



Translation and Corporate Governance in Russia

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This presentation is the property of
Megan Lehmann.

Introduction

- What is corporate governance?
- Brief overview of the history of corporate governance in the US
- Brief overview of the history of corporate governance in Russia
- How does translation fit in?



Introduction

Who are the players in the corporate governance system?

- Shareholders
- The Board of Directors
 - Independent directors
 - External experts
 - Board committees
- The corporate secretary & support
- Management
- Rating agencies
 - Review of a Corporate Governance Score Report



What is corporate governance?

A system of:

- Regulations
- Legislation
- Ethics



Used to:

- Employ
- Monitor
- Enforce

Internal control



What are the purposes of corporate governance?

- Protect shareholder rights
- Serve shareholder interests
- Increase the value of the company's shares

HOW?

Adhere to best practices in disclosure, transparency, reporting & decision making.

Provide the public, investors, regulators and rating agencies with timely and accurate information



Corporate Governance

internal participants



- The Board
 - Board committees
 - Corporate secretary
- Management
 - Management Board
 - CEO
- Shareholders
 - and shareholder representatives



Overview of Corporate Governance in the US



- A focal point of business since the 1930s after the Great Depression
- Traditionally different structure than that of Russian businesses: CEO's role with the BoD and no management board per se
- Similarities: early corporate development in the US and Russia both experienced high concentration of power (Robber Barons, Oligarchs)
- US corporate governance has gone through many changes and legislative developments, may influence the development of corporate governance in Russia

US Corporate Governance



Shareholders oversee
Board of Directors

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Board of Directors
oversees CEO &
management

*



Management oversees
company operations

The US System: Potential Conflicts

The Board hires and fires the CEO...
BUT: the CEO traditionally chairs
the Board of Directors.

The Board is meant to oversee
management, including the CEO...

Can the CEO oversee himself objectively?

*A question of ethics
& a potential conflict of interest...*



US Corporate Scandals

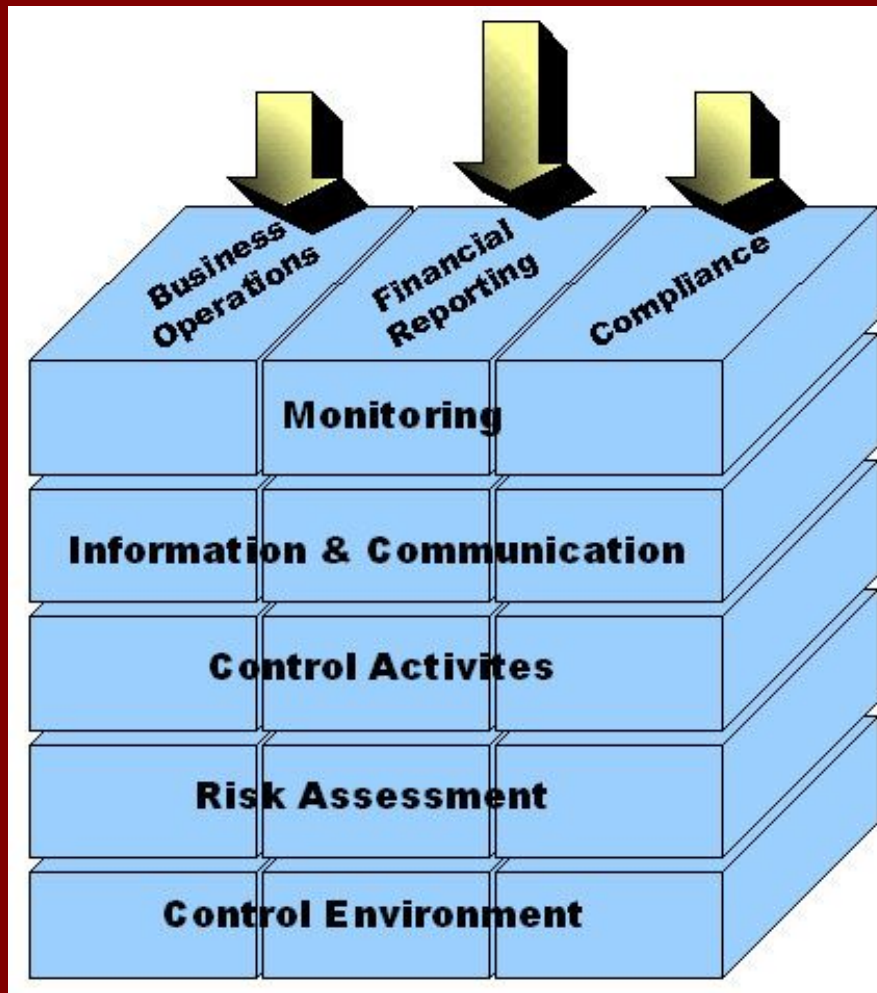
- Enron
- WorldCom
- Arthur Anderson

Demonstrated the results of poor ethics and poor corporate governance practices.

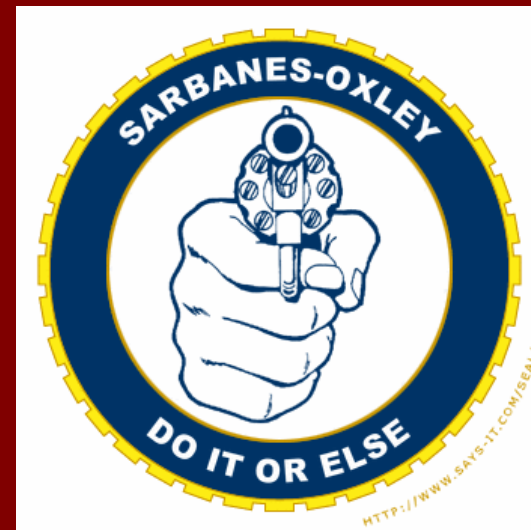
Thousands of jobs lost.

Arthur Anderson exits the audit industry,
reducing the Big Five to the Big Four.

US CorpGov after Enron: New Regulations



Introduction of the Sarbanes-Oxley Act (SOX)



New restrictions imposed on financial reporting practices & relations between independent auditors and corporations

Corporate Governance in Russia



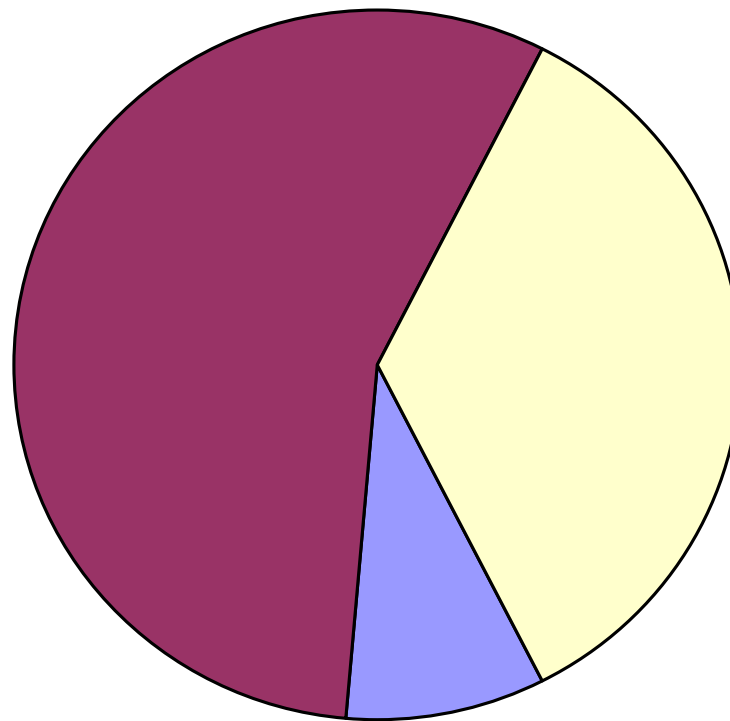
- Still very young: growing, changing and adapting
- Started from a blank slate upon the fall of the Soviet Union and “corporatization,” followed by privatization.

From the Government to the Public

100% state-owned companies were divvied up into calculated authorized capital, which was distributed among:

- **Company managers**
- **Company employees**
- **Federal and/or local government**

Post-Privatization Ownership Structures



■ Management
■ Employees
■ Outsiders

Power Grabbing

Managers sought to accumulate controlling stakes by:

- Intimidating employees
- Retaining inefficient staff



- Preventing sale to outsiders
- Refusing to acknowledge other owners
 - Violating minority shareholder rights

Conflicts: ownership & management

- **Managers were often also owners**
- **Managers had different interests than other shareholders, such as the government**
- **Each pursued their own interest, hindering progress and development**



Progress: transition continues

- Financial crisis of 1998 levels the market
- Globalization trends
- Interest in securing strategic investors, including from abroad
- Desire to earn a solid international reputation



Positive Developments Today



- Boards are no longer just a formality
- Hiring professional corporate secretaries
- Actively cooperating with independent auditors and rating agencies
- Adopting international practices
- National councils and associations for corporate governance

Difficulties Ahead?



Challenges:

- Corruption
- High barriers to entry
- High level of bureaucracy
- Russian stock market issues

Where does translation come in?

- Russian companies are now interested in global practices
- Russian companies hiring independent directors who may not speak or read Russian
- Russian companies now seek to publish annual reports, audit statements and financials in English and Russian

What gets translated?

Everything and anything a director may need in order to perform his duties as a fiduciary, duty of ordinary and prudent care, and duty of loyalty.

- Bylaws
- Meeting minutes & agendas
- Contracts
- Corporate strategies
- Internal audit reports
- Internal correspondence
- Policies & regulations
- Budgets
- Excerpts from legislation
- Excerpts from insurance policies
- Incentives programs
- Corporate Codes

...and the list goes on!

What will you need in your translator's arsenal?

- General legal, and a basic understanding of local legislation and regulations
- General finance, including but not limited to budgeting, audit, accounting, and securities
- Industry-specific terms (i.e. banking, mining, insurance, IT, etc.)

CAT Tools

Definitely use them!

Many corporate documents are drafted, then revised, then revised again, then revised several more times – and you usually have to translate each version. People rarely track the changes, which makes CAT tools invaluable much of the time.

Deadlines are short and volumes are high!

Who are the players in a corporate governance system?



Key External Players:

- Regulators
- Legislation
- Financial standards
- **Rating agencies**

Key Internal Players:

- Shareholders
- Board of Directors
- Management
- Corporate Secretary

Legal Entities in Russia

We all recognize:

- ZAO (closed joint-stock company, CJSC)
- OAO (open joint-stock company, OJSC)
- OOO (limited liability company, LLC)



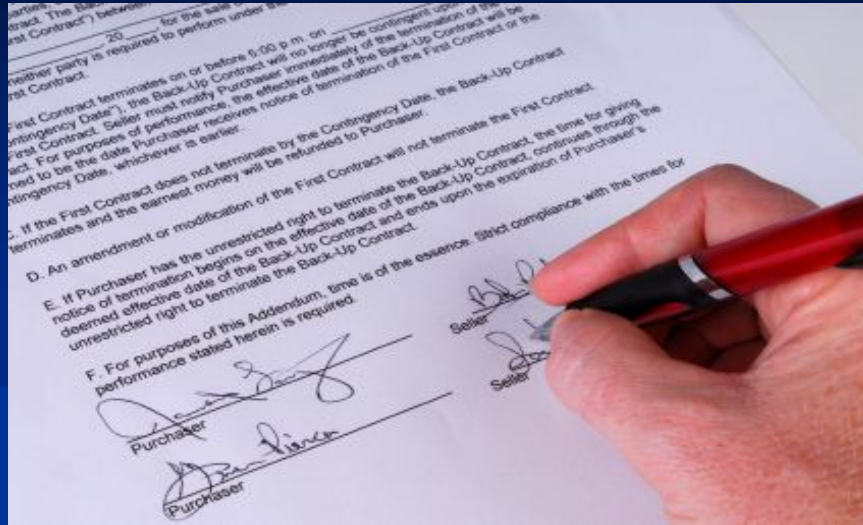
So what's the difference?

Legal formats are governed by the Federal JSC Law

- Both CJSCs and OJSCs may issue stock
- Only OJSCs may issue stock via a public subscription (CJSC via a closed subscription)
- A CJSC may not have more than 50 shareholders
- Both JSC formats must have more than one shareholders



Legislation & Regulations



In the US

- Sarbanes-Oxley
- Delaware state law
- SEC rules and regulations
- Stock exchange regulations
- GAAP
- FASB
- Internal regulatory documents

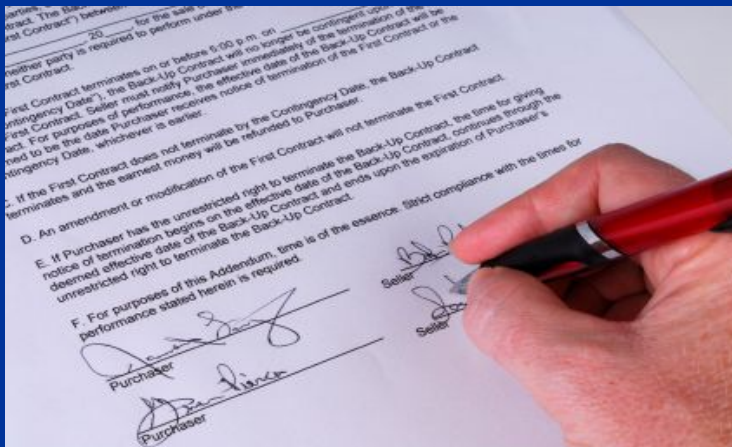
In Russia

- Russian federal law
 - The Federal JSC Law
 - Law on currency regulation and control
- The Russian Federal Civil Code
- CBR Regulations (i.e. the Bank of Russia)
- RAS
- FFMS Regulations (Federal Financial Market Service)
- Internal regulatory documents (bylaws, policies)
- IAS & IFRS

Bylaws

Bylaws set out the procedures under which a management or executive body functions

- I. General outline defining the purpose of the regulations
- II. A definition of the purpose and function of the body, i.e. the Strategy Committee
- III. The Responsibilities of the X committee
- IV. The Rights of the X committee
- V. Committee structure and formation
- VI. Member requirements
- VII. Chairman
- VIII. Secretary
- IX. Meeting procedures
- X. Meeting notification
- XI. Recording quorums and taking decisions
- XII. Meeting minutes
- XIII. Performance appraisal
- XIV. Amending bylaws



Shareholders & Stakeholders

- **Shareholders** own interest (or shares) in a company's authorized capital
- **Stakeholders** include shareholders and any other parties that hold material or other interest in the company: employees, counter parties, subsidiaries, clients, suppliers and sometimes government agencies.





SHAREHOLDERS

- Minority shareholders
- Majority shareholders
- Controlling shareholders
- Blocking stakes



SHAREHOLDER RIGHTS

- Shareholder rights depend on what kind of stock the shareholder owns: common or preferred
- Articles 31 and 32 of the federal JSC law define shareholder rights and responsibilities for common and preferred shareholders, respectively
- A company's charter and GM bylaws will also define shareholder rights



Common shareholders have the right to:

- **Participate in GMs with voting rights**
- **Propose agenda items for GMs**
- **Obtain information about company operations**
- **Receive dividends when paid**
- **Exercise privileges (preferred rights to buy new share issues)**
- **Receive a portion of the company's property under liquidation**



Preferred shareholders have the right to:

- **Receive dividends when paid**
- **Attend and vote at GMs with agenda items on liquidation, restructuring, and charter amendments concerning shareholder rights**
- **Exercise privileges (preferred rights to buy new share issues)**
- **Attend and vote at GMs on all agenda items that fall within their terms of reference AFTER the AGM if the AGM ruled not to pay dividends**
 - *If dividends are paid, then preferred shareholders lose their rights to attend other meetings and vote on issues other than liquidation, restructuring or charter amendments*



Shareholder Representatives / Proxies

- **Promote the interests of shareholders on their behalf**
- **Attend meetings (BoD and GMs) on behalf of shareholders**
- **Vote on behalf of shareholders**
- **Shareholders may elect their representatives to sit on the board of directors**



GENERAL SHAREHOLDER MEETINGS

- **General Shareholder Meeting (GM)**
- **Annual General Shareholder Meeting (AGM)**
- **Extraordinary General Shareholder Meeting (EGM)**
 - **ALSO: Special General Meeting**



WHAT DO GMs DO?

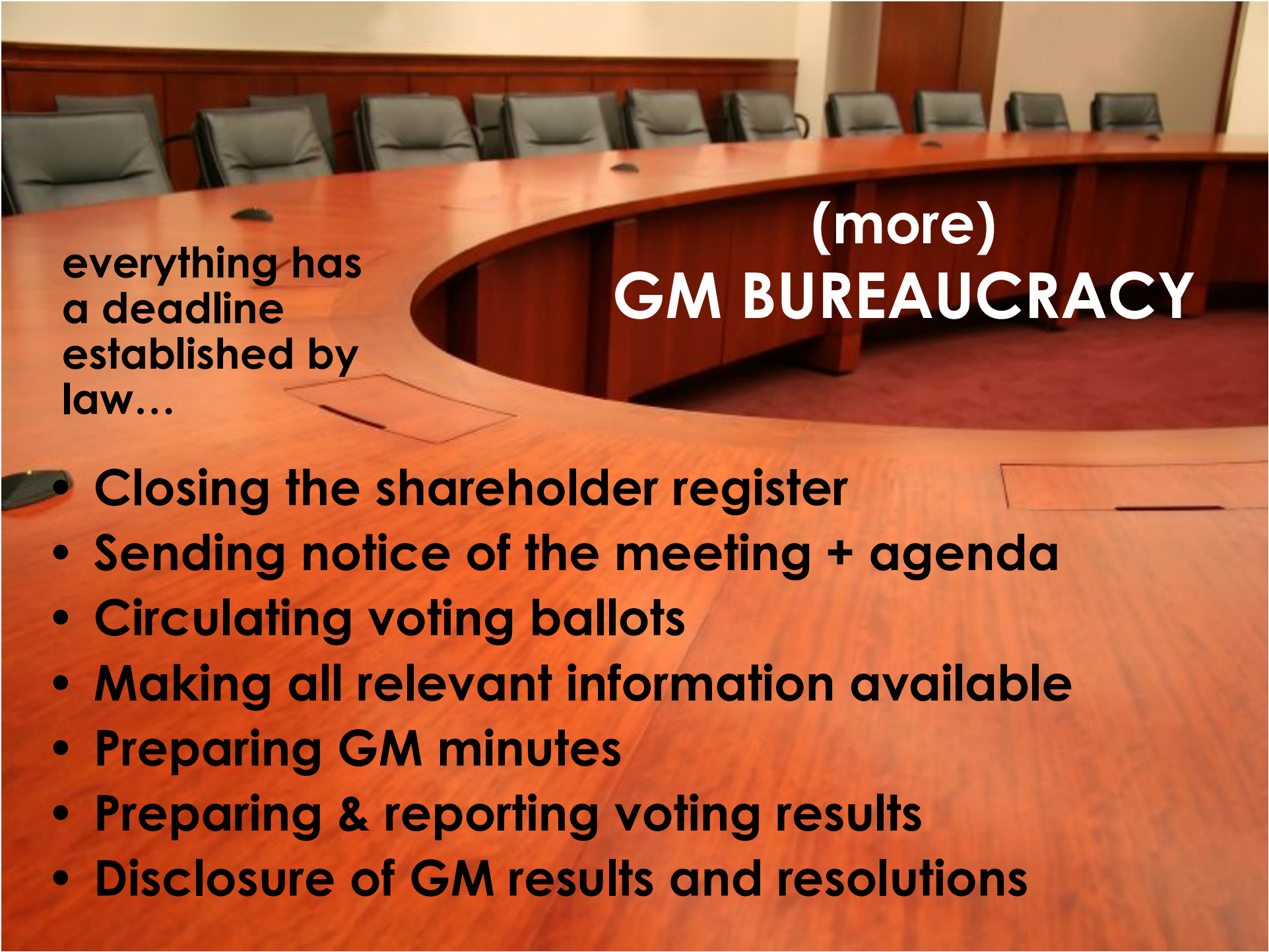
- **Elect (and reelect) the Board of Directors**
- **Approve amendments to the charter**
- **Approve transactions with interest**
- **Authorize restructuring (including M&A) or liquidation**
- **Authorize an increase or decrease in the company's authorized capital**



GM BUREAUCRACY

The BoD must rule to convene a GM

- 20 days before the GM date for an AGM
 - 30 days if the agenda includes an item on restructuring****
- 50 days before the meeting date for an EGM**



**everything has
a deadline
established by
law...**

**(more)
GM BUREAUCRACY**

- **Closing the shareholder register**
- **Sending notice of the meeting + agenda**
- **Circulating voting ballots**
- **Making all relevant information available**
- **Preparing GM minutes**
- **Preparing & reporting voting results**
- **Disclosure of GM results and resolutions**



What gets translated for a GM?

- **Required meeting material**
 - (often has already gone through the Board)
- **Meeting notices**
- **Agendas**
- **Ballots**
- **Minutes**
- **Voting results**

The Board of Directors



The Board of Directors

- Shareholder representatives
- Directors
- Independent Directors
- Management representatives
- Chairman of the Board
- Corporate Secretary

Board Committees:

- Strategic
- Audit
- Risk
- Remuneration



Directors

What does their job involve?

3 Key Duties:

- Serve as a **fiduciary**: a person entrusted with handling a company's **financial and material** decisions
- Duty of ordinary and prudent **care**
 - knowing what's going on
 - ensure a functioning reporting system
- Duty of **loyalty**
 - to shareholders
 - to corporation



Independent Directors & Independent Status

An Independent Director:

- may not be an officer or employee of the company and has not been for the past 3 years
- may not be an officer of another company in which any of that company's officers is a member of the board committee for nominations and remuneration
- may not be affiliated with a company officer
- may not be affiliated with the company or its affiliated parties

Independent Status Requirements



Independent Directors & Independent Status

An independent director:

- may not own enough interest in the company to nominate him/herself to the Board of Directors
- may not receive remuneration for consulting or other services provided to the company (other than directorship remuneration)
- may not represent the interests of external consultants or counter parties
- must publicly declare his or her independent status prior to election to the board.

Independent Status Requirements



External Experts & Consultants

- May be elected to sit on board committees (with or without voting rights)
- May be asked to attend some board meetings (no voting rights)
- Provide consultation in their field of expertise



Board Committees

- Audit Committee
- Strategy Committee



- Risk Committee
- Nominations & Remuneration Committee

Board Committees

- Help save time at board meetings
 - Prepare issues for board review
 - Weed out issues that don't need to go to the board
- Work closely with management
 - instruct management on preparing meeting material, papers, analyses, budgets and policies

Board committees are formed and elected by the board of directors





The Audit Committee

- Oversees all kinds of audits:
 - Quarterly, half-yearly, annual
 - Independent and internal
 - Financial and other themes
 - Planned and unplanned
- Oversees the internal control system

Audits are a regular and necessary part of corporate operations and provide information for investors, the public, and regulatory bodies.



Audits & Audit Reports

- Internal Audit Department

- Revision Commission

(statutory audit board – required by law)

The Big Four

- Ernst & Young
- KPMG
- Pricewaterhouse
Coopers
- Deloitte Touche
Tohmatsu

- Independent (external)
auditor
 - IFRS Financials (annual)
 - Big Four
 - RAS Financials (annual)



Audit Best Practices

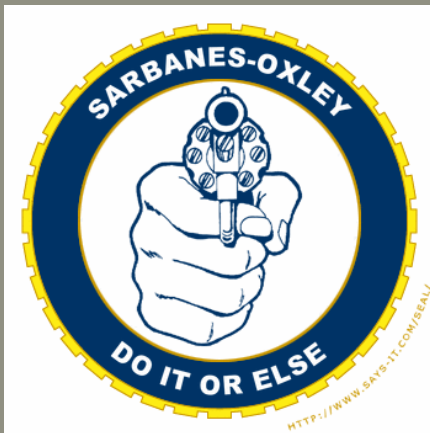
The Sarbanes-Oxley Act

- Auditor rotation

Change the independent auditor every 4-6 years

- Restrictions on non-audit services

A company's independent auditor may not provide certain other additional services, including: legal services, bookkeeping, internal audit outsourcing, or financial system design





Other Guidelines for Best Audit Practices

COSO: Committee of
Sponsoring Organizations
(of the Treadway Commission)

BASEL-II

A set of audit and reporting guidelines for **banks** based on the Basel Accords, issued by the Basel Committee on Banking Supervision.

A set of recommendations on:

- Control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring



Accounting Standards

IFRS & IAS

International Financial Reporting
Standards

&

International Accounting Standards

RAS

Russian Accounting Standards

There are some
differences between
IFRS and IAS.

Both IAS and IFRS
are both applied
today.

IFRS is a more recent
set of standards than
IAS.

Russian law requires companies to issue
RAS financials but many companies also
issue IFRS reports since RAS is generally
inaccessible to foreign investors.

The Risk Committee

- Oversees the company's risk management function
- Performs risk assessment
 - Risk mapping
 - Scenario-based analysis
- Works closely with the CRO



The Risk Committee

Risk reports will address the management of a number of risks:

- ❑ Credit risks
- ❑ Liquidity risks
- ❑ Industry-specific risks
- ❑ Operational risks
- ❑ Reputation risks
- ❑ Legal risks
- ❑ IT risks
- ❑ Regulatory risks
- ❑ Counter party risks



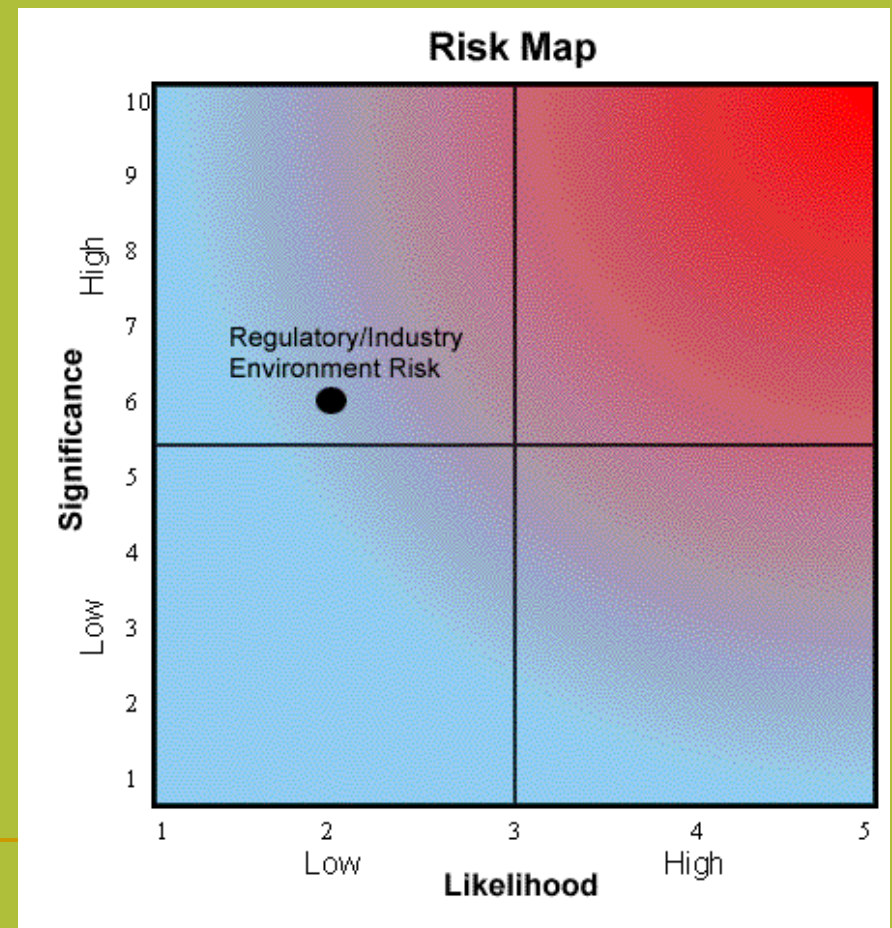
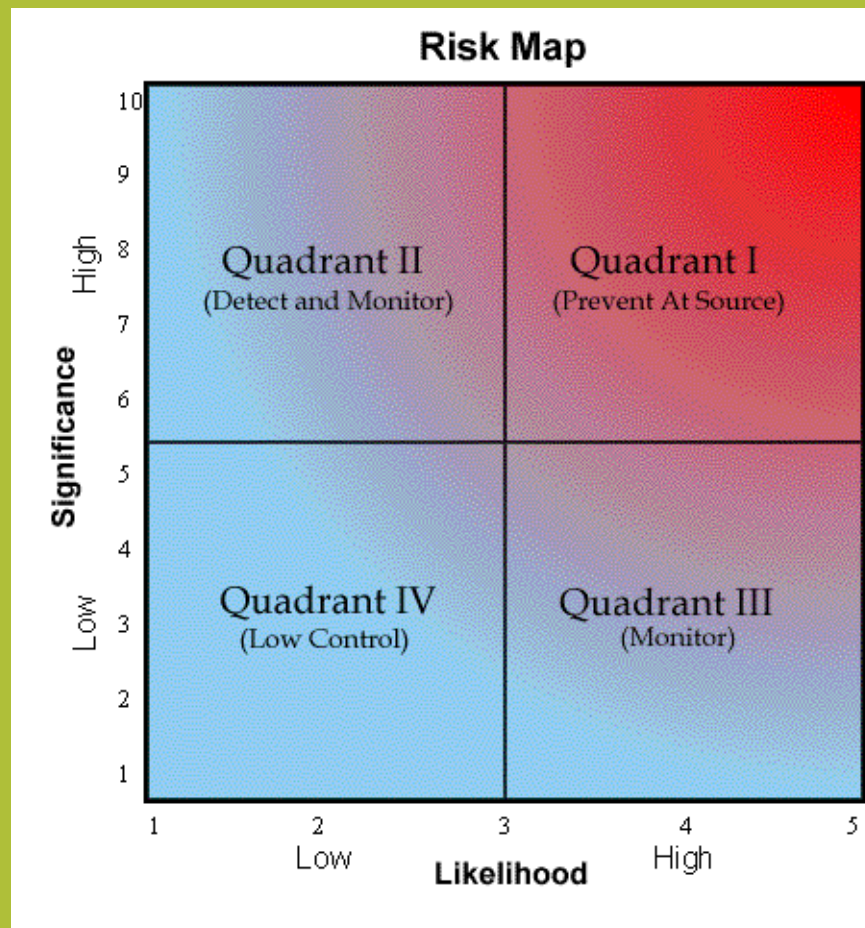
Risk Assessment Surveys

Risk assessment surveys are used to evaluate and prioritize identified risks. This step in the risk assessment process comes before risk mapping.

Significance	Likelihood of Occurrence	Risk	Business Risk Definition
(Rate 1-10, with 10 as the most significant risk; only use each number once)	(Rate 1-5, with 5 as certain to occur and 1 not likely to occur)		
1. <u>6</u> (Example)	<u>2</u> (Example)	Regulatory/Industry Environment	1. The risk that changes in regulations and actions by regulators can result in increased competitive pressures and significantly affect the company's ability to efficiently conduct business.

Risk Mapping

Risk mapping is a tool used to prioritize different risks in terms of likelihood and significance.



Scenario Analysis

- best scenario
- worst scenario
- no-change scenario
- market crisis scenario

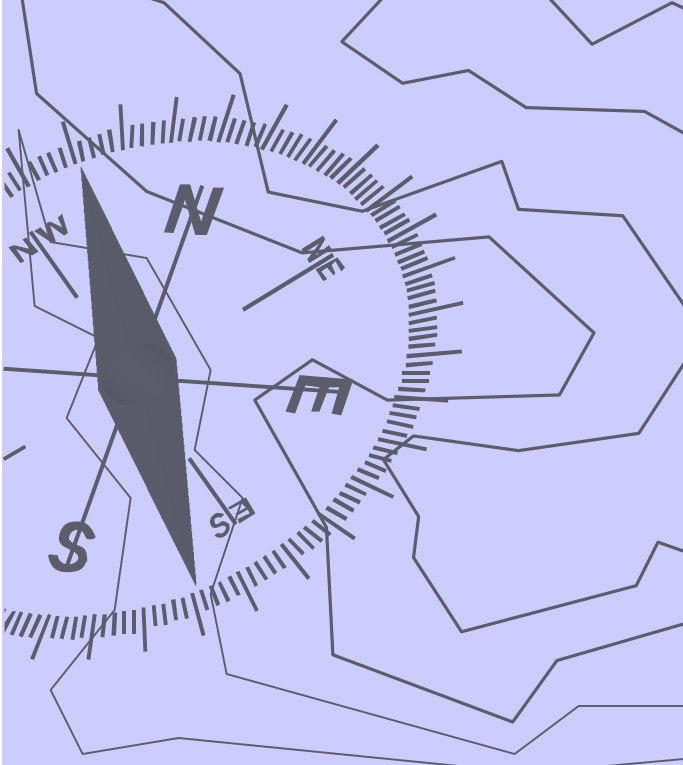
The implications and likelihood of different risks can vary in different scenarios. Corporations should manage risks and aim to be prepared for worst case scenarios.

The Strategy Committee



► Oversees the preparation of all kinds of corporate strategies:

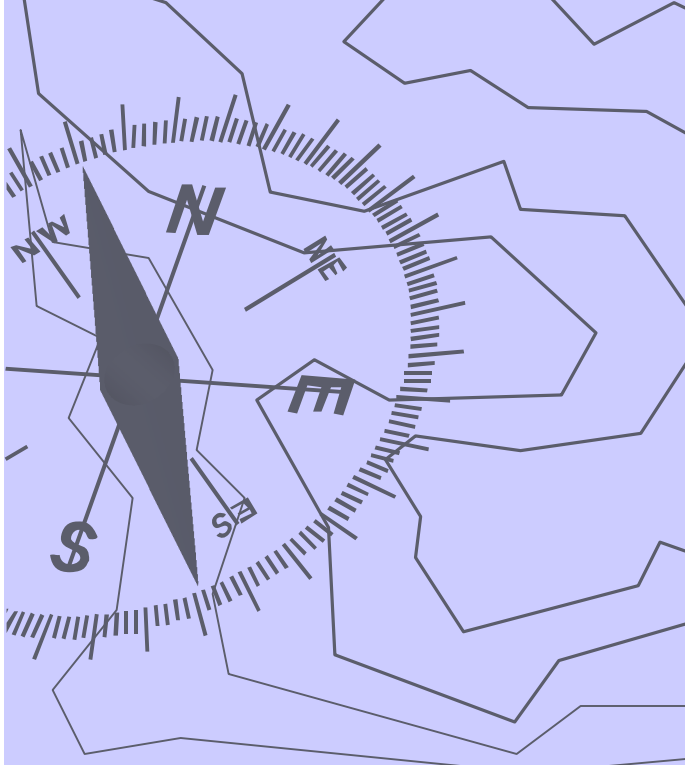
- long-term business
- retail
- investment
- HR
- IT
- branches



The Strategy Committee



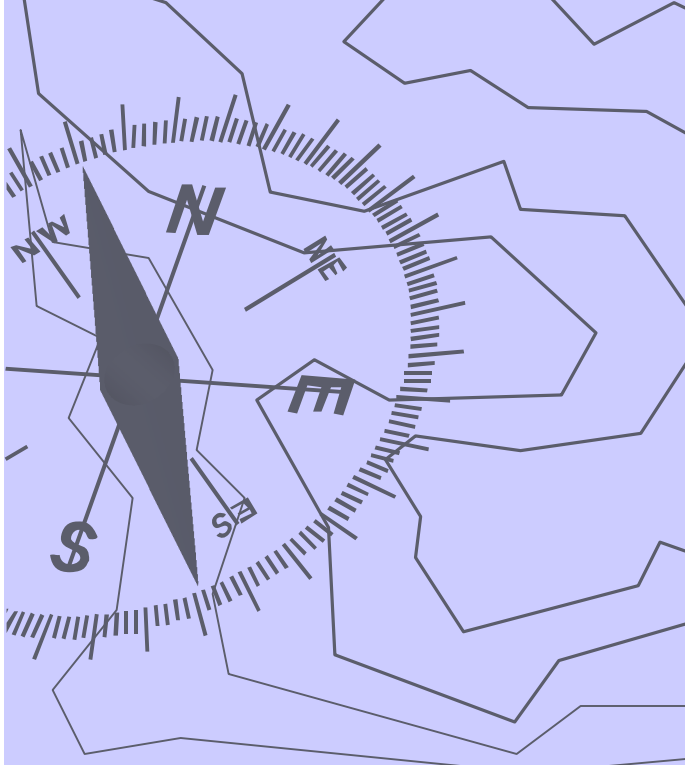
- ▶ Keeps the organization abreast of where it stands among its competitors:
 - peer analysis & benchmarking
 - ▶ Does the company measure up?
 - perception audits
 - ▶ What do customers think?
 - ▶ What does the public think?



The Strategy Committee



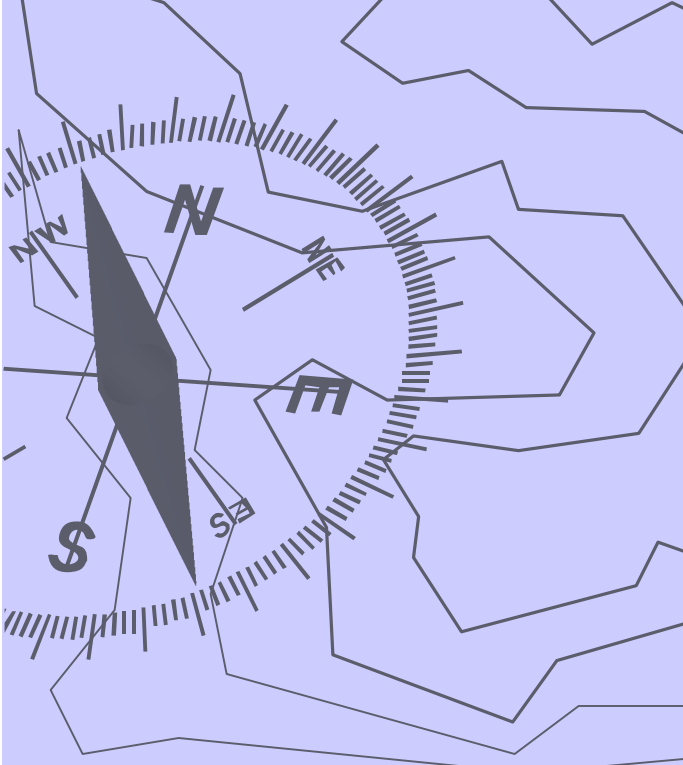
- ▶ Keeps company focused on the areas in which it excels, and out of the fields in which performance has been poor
- ▶ Considers barriers to entry for introducing new (or expanding existing) lines of business



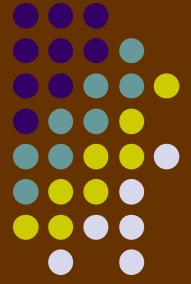
The Strategy Committee



- ▶ Oversees the drafting of (non-operating) budgets for company strategies
- ▶ Like the Risk Committee, the StratCom also considers tax, regulatory, political and legislation risks



THE COMPENSATION COMMITTEE



- Highly confidential information
- Considers:
 - potential new hires & candidates
 - open vacancies
 - market level remuneration for specific positions
 - the HR Strategy (with the Strategy Committee)
 - remuneration & incentives packages for various employee groups



REMUNERATION DOCUMENTS



Short proposals backed by the CEO concerning:

- pay raises, promotions and transfers
- adjusting an existing remuneration package for a specific employee or group of employees
- a remuneration package for a new hire or group of new hires

These proposals primarily concern senior management, not employees in the lower rungs.



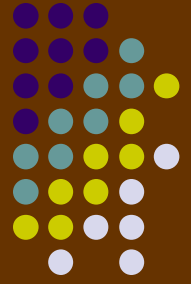
NOMINATION PROPOSALS



- Nomination proposals will be backed by the CEO or the HR Director
- Nominations may be made by the CEO, another member of senior management, a director, the Chairman of the Board, or a third-party executive search firm
- The company may also commission a third-party firm to comb the market for potential candidates and expected salary levels in a certain field



INCENTIVES PROGRAMS



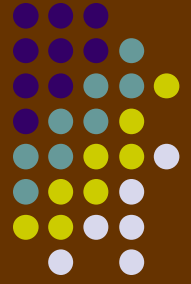
Incentives programs set out:

- remuneration policies
- bonus policies
- benefits policies
- KPIs (key performance indicators)

It is not uncommon for members of senior management to have addenda to their work contracts setting out their bonus and benefits terms and conditions as well as KPI expectations and other targets that they are to work towards (often for a period of one year).



PERFORMANCE APPRAISALS



Annual reviews of:

- CEO
- Corporate secretary
- Board of directors (often performs its own appraisal)

CEO reviews senior management

Committee will discuss members of management whose performance is under par



The Corporate Secretary



- secretarial functions for the BoD, committees and chairmen
- travel & accommodation arrangements
- preparation and storage of documentation (incl. minutes and agendas)
- ensure smooth communication between the BoD, the management board and shareholders

The Corporate Secretary



- Also responsible for organizing
 - board meetings
 - board committee meetings
 - general shareholder meetings
 - disclosure of corporate events
- and ALL related documents and paperwork!

...the list may look short, but that's a lot of work!

The Corporate Secretary's Support



The corporate secretary must delegate some responsibilities to her support team, which may include:

- one or more personal assistants
- legal counsel
- board committee secretaries
- a translator 😊

Meetings



- Board meetings are often held once a month (depends on the company's needs)
- Board and committee meetings are where the nitty-gritty and behind-the-scenes decision making takes place
- Meetings are also a place you may find interpreters (esp. for Board meetings)

Minutes



- Formal records of what took place at a meeting:
 - Who attended
 - Who said what (level of detail varies greatly)
 - Who voted and how
 - What resolutions were passed

A major factor in measuring a company's level of transparency and disclosure.

Rating Agencies & CGS Reports

- International credit rating agencies assign ratings to companies and countries evaluating their solvency
 - Fitch
 - Moody's
 - Standard & Poor's (S&P)
- Credit ratings provide information for current and potential investors

Rating Agencies & CGS Reports

- Standard & Poor's also issues Corporate Governance Scores (CGS).
- S&P began issuing CGS reports in 2000 in the US, but stopped issuing public CGS reports in 2005
- Companies can still request a CGS report from S&P:
 - Abridged reports (available to S&P subscribers)
 - Full reports (confidential and available to the company only)

Rating Agencies & CGS Reports

STANDARD
& POOR'S

Corporate Governance Score

Rating Agencies & CGS Reports

- Ownership structure & external influences
 - transparency of ownership
 - ownership balanced, or under tight shareholder control?
- shareholder rights and stakeholder relations
 - transparency of shareholder meeting procedures
 - transparency of cash flow and dividend procedures

Rating Agencies & CGS Reports

- transparency, disclosure and audit
 - information the company releases about itself
 - promptness with which information is released
 - regularity and quality of reports (financials, audits, etc.)
- board structure and effectiveness
 - number of independent directors on the board
 - frequency of meetings
 - board committee activities
 - the way in which decisions are generally made

Rating Agencies & CGS Reports

- This sample report illustrates what some of the most important factors are in good corporate governance
- The official S&P translation serves as an excellent resource for corporate governance terminology

resources

- **The Russia Corporate Governance Manual (published by IFC)**
<http://trade.gov/goodgovernance/CorpGovManual.asp>
- **Ernst & Young's English translations of Russian Federal legislation**
<http://tax.eycis.info>
- **Aktsionernoye obshchestvo Journal**
www.ao-journal.ru

resources

- **The ICLG: Institute of
Corporate Law & Governance**
www.iclg.ru
- **Corporate Governance in
Russia**
www.corp-gov.org

resources

- **The National Council for
Corporate Governance**
www.nccg.ru
- **The Independent Director's
Association**
www.nand.ru/eng/index.php

the end