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**Major issues on implementation of corporate governance disclosure requirements  
Report by the UNCTAD secretariat**

**Executive Summary**

The nineteenth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), which took place in Geneva from 25 to 27 September 2002, requested that field case studies be conducted in the area of transparency and disclosure requirements in corporate governance. Accordingly, five country case studies focusing on major issues in implementing corporate governance disclosure requirements were conducted. The countries studied were Brazil, France, Kenya, the Russian Federation and the United States of America.

This report presents a summary of the major findings of the case studies. The transparency and disclosure requirements on corporate governance that the nineteenth session of ISAR discussed were used as reference points in conducting the study. The detailed findings of the studies can be found in the following documents: TD/B/COM.2/ISAR/19/Add.1, TD/B/COM.2/ISAR/19/Add.2, TD/B/COM.2/ISAR/19/Add.3, TD/B/COM.2/ISAR/19/Add.4 and TD/B/COM.2/ISAR/19/Add.5

The main objective of the report is to draw lessons learned in the countries where the case studies were conducted and to share these with other member States that are interested in strengthening their financial markets by implementing improved transparency and disclosure requirements on corporate governance.

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## I. Introduction and background

1. The mandate of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) is to promote corporate transparency and disclosure. In the light of this mandate, ISAR discussed best practices on corporate governance disclosure requirements at its nineteenth session. The discussions were based on the report prepared by the UNCTAD secretariat based on the informal consultations of the Ad Hoc Group of Experts on Corporate Governance Disclosure entitled “Transparency and disclosure requirements on corporate governance” (TD/B/COM.2/ISAR/15).

2. The objective of that report was to provide a technical tool or checklist for regulators, enterprises and other interested parties in developing countries and in countries with economies in transition to assist them in developing their own guidelines on corporate governance disclosure. It provided a list of best practices for corporate governance disclosures required or recommended in different countries and/or used by enterprises to describe the state of corporate governance. The checklist also illustrated the increasing convergence of opinion on the content of corporate governance disclosures.

3. After its discussions ISAR agreed that further work was needed in the area of transparency and disclosure requirements for corporate governance, especially in the area of implementation. It was suggested that further work in this area include local case studies and implementation guidance. It was agreed that the twentieth session of ISAR would review the field case studies and consider ISAR’s contribution to the practical toolkit for corporate governance.

4. Consequently, five case studies were conducted. The objective of the case studies is to provide an overview of the state of corporate governance disclosure in the countries concerned and to highlight implementation issues. The studies should lead to practical insights into what has been done in selected countries to improve disclosure and what challenges those countries face regarding the implementation of international best practices. Each of the case studies could be used to draw lessons learned in the countries and share these with other member States that are interested in strengthening their financial systems by implementing improved transparency and disclosure requirements.

5. The objective of the present report is to summarize the findings of the country case studies and identify common issues. Such analysis is an important prerequisite for the effective incorporation of global principles into national policies. It could also improve national adaptation and implementation of corporate governance practices.

6. The countries in this survey are Brazil, France, Kenya, the Russian Federation and the United States of America. They were selected for the case studies because they are representative of different levels of economic development, financial market sophistication and progress in corporate governance. Additional considerations were the relevance of particular developments within the country.

7. It was felt that a number of other countries would also constitute a useful basis for analysis of issues related to good corporate governance disclosures. However, owing to resource constraints they could not be included in the study at this stage. Additional case studies could be conducted at a later stage if deemed necessary, *and if resources are available*, for the purpose of providing guidance to developing countries and countries with economies in transition in the implementation of best practices on corporate governance disclosure.

8. Each study discusses corporate governance disclosure in the context of the following issues: the institutional and legislative framework for disclosure, including stock exchanges; codes of conduct and company practices; assessment of the extent to which best practices are reflected in the disclosure requirements of selected countries and how enterprises generally comply with these requirements; and overview of implementation challenges. It is important to note that a detailed survey of enterprises' compliance with relevant regulations/requirements was beyond the scope of the case studies. This could be the subject for further study.

9. Each country's disclosure requirements were reviewed using the framework provided by the UNCTAD/ISAR report and cover financial and non-financial disclosure. Whilst information could not be found on all disclosure practices, sufficient information was available to provide a reliable picture.

10. This document summarizes key observations regarding the country case studies grouped as those which are common to all selected countries and as those which are different. It provides a summary of governance disclosure requirements based on the UNCTAD/ISAR report as a reference point. It also highlights major implementation issues in the area of corporate governance disclosure.

## **II. Key observations regarding the country case studies**

### **A. General observations**

11. It is important to recognize that the countries selected for the case studies have different levels of development and that a number of differences arising in this regard have to be considered as given. While most of the differences are beyond the scope of analysis of this paper, some of them most relevant from a corporate governance viewpoint are worth mentioning. They include the ones described below.

12. *Size of the capital market and economy.* One of the underlying differences is the size of the markets and their relevance in the context of the national economy. Kenya has the smallest market and the United States the largest. Brazil, Kenya and the Russian Federation have limited liquidity, which makes it difficult for large investors to buy and sell without causing significant stock price movements. There are also considerable differences with respect to the level of State ownership. In Kenya the largest enterprises are government-controlled and, in aggregate, produce a larger share of gross domestic product than the large private sector firms. Government ownership of productive capacity is low both in the United States and in France.

13. *There are also considerable differences in the experience with market regulation.* Some countries such as the Russian Federation have newly created markets. Others have established

relatively new markets, for example Kenya. Brazil, France and the United States have the longest market traditions.

14. *Confidence in the market varies.* Another fundamental difference is the faith that countries have in their own capital markets. In the United States the large number of corporate restatements has shaken faith in the financial system and raised questions about its integrity. The United States is, however, a country where there has always been an enormous faith in the markets and in disclosure as an oversight tool. On the other hand, Brazil and the Russian Federation are both countries in which a profound scepticism can still be observed with respect not only to the securities markets but also to the quality and effectiveness of disclosure.

15. *Differences in regulatory approaches.* Some countries have more formal regulations. For example, French tradition calls for substantive legislation. Other countries such as the United States rely heavily upon disclosure-based regulations. However, the traditional focus in the United States on disclosure is shifting towards more substantive legislation, greater regulatory involvement and an emphasis on enhanced enforcement. Brazil relies fairly heavily on voluntary codes of governance promulgated by securities market regulators, listing requirements of the stock exchange and private sector initiatives. Voluntary approaches form an important component of change in Brazil. Voluntary codes promulgated by regulators also exist in the Russian Federation. Countries also set very different priorities depending upon local circumstances. For example, in Kenya and neighbouring countries, ensuring political stability is a fundamental prerequisite for economic growth. Sound private sector governance is elusive when the rule of law is not enforced. In general, it seems that clear notions of how to deal with the large variety of issues and local circumstances are just emerging. The implementation of certain agreed upon governance principles remains a thorny question.

16. *Ownership structure.* One of the most fundamental differences is the ownership structure of enterprises. In most countries, control of enterprises is concentrated in the hands of a few dominant shareholders. Concentrated ownership is the norm in Brazil, Kenya and the Russian Federation. The United States and other countries of the Anglo-Saxon tradition typically have fragmented ownership. France was generally considered to be somewhere in between, until foreign investors started to buy into French enterprises. Today, foreign investors control most of half a dozen major French enterprises and may thus shift the balance of power. Different ownership structures tend to be associated with different governance problems. Countries with concentrated ownership tend to be concerned, first and foremost, with establishing and protecting the rights of certain specific minority shareholders. Countries with very fragmented ownership, on the other hand, appear more concerned about aligning shareholder and management interests.

### **International convergence**

17. *There are many factors which are common to building a sound corporate governance system and disclosure as part of it. There is a consensus on what constitutes good governance and on the goal.* Until recently there was still a debate about the meaning of governance. Consensus on what constitutes good governance is a recent phenomenon. Most national codes agree on the principles and in many cases on the level of detail. They seek to protect stakeholder rights, support the concept of independence and a balance of power in the boardroom, and recognize the importance of transparency and disclosure. Most propose board structures to

promote an efficient balance of power, such as independent committees, and in particular, audit committees.

18. *The international reference points are clear.* The key international reference points for good practice in corporate governance are increasingly accepted. In 1999 the Financial Stability Forum (FSF) identified 12 core standards that it felt should be adopted to build and maintain a sound financial system and avoid a repetition of the Asian crisis of 1997. The FSF's Compendium of Standards identifies the Principles of Corporate Governance of the Organisation for Economic Co-operation and Development (OECD) as the international reference point in the area of governance. The key standards for disclosure are International Financial Reporting Standards (IFRS), promulgated by the International Accounting Standards Board (IASB); International Standards on Audit (ISA) of the International Federation of Accountants (IFAC); and the Objectives and Principles of Securities Regulation of the International Organization of Securities Commissions (IOSCO). These standards form the core of recognized international pronouncements on governance.

19. *Other important international codes and deliberations can serve as reference points.* These are the International Corporate Governance Network (ICGN) code on governance and its code on voting practices, the corporate governance code for the European Association of Securities Dealers (EASD) and that of the Commonwealth Association of Corporate Governance (CACG). Each is addressed to enterprises. The OECD Principles of Corporate Governance differ in that they are the only code addressed primarily to policy makers. While national codes reflect local governance practices, most of the recent developments also draw heavily upon the knowledge acquired through pre-existing codification efforts. As a result, even national codes increasingly reflect the international consensus. The UNCTAD/ISAR Transparency and Disclosure Requirements for Corporate Governance addresses both policy makers and enterprises, and is the newest addition to this group.

20. *International agreement on reference points allows concerted action.* Prior to the recognition of international reference points, much of the debate surrounding governance revolved about the relative merits and demerits of insider versus outsider systems of governance.<sup>1</sup> The recognition of international reference points has allowed the debate to move on to more practical concerns. Accepted international reference points allow international institutions to better focus their assistance efforts. The World Bank's Global Corporate Governance Forum is currently engaged in partnership with the OECD in a global effort to provide policy advice on governance. Such an effort would have been considerably less focused in the absence of agreed principles of governance. The UNCTAD/ISAR list of best practices on corporate governance disclosure has also been developed on the basis of the consensus achieved

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<sup>1</sup> Outsider models prevail in the United States, the United Kingdom and other countries that have traditionally relied on equity markets to finance their enterprises. Ownership tends to be spread among many shareholders, with the Chief Executive Officer and management enjoying significant autonomy in relation to owners. Discipline is exercised by market mechanisms, including takeovers and the depression of share values due to sales. The insider model found in most other countries tends to be characterized by concentrated ownership that allows for close monitoring of management and close relationships between managers and shareholders. Banks may exercise discipline. The insider model ostensibly allows for closer oversight but has not proved more effective in preventing mismanagement or shareholder abuses.

on what constitutes adequate transparency and disclosure on corporate governance. It is also acknowledged that more guidance at the international level is needed in order to ensure practical implementation on points agreed.

## **B. Commonalities**

21. Even though there is considerable consensus on what constitutes good governance, it is often said that “one size does not fit all”. Differences between countries are pointed to as barriers to the development of principles of general applicability. While differences among countries can be significant, there appears to be a fair amount of consensus on the level of principles, if not on the level of implementation.

22. The aspects described below could be summarized as common features of corporate governance disclosure.

### ***Corporate governance legislation***

23. *Importance placed on corporate governance.* There is heightened interest in governance in general and corporate governance is certainly the flavour of the moment. Of limited interest until fairly recently, the governance movement has come into its own with activity on all fronts. The case studies show the extent to which countries are taking action. In each of the countries studied, corporate governance reforms are on government agendas. All of these countries have undergone recent, and in some cases profound, changes in their legislation.

24. Recent corporate failures have served as the impetus for efforts to improve governance practices. They have demonstrated that no country, regardless of its size and market tradition, is immune from governance problems. However, there is the risk that once the current market and economic malaise wears off, the importance of governance will be forgotten, or if it is not forgotten, that governance projects will be slowed or put on hold until the next crisis forces a re-examination.

25. *Enforcement problems are a commonality.* If one element stands out among the countries, it is that enforcement is an overriding concern. Most, if not all, countries have significant substantive regulation and disclosure requirements that should, broadly speaking, cover most basic governance disclosures. However, without a market regulator that can effectively monitor for violations of law and mete out punishment, the disclosure regime will not function.

26. *Listed enterprises are the primary concern of efforts on improved corporate governance and disclosure.* In all the countries studied listed companies are the focus of regulators and regulations. However, in all countries small and medium-size enterprises play the most important role in national economies. There are also large enterprises that are not listed but have a significant impact on society, and yet they escape disclosure requirements. This area therefore, needs further attention.

27. *Regulation versus voluntary approach.* Businesses tend to prefer voluntary approaches to disclosure wherever possible. One hears criticism of substantive legislation as a punishment of

the majority for the failings of a few. Enterprises tend to point to the virtues of voluntary approaches and in some cases self-regulation. The theory has been that enterprises that voluntarily adopt better disclosure practices are able to improve their reputation in the market, benefit from a lower cost of capital and ultimately enjoy better cash flows and higher share values. Another advantage of voluntary approaches is that they can help avoid perfunctory disclosure or “box ticking”. On the other hand, voluntarism has its limitations. Enterprises that need to improve most are unlikely to respond. Furthermore, voluntarism without monitoring, regulation and penalties may leave the door open to widespread abuse. Voluntarism appears to have limits where a sense of business ethics is not well entrenched in society and among business leaders. Voluntarism also has limits in encouraging broad systemic change.

28. *Coordination among parties involved.* In all the countries reviewed it appears that a number of regulatory authorities are dealing with the governance-related issues. This may lead to inconsistency of requirements and to other complications for enterprises, which may be overwhelmed by demands for disclosure of information for different purposes. For example, some governance-related disclosure could be primarily of an accounting nature, some could be more directly related to shareholder rights, while other disclosure would reflect the interests of society. Therefore, efforts might be needed to coordinate and harmonize developments in the area of corporate governance disclosure.

#### ***Private sector***

29. Considerable activity is visible in the private sector as well. Most countries have already established governance codes. The case studies show an increasing number of initiatives among stock exchanges, governance associations and ratings agencies. The impact of these private sector initiatives is varied: rules set by stock exchanges can have the force of law. Governance codes, on the other hand, may be voluntary. Both can be effective. Business groupings in all of the countries under review have made governance a priority item on their agendas and are providing training and other services to improve governance in practice. It is probably safe to say that corporate governance has, in one form or another, been the topic of discussion for every publicly traded enterprise in the countries reviewed.

30. *Increased awareness.* The media and organizations such as ratings agencies play a key role in keeping governance practices in the spotlight. Foreign investors, who tend to make up a significant portion of trading volume on most of the exchanges that were surveyed, could be important for the transfer of knowledge about the disclosure requirements they expect to find on the basis of their experience in international markets.

#### ***Impact of the US rules***

31. *US rules are also a reference point and have an impact on all other countries in the studies.* Like international standards, United States governance and disclosure practices have a broad international impact. The main difference between US practices and those identified by international forums such as the Financial Stability Forum is that US standards are not agreed upon and do not undergo international consultation to the extent that international reference points do. US standards do, however, have tremendous importance as they regulate the world’s largest securities market, a market that is home not only to US corporations but also to a



considerable number of leading enterprises throughout the world. US rules, in particular the Sarbanes-Oxley Act of 2002 (SOA), have been examined and discussed throughout the other case study countries.

32. *SOA has broad international impact.* The Sarbanes-Oxley Act of 2002 is worth further mention. It has a profound impact on foreign enterprises' listing on US exchanges and level 2 and 3 American Depository Receipts (ADRs) since those enterprises do not benefit from any exceptions to the legislation. This has far-reaching consequences in a number of areas. Most foreign enterprises will have to establish independent audit committees with new responsibilities. Executives will have new obligations such as signing off on financial statements and will suffer considerable penalties for misstatements, including fines and imprisonment in the United States. Audits will have to comply with the SOA, in particular heightened requirements for auditor independence that include limitations on the services that auditors may provide to a client. This may conflict with the national legislation of foreign enterprises. There are many other requirements that are covered in some detail in the US case study.

33. *The international reach of SOA is causing consternation among some.* The international reach of the Sarbanes-Oxley Act has raised concerns in most countries with enterprises that list in the United States. Some countries, in particular those of the European Union, perceive SOA as a threat to their ability to set domestic rules. Others are looking to SOA to see what practices it might be useful to adopt locally. While US practice is controversial, listing in the United States is, of course, voluntary. A number of European enterprises that had contemplated listings are now reportedly putting plans on hold to allow for further consideration of the impact of the new rules.

34. *The audit committee requirements of SOA are causing problems.* One of the areas in which the Sarbanes-Oxley Act is having the greatest impact is its requirement that enterprises establish audit committees that are fully staffed by independent directors. While most enterprises in the United States have audit committees, many do not, and fewer foreign enterprises do. Few audit committees globally are fully staffed by independent directors and practical questions have been raised about where to find the necessary number of qualified directors (as well as about the very definition of an independent director). Perhaps more vexing are the new powers that are given to US-style audit committees. Since the passage of legislation, they must decide on the services that auditors provide and are more directly responsible for the relationship with the auditor than ever before.

35. *Changes would conflict with company law.* For example, responsibilities conflict with the responsibilities assigned to "Fiscal Councils" and "Revision Commissions" in Brazil and the Russian Federation respectively as laid out in company law. In Brazil and the Russian Federation, the mission and the scope of the councils and commissions are narrower than those of an audit committee. Their focus could better be described as monitoring compliance with law and regulations. While many enterprises will seek to adapt their local structures and have them recognized as audit committees by the United States, changes to adapt Fiscal Councils and Revision Commissions to the requirements of SOA may require rewriting of company law.

### ***Audit requirements***

36. *The role of the audit committee and the auditor requires further examination.* Even in the absence of developments in the United States, the role of the audit committee and the relationship between the auditor and the enterprise were being examined. Increasing demands are being made for greater professionalism and independence in all of the countries under consideration, and actions to strengthen the accountability of auditors are being considered. Practical guidance on how to establish audit committees and help them fulfil new expectations would be useful for a number of countries.

### ***Accounting and audit standards***

37. *IFRS are an expressed goal.* In all of the countries surveyed, save Kenya, convergence with International Financial Reporting Standards is an expressed goal. Most countries have voiced a variety of concerns regarding their implementation. Concerns include the complicated nature of some of the IFRS, particularly financial instruments and fair value accounting, translation difficulties, disagreements over the substance of some standards, the limited size of the capital market<sup>2</sup> and limited guidance on how to actually implement IFRS for the first time. Problems are also caused by the tax-driven nature of existing accounting, especially in *small and medium-sized enterprises* (SMEs). In the United States there is concern regarding the potential loss of control over accounting regulation as one of the most fundamental aspects of the function of its securities markets.

38. *Few countries have formally implemented IFRS.* Kenya stands out as being one of two countries to have formally adopted and implemented IFRS. The fact that only two countries have done so to date indicates that the process is fraught with difficulties. The absence of experience and guidance on how to manage a transition to IFRS appears to heighten the risks associate with their adoption. Notwithstanding, the direction has been set. The Russian Federation plans full convergence for 2004 for its listed companies, and European Union countries are required to comply with IFRS by 2005.

39. *How to implement IFRS properly is not clear.* A number of approaches to implementing IFRS exist. They include adopting IFRS word for word; modifying national standards so that they correspond in their essence to IFRS; adopting some IFRS but not others; and interpreting IFRS in such a manner that there is no conflict with national practices. Standard setters at the IASB would prefer to see adoption of the letter of IFRS and unbiased interpretation; however, the practicality of this approach is not proved.

40. *There is a real danger that IFRS will become watered down.* Some have expressed concern about watered down IFRS (so-called IFRS light) and the potential for different IFRS in every country. The Council of Finance Ministers of the European Union, for example, has recently indicated a possible delay in the implementation of IASs 32 and 39 that would require marking to market certain assets and liabilities.<sup>3</sup> Some argue that IASs that require fair value accounting would make it appear that many enterprises, particularly in the insurance industry,

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<sup>2</sup> IFRS are designed primarily for companies that raise capital in the financial markets.

<sup>3</sup> Presse 201, 2520<sup>th</sup> Council meeting, Economic and Financial Affairs, Brussels, 15 July 2003, p.14.

are bankrupt. Further guidance and case studies on how to implement IFRS would be very useful. ISAR has recently developed guidelines for accounting by SMEs that are consistent with IASs/IFRS.

41. *There does not appear to be a similar impetus to implement ISAs.* There does not appear to be a similar impetus to implement ISAs among the study group. ISAs do not yet have the same level of recognition by the International Organization of Securities Commissions (IOSCO), as that enjoyed by IFRS, and efforts are being undertaken at the International Federation of Accountants to upgrade them in the way that IFRS were upgraded prior to their acceptance by IOSCO.

### ***Access to information***

42. *Access to information is a concern everywhere.* Most countries are making efforts to enhance access not only to filings but also to executives and directors through general meetings. Use of modern information technologies is also prevalent. For example, enterprises can file electronically in Brazil and the United States, and interested users can download this information. However, there are differences in terms of the quality and quantity of filings.

43. *Enterprises are also making extensive use of the Internet.* The Internet has made enormous inroads in countries such as Brazil, where websites of major corporations and regulatory bodies are of a quality that compares favourably with the best internationally. The Internet, used initially as a marketing tool by companies, now provides real data to markets and investors. It also has the advantage of putting small investors on a more even footing with institutional investors who have access to screen-based services and other sources of information.

44. *The Internet enhances transparency but is not official disclosure.* While the Internet seems to permit significantly greater transparency, it is not fully recognized as a legal channel of disclosure. In the United States, new legislation requires that certain disclosures be filed with the markets regulator and made public on the Internet. By and large, the law and regulation relating to disclosure via the Internet are still being developed. The Internet also raises issues regarding its global reach and the international effects of its regulation. Despite open questions about its status as a disclosure channel, its potential as a rapid and cost effective means of transmitting information is proven.

45. *Countries are concerned about being understood.* One of the manifestations of this is the increasing use of the English language in disclosure. In France, English appears to have been adopted alongside French as an official financial language. French enterprises have increased their use of English in both the NextPrime and the NextEconomy segments of the Euronext exchanges, whose official language is English. Brazil caters to the needs of foreign investors by requiring the use of a common business language for its highest-level listings. While English-language disclosure is not, ostensibly, a concern in the United States, legislators and regulators increasingly call for disclosure in "plain English". Much US disclosure has been criticized for its opacity. Disclosures that were crafted by financial markets professionals have been found to be

simultaneously factually correct and entirely incomprehensible—sometimes even to the experts who wrote them.

### ***Increased social and environmental disclosure***

46. *Social and environmental disclosure is making impressive inroads.* Many of the enterprises in the study provided extensive information on their social and environmental practices. Law does not generally require this information, however; enterprises provide it voluntarily.

47. *This type of disclosure still suffers from limitations.* The limitations on both social and environmental disclosure are well understood. By their very nature, social and environmental disclosures may suffer from difficulties in measurement. Some of the factors that are disclosed are qualitative and, unlike in financial accounting, cannot be quantified by a simple bottom line. The ISAR guideline for environmental costs and liabilities, and the ISAR manual for eco-efficiency indicators, have been used by the European Commission, stock exchanges in developing countries and enterprises as a useful starting point for environmental disclosure. However, social disclosure is still an emerging field, and there is considerable room for improvement in terms of comparability of reporting, consistency and verifiability of information. In the absence of standards to make information more credible, some companies use disclosure as a marketing tool without necessarily changing the substance of their actions.

48. *Rules regarding the conduct of general meetings are being improved.* Annual general meetings of shareholders cannot be considered anywhere as sufficient means of communicating with shareholders. General meetings evolved out of historical reporting practices that are today largely outdated. Today, official filings, the Internet, analysts' meetings and direct meetings with large shareholders are more effective means of communication. General meetings nevertheless continue to play an important role by providing a forum in which executives can be held publicly to account. The procedures for filing notice, amendments, resolutions and voting procedures are being improved with a view to enhancing timeliness, relevance and fair and open access.

### ***Other commonalities***

49. *Other issues regarding disclosure.* Some other observations common to the countries reviewed relate to the confidentiality of information to be disclosed; timeliness of disclosure, especially in relation to price-sensitive information; and the role of intermediaries such as lawyers, analysts, consultants and other advisers in the disclosure process.

## **C. Differences**

50. Despite the commonalities outlined above there are significant differences in governance-related disclosure among the countries that were reviewed. Some of the implied differences related to economic, political and cultural areas were discussed above. However, in relation to corporate governance disclosure these differences in most cases appear to be more in terms of the scale of changes and resources needed rather than in terms of the substance of these changes. Although improved corporate governance requires significant resources in all countries, costs are

relatively higher for emerging countries as their institutional infrastructure and regulatory framework are at present less equipped for the efforts needed. For example, the gap between their current accounting/reporting systems and international requirements is much wider than in more developed markets, and they will therefore need more resources and more time to implement IFRS and financial reporting requirements.

51. Countries also differ in terms of their access to and participation in the process of developing new benchmarks and requirements on improved corporate governance and disclosure. At present, developing countries and countries with economies in transition are less involved in the international processes of identifying best practices on corporate disclosure. Therefore, many of these countries which are most in need of being guided in the process of what is needed for improved transparency are not part of such discussions, although their wider involvement may be beneficial for facilitating consensus and buy-in of the worldwide agreed best practices.

### **III. Disclosure practices compared to the ISAR Transparency and Disclosure Requirements**

52. Disclosure practices were surveyed in the process of compiling the case studies and were compared with the ISAR Transparency and Disclosure Requirements, which are divided broadly into areas of financial disclosure and non-financial disclosure.

53. *Financial disclosure.* In the area of financial disclosure all countries have requirements for the disclosure of the enterprise's financial and operating results, related-party transactions and critical accounting policies. However, even with detailed disclosure requirements, not all enterprises actually disclose the financial information necessary for *both* shareholders and other stakeholders to properly understand the nature of the business. In some cases, local accounting standards are simply not suited to the task. In other countries, enterprises may comply with the letter of the law while subverting its spirit. In others still, disclosures may be so convoluted that they are incomprehensible even to the most sophisticated reader. Accounting policies are generally disclosed in all of the countries, although the impact of alternative accounting approaches is generally not discussed.

54. *Transparency in ownership and control.* In most of the countries reviewed, transparency in ownership and control structures could be considerably improved. In many cases, beneficial ownership remains difficult to ascertain, and pyramid structures and interlocking board directorships may make conflicts of interest difficult to detect.

55. *Non-financial disclosure.* Disclosure requirements in the countries studied compare favourably with these requirements. Perhaps one exception is that enterprises are not generally required to disclose the rules and procedures governing the acquisition of corporate control as specified in the requirements. These rules and procedures are more likely to be found in legislation, regulation and stock exchange rules. Enterprises in all countries are generally required to disclose extraordinary transactions such as mergers and sales of substantial portions of corporate assets, and are required under certain circumstances to seek shareholder approval.

56. *Board processes.* The ISAR recommendations cover a large number of aspects of board processes, including the following: the structure, role and functions of the board, and board committees; duties and qualifications; evaluation mechanisms; directors' remuneration; succession planning; and conflicts of interest. Disclosure in the countries studied was good on a general level, but becomes progressively weaker as the requirements become more detailed.

57. All countries have general requirements for disclosure of the composition of the board, and the balance between executive and non-executive directors. Requirements for the disclosure of existence of key committees are usually present. Disclosure of the functions of individual directors, on the other hand, is not usually made. The duties of individual directors, and the number of directorships held, are also not generally disclosed. Qualifications and biographical information are required, but the information provided in practice may be limited, thus making it difficult to assess the competence of directors in many countries. Disclosures can range from relatively detailed information to simple lists of the names of board or committee members.

58. The ISAR report suggests disclosure of *potential compromises affecting the independence* of directors and disclosure of why they are not significant. Requirements for evaluation of the level of independence and explanation of cases in which there is doubt are not widely apparent and disclosure seems limited. Detailed disclosure on development and training, and continuing education could not be found, nor on professional advice that has been sought. Performance evaluation of the board is rarely disclosed, much less how performance evaluations are used to improve governance.

59. *Disclosure on salary, share options and other associated benefits, financial or otherwise.* Executive and director remuneration is a sensitive issue in most countries. Filings in the United States provide the most detailed disclosure on the compensation of executives and board members, including the number of options, and information on other benefits. Disclosure in France appears to be good, though generally in aggregated form. Remuneration disclosure is low in the Russian Federation. A small number of enterprises, primarily in the United States, are disclosing the costs of their options voluntarily.

60. The length of directors' contracts and potential compensation for severance payments in the event of a takeover could not be determined in any of the countries. In the United States details of "golden parachutes" that would be triggered in the event of a takeover must be disclosed in proxy statements. Succession planning is another topic on which there appears to be limited disclosure. Specific succession plans for key executives and other board members do not appear to be generally disclosed. Conflicts of interest do not appear to be generally disclosed, nor do formal procedures to address conflicts of interest.

61. Material information regarding *employees and other stakeholders* is generally disclosed. The use of the materiality concept to distinguish mandatory from voluntary disclosure is important. Traditional definitions of materiality come from the financial markets and generally refer to information that may impact on the decision of an investor to buy, sell or hold shares. Definitions that correspond to this general notion of materiality from the point of view of the investor are common in accounting standards.

62. However, what is material to an investor—a significant change in earnings projections—may be of less interest to an employee or the public, who might be interested in planned layoffs. This latter type of disclosure may or may not be material from an accounting perspective, and while some enterprises in all of the countries surveyed disclose information relevant to other stakeholders, this type of disclosure suffers from an absence of recognized standards and practices. Enterprises may be obliged to disclose certain key employee rights and mechanisms for protecting the rights of employees in the workplace. These types of obligations are generally found in labour law. The extent to which these types of disclosure are required for other stakeholders beyond labour and shareholders could not be determined in the case studies.

63. The ISAR requirements outline a need for information on the enterprises' *environmental and social stewardship*. Examples of social and environmental disclosure could be found in all countries, although its prevalence and the depth of the disclosure varies. Enterprises in Brazil, France and the United States showed some sophisticated practices. Disclosures tend to be made by enterprises that have a significant environmental or social impact, such as energy providers or providers of public transportation services. Legal requirements tend to be fairly limited and most enterprises develop their own approach to reporting. The exception is France, where enterprises are required to produce a “social balance sheet”.

64. The ISAR requirements discuss assurances regarding *risk management* objectives, systems and activities, provisions for mitigating the possible negative effects of risk-bearing activities, and internal control systems and their effectiveness. Material foreseeable risk factors are usually discussed in filings for initial public offerings. In addition, certain risk factors must be disclosed in the financial statements according to most accounting standards if there is a reasonable presumption that they could occur. Management is generally responsible for reporting that appropriate internal control systems are in place. The extent to which the board is responsible for disclosing the mitigating of negative effects of risk-bearing activities could not be ascertained.

65. The ISAR requirements suggest that the board disclose that it has *confidence that the auditors are independent*, as well as in the process for interaction with and appointment of internal and external auditors. In many countries efforts are underway to increase auditor independence and to make the auditor increasingly responsible to the board as a representative of shareholders, rather than management. Implementation of this broad objective manifests itself through mandatory independent audit committees in the United States and limitations on the services that auditors can provide the enterprise in Brazil. In both countries, the board must fulfil certain responsibilities to help ensure auditor independence, for example the approval of non-audit services rendered by the auditor. An assessment of current rules would not appear to specifically require that the board disclose that it has confidence in the independence of the auditor and that the auditor's independence is uncompromised, or in the process for interacting with the internal and external auditors.

66. The ISAR requirements suggest that *notification of the agenda* be made in a timely fashion in an internationally used business language. All countries have established rules governing the timing and content of notification. None have an across-the-board requirement for

notification in an international business language, although Brazil has a foreign-language disclosure requirement for enterprises that are listed on foreign markets.

#### IV. Conclusions

67. The comparison of the disclosure requirements of the countries covered in this survey should be cause for optimism. Countries have legislation and regulation that correspond well not only with ISAR's Transparency and Disclosure Requirements for Corporate Governance but also with the requirements at the detailed level. However, enterprise practice across the study group varies widely.

68. Enforcement and legal recourse are of paramount importance. Beyond enforcement, other key elements that need to be in place are active owners that are able to exercise their rights effectively, particularly voting rights.

69. The case studies illustrate clearly that disclosure has its limitations. No amount of disclosure or substantive regulation will be able to prevent individuals who are intent on defrauding enterprises from doing so. This does not, however, diminish the importance of disclosure as an oversight tool. A well-conceived disclosure regime remains one of the most effective oversight tools available.

70. The costs of disclosure are real and cannot be ignored. Some of the direct costs related to improved governance disclosure are for the hiring of staff to develop procedure and documents. There are also indirect costs. Governance requires executive and managerial time, and education and training are required in order to instill new attitudes, techniques and approaches. However, the benefits are likely to outweigh the costs when one considers, for example, the enormous losses in asset values, costs of layoffs and the loss of pensions that were suffered as a result of the Enron bankruptcy in the United States and the damage to the credibility of financial markets. Therefore, one of the prerequisites of improved disclosure on corporate governance is that sufficient resources be available for this in both the public and private sectors.

71. *Implementation, more than policy guidelines, is country-specific and idiosyncratic.* There is a broad consensus on the principles that determine good governance. However, there is considerably less agreement on how to implement those principles. Each country has specific conditions, related to the size of markets, the effectiveness of the judicial system, the sophistication of investors, the quality of public sector governance, resources and the development of the business media, among others. The list could be extended indefinitely. Implementation is a highly specific exercise. More than with general principles, one size does not fit all.

72. *There might, nevertheless, be some areas that might lend themselves to a "toolkit" approach.* This being said, some areas have emerged from the cases that would appear to benefit from further practical guidance. These include guidance on the role of the audit committee in governance; how to establish and run effective audit committees, including their relationship with the auditors; the introduction of IFRS; and addressing the problem of improved accounting by SMEs.



73. Improvements in governance are much more likely to have a positive impact on emerging and developing markets than in established markets. While challenges in developing countries are greater than in countries with established markets, the benefits of governance can also be expected to be proportionally larger. The premiums that investors demand from enterprises in countries where governance falls below their expectations are considerable. By closing obvious gaps, developing countries have the opportunity to reap considerable benefits.

74. The case studies show that ISAR could further contribute to improved transparency and disclosure in corporate governance. It may consider developing its work in this area further, with a view to drawing up implementation guidelines on transparency and disclosure on corporate governance. Such an output could become voluntary technical guidelines and could be of particular benefit to member States that are in the process of reviewing their requirements in this area, as well as to those that are beginning to consider putting in place transparency and disclosure requirements. The twentieth session may call on an ad hoc group to conduct consultations during the inter-session period and present proposals on implementation guidelines to the twenty-first session of ISAR.