an important agent in developed market economies and whose requirements partially provide the basis for the formation of their normative corporate governance base;
- The underdeveloped stock market leads to a low liquidity of stock of most enterprises and the impossibility of attracting small (institutional) investors; on the other hand, the lack of a stock market makes the enterprises uninterested in a good reputation, specifically, in high standards of information disclosure;
- In many cases in Russia the relationships with the creditors or other stake-holders are far more important for enterprise leaders than the relations with the proprietors;
- Finally, the “non-transparent” property relations: the peculiarities of privatization and post-privatization development have led to a situation where it is practically impossible in the majority of cases to distinguish a genuine proprietor from a nominal one;

---

<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 revision.

- To a certain measure, the non-transparency of property relations results in a high degree of affiliated relations and non-transparency of business in general.

**And now let me dwell in some detail on financial non-transparency.** Excess financial “seclusion” of the Russian enterprises (when full information is available only to a real proprietor, who may well not coincide with the nominal one) is practically an element of the corporate culture.

**What is the particularity of such situation in the Russian economy?** At present, there is a tendency towards excessively high (according to world standards) concentration of property ownership, a dominant proprietor is emerging, which is quite a natural process for economies in transition. Research shows that at present, industrial enterprises finance up to 70% of all capital investments from their own resources, and today, when investment in fixed assets has invigorated, this is the principal source for the enterprises. Thus, last year less than 10% of profit was channeled for investment purposes, whereas in the current year this share has more than doubled.

The disproportion consists in the fact that the enterprise’s choice of strategy – “openness and exit to the stock market” or “seclusion and orientation on internal resources” – does not depend on the size or the property structure, and is not connected with the enterprise’s organizational-legal form. Practically all enterprises, with rare exception, tend toward the second option.

On the whole, one may say that it is caused not only by macro-economic reasons, but also by the fact that enterprises have for a long time been orienting on self-financing and credit resources. At the same time, there is a whole stratum of new enterprises, which have demonstrated the effectiveness of another strategy and carry it out quite successfully. It is very important from the point of view of image and should be cultivated as “successful experience.”

The increase of financial transparency is a goal, which is pursued by not very many enterprises. It is important to indicate the other reasons of such behavior of the managers and proprietors. Discussions often raise the **problem of violation of lawful rights of shareholders** to complete information. This is, undoubtedly, an important issue.

At the same time, I would like to draw your attention to **the problem of compliance of requirements of information disclosure with the enterprise organizational-legal form.** For example, the requirements of information disclosure by private joint-stock companies should, probably, be much lower than such requirements for public joint-stock companies. Enterprises should be offered a choice, so that the disadvantages of one organizational-legal form would be compensated by certain advantages over another.

On the whole, it is necessary **to optimize legislative requirements of information disclosure**, but at the same time, everything fixed by the legislation should be demanded very strictly. In this connection, it is important to increase responsibility for non-disclosure of information or the submission of unreliable information. It is also important to settle the issues of transparency of property, which would require the regulation of interested deals and extension of the notion of affiliated persons.

Financial transparency has never been an ultimate goal – it is one of the conditions of investor trust. Financial transparency is more like an indicator. It shows to what extent the enterprise is protected against abuse by the shareholders, the state, represented by the tax bodies, other creditors, and to what extent the owners are prepared to share control with the other investors in exchange for investment. All these problems involve all aspects of corporate governance.

### *Accounting and Auditing*

Another problem consists in the fact that the companies starting to change their strategy towards financial transparency and the stock market encounter extremely high expenses switching over to IAS. This really is an expensive venture. But at the same time, openness and transparency of activity of enterprises and organizations should be based on international standards of financial accounting.

There are several hundred large companies in Russia, many of which are transnational, and they experience already today acute necessity for maximally facilitating the use of international standards and the accounting system, adequate to these standards. As a matter of fact, it is possible to obtain the information necessary for compiling tax declarations from any properly organized accounting system. However, for the majority of Russian enterprises the transition to international standards is not a matter of priority.

The reform of the system of accounting and financial reporting is a substantial task, requiring significant investment of material, time and labor resources. This is why the process of formation and implementation of the concept of development of accounting in Russia should be mostly oriented on achievement of long-term strategic goals of the Russian economic development, and in particular, integration in the world economy and gaining solid positions on the world commodity and stock markets.

Priority objectives of the accounting reform include the creation of a normative base, adequate interpretation of all of its provisions, conveying the information on normative and methodological documents to the professional community, ensuring control, above all, on the part of the professional community, over the correctness of applying the normative base of the reform.

In this connection, it is necessary to impart a new impetus to the work of the **Inter-departmental Commission for Reform of Accounting**, whose performance requires the participation of leading specialists and experts in this sphere.

**The harmonization of the Russian provisions on auditing with the international auditing standards** should also become a component part of the reform. The standards should be worked out by the auditors themselves, rather than by the state.

The adjustment of financial reporting of credit organizations and public joint-stock companies, whose transparency influences the investment attractiveness of the economy most of all, to the international standards of financial accounting should, first and foremost, be accompanied with the corresponding normative changes of the auditing practice.

The introduction of a single system of regulation, surveillance and standardization of auditing is a necessary follow-up of the normative changes of auditing in Russia, as this form of activity involves high financial risk and should be subject to strict regulation by the state and the professional community.

It is possible to affirm that the companies that will manage to live up to the new requirements will gain both professionally and economically. But those who will fail to adjust to the changes may face a possible withdrawal from business.