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Corporate Governance – a Component of Transparency and Corruption Prevention

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Reviewer – Munteanu Stela, Ph.D. in economics

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Introduction

The failures of major corporations (Enron, Arthur Andersen, Marconi, Parmalat) have revealed the importance of a good corporate governance and have shown that inadequate corporate governance, even in conditions of a well developed market economy, may seriously affect both the shareholders, the stakeholders (creditors, the state, the investors, the suppliers, the consumers) and the well being of many layers of the population – the employees, the depositors, the retired. It should be mentioned that the emerging problems could have less negative consequences if more efficient methods existed for control and monitoring of the responsibility of corporate management and of the transparency of their activity. There are also numerous examples of this sort in the Republic of Moldova, if we are to recall the failures of the capital market and banking sector.

Is corporate governance of importance in developing countries? Should it be placed in the focus area of decision makers of companies and of the governments of these countries?

Until recently few were concerned with the problems of corporate governance, it being generally perceived as an important issue only for the companies listed on the Stock Exchange and Securities Exchange. On the other hand, the small companies that are not listed on the exchange and which make up a large share of the total companies doubt the need for introducing standards for corporate governance in their activity, arguing that small companies have a limited number of shareholders and the introduction of corporate governance principles is costly. This is the reason why developing countries pay inadequate attention to the problems dealing with the quality of corporate governance, while the implementation of such respective principles is carried out reluctantly.

Although the financial crises of 1997–2000 in Asia, Russia and Latin America have shown convincingly the need for strict corporate governance, few developing countries maintain this issue in a focus of the decision makers. It should be mentioned that the inefficient procedures for corporate governance are a great danger not only for individual corporations, but also for the society as a whole.

As defined in the Principles of Corporate Governance of the Organization for Economic Cooperation and Development (OECD), corporate governance is a set of relationships between the management of an entity, which is provided with the trust for day-to-day management of the company's affairs, the Administrative Board, shareholders and other stakeholders. The corporate governance offers also the management organizational structure of the company and it establishes means for achieving the objectives and for monitoring its performance. One of the areas in need of improvement in corporate governance is the development in the securities market, it having become an important sector of the economy because this is the sector that the sale-purchase of shares takes place and investments are attracted for restructuring and renovation of companies.

The investors become increasingly demanding in respect to the quality of corporate information, mode of their disclosure and implementation of standards for corporate governance in companies in which they intend to invest capital.

The promotion of efficient steps in corporate governance, the implementation of Business Principles recently developed by the representatives of the private sector, nongovernmental organizations and the Union of Trade are efficient actions for the prevention and fighting of corrupt acts. The Business Principles are directed towards practical guidance of large, small and medium companies in fighting corruption and bribery by promoting the advantages of a continuing business.

There are many companies in the Republic of Moldova that were privatized or are still state owned, in which the control over the management is inconsistent or almost nonexistent. In such conditions the introduction of the corporate governance principles, of Business Principles, and implementation of an adequate control system is an urgent need. In order to encourage foreign investments, the Republic of Moldova needs to develop a business environment capable of assuring a high level of corporate governance.

The developments of codes for corporate governance are the first step for prevention of violations in the area of corporate governance. The objectives of the code are not to prescribe the corporate behavior in any detail, but to provide for the necessary disclosure, so that the investors and other stakeholders may assess the performance of companies and the practices for corporate governance.

The aim of this work is to collect and present the information on corporate governance practice both in an international context and in a regional one and specifically to identify the current situation in the area of corporate governance in the Republic of Moldova.

This work was developed based on the sociological research "Problems of corporate governance in Moldova" carried out by Transparency International-Moldova in two directions: the interviewing of 300 shareholders in the city of Chisinau on the observance of their rights and of 150 managers of joint stock companies about problems related to corporate governance.

In Chapter I the concept of corporate governance is presented along with a brief historical profile of its development, the models for corporate governance are investigated and the importance of corporate governance for companies' performance is analyzed.

Chapter II presents a review of control tools of corporate governance, especially of codes for corporate governance, and principles of corporate governance, which are conditions for protection of shareholders' rights and for prevention of corruption in its many forms (such as abuse of authority, trading in influence, „godfather" nepotism, etc.). This chapter also includes a brief analysis of the legal framework for corporate governance in transition countries, including in the Republic of Moldova, and its compliance with the OECD principles, showing the opinions of managers and shareholders in Chisinau regarding observance of shareholders' rights, equal treatment of all shareholders, responsibility of companies' management authorities, etc.

In Chapter III the problems dealing with corporate information disclosure and its transparency in the Republic of Moldova are investigated, with particular focus on the provisions of the legal framework and its observance, methods for information disclosure, etc. In the same chapter the importance and timeliness of the implementation of an adequate internal control, internal and external audit, and financial reporting are underlined, which are extremely valuable tools for prevention of fraud, embezzlement, abuse of authority and other acts of company management corruption.

In Chapter IV a review of the situation in capital markets in transition countries of South East Europe is made while the basic features and development tendencies of the securities market in the Republic of Moldova are analyzed, the main obstacles to its development are considered.

And, finally, conclusions are made and recommendations are formulated for the improvement of the situation in the area of corporate governance.

Chapter I. Corporate governance: general notions and importance

1.1. General notions on corporate governance

A modern business company is a contradictory entity, because there are no directions on who should be involved in the corporate governance and in what way should the proceeds and risks pertaining to its activity be routed. On the one hand, the company is just a set of assets, the fair value of which could be assessed through the cash flow generated for shareholders. The introduction of a strict corporate control may be believed not only justifiable from a legal viewpoint but also from an economic one, and is conducted to increase of shareholders' property and to staff changes in the case of nonperforming managers. On the other hand, the company is a component of a social entity in which the interests of shareholders and managers cross each other, as well as the interests of employees, banks and those of the whole civil society[1].

In the opinion of Thompson and Driver (2002)[2], the company is not a purely commercial entity, but also a public institution with its obligations and responsibilities. According to this opinion, the profit of the shareholders resulting from modifications made in management and control should be assessed against the costs that might be imposed to other constituents.

The features of the corporate governance system were revealed and described by William D. Schneper and Mauro F. Guillén (2002)[3]. The corporate governance system of any country results from:

- the norms and values of each group of shareholders;
- assuring the protection of each group of shareholders' rights;
- an environment in which the shareholders' groups influence each other.

The relationships between shareholders and managers of a company are of special importance since their interests may differ in many cases. The shareholders want net profits and dividends as large as possible, a strict control of the decisions by the company's board and mangers, and an increase in their shares value. The managers want greater decision making and negotiation authority, bigger salaries, bonuses and compensations, participation in company's capital. The employees, in their turn, want secure jobs with high yet stable remuneration. The role of corporate governance is to balance these interests by clear definition of responsibilities of company's boards, by introduction of corporate governance codes, by equal treatment of all shareholders irrespective of the amount of their shares, and by assuring transparency of major operations and conflicts of interests at general meetings of shareholders.

The international practice of corporate governance consists of a number of varied applications. Initially corporate governance included the relationships between mangers and shareholders. Later, other aspects of corporate governance have emerged such as mutual relationships between the company and its management with the stakeholders: employees, creditors, suppliers, and civil society. Several definitions of corporate governance are given below.

[1] Fligstein, 1990; Davis and Stout, 1992; O'Sullivan, 2000; Guillén, 2000; Aguilera and Jackson, 2003.
[2] Thompson, G. F. and Driver, C. Corporate Governance and Democracy. The Stakeholder Debate Revisited, Journal of Management and Governance, Vol.6, No.4, 2002.
[3] William D. Schneper, Mauro F. Guillén. Stakeholders' rights and Corporate Governance: a cross-national study of hostile takeovers, 2002. http://www.econ.upf.es/docs/seminars/guillen.pdf

Table 1. Corporate governance

Definitions	Sources
Corporate governance is the mode in which a company is managed and controlled. The corporate governance regulates the distribution of rights and responsibilities between different categories of persons involved in the company, such as: the board of the company, its directors, the shareholders and other categories. It establishes the rules and procedures for decision making regarding the company's activity. This system sets the structure and the decision making authority with respect to the company's objectives, the means to achieve them and the system for performance monitoring.	Cadbury Commission, 1992, OECD, April 1999
Corporate governance entails a set of relationships between the management of an entity, its board, the shareholders and other associated parties. This also provides the structure which sets up the company's objectives, as well as the means for achieving the objectives and for monitoring its performance. A good governance of corporations should provide the motivation for achieving the objectives which are in company's interests and in the interests of the shareholders and for promoting an efficient monitoring, thus encouraging the companies to use their resources in an efficient manner.	White Charter, OECD Principles, Preamble,1999
Corporate governance includes legal norms, normative acts and activity practices in the private sector which allow the corporations to attract funds and human resources, to effectively exercise entrepreneurship activity and, finally, to assure the continuity of their operation by increasing their long term value and observing the interests of the shareholders and of the society as a whole.	Notes of Corporate Governance Manual http://www.ifc.org
Corporate governance represents the relationships between the shareholders, the Administrative Board and the managers of the company established by the Charter of the company, its operational policy and the legislation.	Glossary of Corporate Governance Terms &Acronyms www.thecorporatelibrary.com
Corporate governance is a set of relationships between the owners of the corporation and the employed managers, as well as other stakeholders – employees, partners, creditors, and local authorities, through which the balance of their interests is achieved using a certain model of corporate governance established by the law.	Concept for corporate governance of national economy companies of the Republic of Moldova[4]

By examining the above definitions we may conclude that the notion of corporate governance is viewed through the aspect of an economic entity's (company's) operation, and the relationships between their governing bodies and different stakeholders such as shareholders, employees, creditors, suppliers, as well as local authorities and the civil society. The notion of corporate governance stipulated in the *Concept for corporate governance of national economic companies* approved by Government Resolution of the Republic of Moldova No. 22 on January 16, 2003 includes a multitude of relationships between the management of companies and stakeholders and it determines the balance of their interests.

The local managers interviewed within the social research carried out by Transparency International-Moldova in the city of Chisinau view the range of corporate relationships in the same aspect.

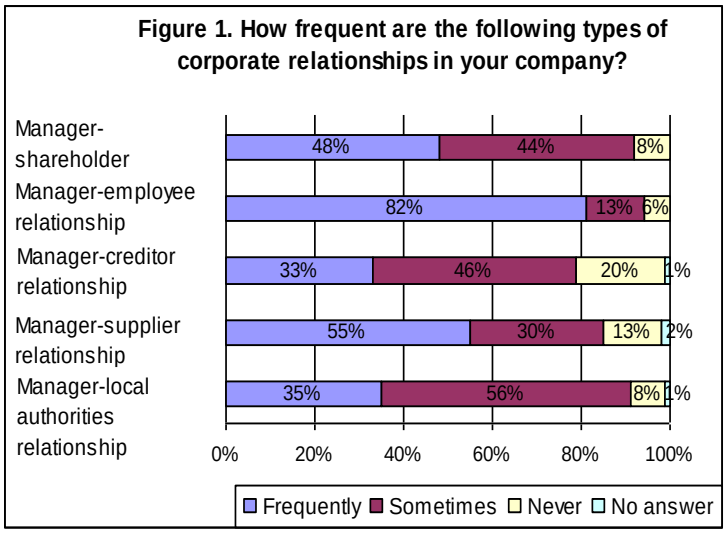
Referring to the frequency of some corporate relationships, the respondent managers stated that relationships manager – employees prevail in the company (82%), while the relationships manager – supplier amount to 55%.

The manager–shareholder relationships which are extremely significant in the context of corporate governance are placed by the Moldovan managers in the third place (48%) on their agenda.

[4] Resolution of the Government of the Republic of Moldova on adoption of the Concept for corporate governance of national economy companies No.22 of January 16, 2003 (*Monitorul Oficial al Republicii Moldova* No.3–5 of January 21, 2003).

For comparison, a research carried out by Economist Intelligence Unit Limited, funded by KPMG International, has reveled that 46% of the interviewed mangers placed the problems related to corporate governance among the first three priority issues on their agendas, while 14% place them as first priority[5].

The fact that these relationships currently are considered by the Moldovan managers to be important does not mean that they are solved in practice. In the Republic of Moldova, both in some companies with local or foreign investors and in some state own companies, the control over the management is inconsistent or almost nonexistent. In these conditions the introduction of corporate governance principles for improvement of economic performance of companies and the implementation of an adequate system for control over the management is an urgent need.



1.2. Models for corporate governance

The following models for corporate governance exist:

- **The American model** based on the rule of "outsiders", that is independent persons and individual shareholders that have no business connections with the corporation. The social capital is dispersed among a large number of shareholders which are interested mainly in dividends. The sharegholders are "aggressive and revolutionary" in the sense of forcing ahead the implementation of efficient policies, and opting for rapid reorganization of nonprofitable units and funding new profitable activities.

The positive aspect of this model is the insurance of the investments mobility and their removal from inefficient and stagnating areas into areas that develop in an effective way. A negative side to this model is its excessive focus on profitability at the expense of development and implementation of development strategies. This model prevails in USA and Great Britain. As stated by Seely (1991), "public companies promote business not in order to reimburse funds to creditors, to encourage the loyalty of their employees, to raise the interest of the community in which they operate or to produce the highest quality products. The aim is but one – to enrich the shareholders"[6];

- **The German model,** which is based on high capital concentration. As compaired to the Amercian structure, the German model differes in that its major shareholders are connected to the corporation by common interests and they take part in the management and control of their company ("insiders").

The advantage of this model is that the shareholders are oriented towards a long term strategy and towards business stability. On the other hand, they are not flexible in making prompt decisions dealing with the liquidation or sale of some inefficient lines of the business;

- **The Japaneze model,** which is characterized by cohesion or unity at a company level and at a business level which some industrial groups called holdings.

This model shows also an active role by of the state, which has participated in strategic planning over the years.

[5] The Economist Intelligence Unit Limited, 2002, www.eiu.com.
[6] Seely, Michael A. Vision of Value-Based Governance, Directors and Boards, 1991.

In the Republic of Moldova a model prevails which is based on high capital concentration. According to the data by the National Commission for Securities as of April 30, 2002 in each of the 1,484 joint stock companies in the country (in about 50% of the companies the registrars carry the business data) there is one shareholder that owns over 50% of the company's stock and which generally controls the activity of the company. In 1,223 of the joint stock companies (about 49%) there are shareholders owning from 25% to 50% of the block of shares in the company. Simultaneously, in each joint stock company there is a shareholder, two or more owning from 5% up to 25% of the stock[7].

The structure of the management authorities of companies also varies from one country to another. Some countries, such as Germany and the Netherlands have developed a two-headed structure for company management. There is a distinct difference between the Administrative Board composed of investors, creditors, and employees which is responsible for the supervision of the company's activity and the Executive Board or the management that is responsible for the day-to-day operation.

In other highly developed countries, such as, in Great Britain and in Canada, there is only one Administrative Board in which independent members (having no executive responsibilities) hold a significant share. The basic requirements are their non-affiliation and non involvement in day-to-day operations of the company.

In the Republic of Moldova the management bodies of a company include:

- The general meeting of shareholders;
- The Board of the company;
- The executive body of the company.

In Title IV of the *Law on Joint Stock Companies* No.1134-XIII of April 02, 1997 the responsibilities and obligations of the management bodies are clearly stipulated along with the mode for convening and election of such bodies.

1.3. Importance of corporate governance (empirical studies)

The promotion of corporate governance principles, as well as the efficient actions of corporate governance has become a basic issue for the reform of economies, both in countries with well developed economies and in developing countries. These aspects are also related to the anti-corruption problems because they are oriented towards structures and areas in which this scourge, corruption, may emerge.

The financial crises of Asia, Russia, and Latin America have reveled that inapplicable or inefficient corporate governance procedures present huge dangers both for companies and for the society. The failures of corporate governance may be as destructive as any economic shock. After the financial crisis in Asia, the former Governor of Thailand Bank, Chatu Mongol Sonakul, mentioned: „I have no doubt that in order to solve the economic crisis of Asia the government and the corporate sector should have cooperated better. I do not want to say that the reason for the recent economic crisis was insufficient cooperation between the two parties. On the contrary, they have cooperated only too well and came to a mutual agreement. The financial crisis of Asia has shown that in case no transparent controls exist, the rights of shareholders are not observed and the administrative boards are not responsible, mighty economies may collapse rather rapidly when the trust of the investors disappears".

The countries in transition have started to focus their interest on corporate governance because during privatization many large companies emerged with some of them still partially state controlled. The insurance of some adequate standards in this area encourages increased trust by the public in the

[7]Resolution of the Government of the Republic of Moldova on adoption of the Concept for corporate governance of national economy companies No. 22 of January 16, 2003 (*Monitorul Oficial al Republicii Moldova* No.3–5 of January 21, 2003).

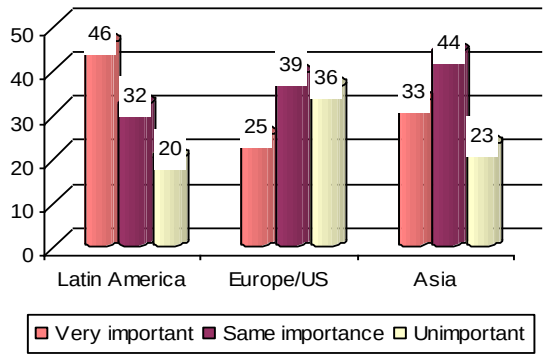
transparency of the privatization process and contributes to obtaining the highest return on investments on a national level.

In the research of the investors' perception carried out in 2000, McKinsey[8] stated that investors pay prior attention and pay more to companies that are well governed (that have good corporate governance practices). The results of this research include responses by over 200 institutional investors, which, taken together, manage assets of companies amounting to approximately 3, 25 trillion US dollars.

It should be mentioned that the most important findings of the research were the following:

- three fourths of the respondent investors stated that in the process of a companies' evaluation and selection the experience in corporate governance of the Administrative Board is considered to be on the same order of magnitude as the financial performance of the company;
- in Latin America 46% of the respondents believe that the practice of corporate governance by companies' boards is more important than the financial side of the company;
- when selecting a company eligible for investment from among companies with similar financial performance, the investors give priority to companies with good corporate governance practices (approximately 80 % of the respondents). However, situations differ from country to country. For example, in Great Britain the respondent investors were attracted to companies with good corporate governance practice 18% more frequently when considering companies with the same financial condition. In Italy the investors invest 22% more funds in shares of well governed companies and 27% more in Venezuela or Indonesia;
- in Asia and Latin America the investors do not trust the data from financial reports, because they are limited and irrelevant. They are willing to trust their investments in companies with adequate corporate governance that observe shareholders' rights. Due to the fact that in Europe and in the US the requirements of accounting standards are higher and the disclosure of company's reports is greater and the information is more relevant and it is supplied on time, the investors are less concerned with the issues of corporate governance. The research has also shown that European and US investors have access to information on major operations and conflict of interest which are published by the companies;

Figure 2. Is CG important than performance of the company? (%)



- in Latin America the local investors are concerned with transparency and disclosure of information, while the foreign investors – with the protection of shareholders' rights. In Europe the investors pay attention both to information disclosure on policies of corporate governance of the company and its presentation to their shareholders and for the need for strengthening corporate governance within the framework of the Administrative Board. The fact that the majority of the investors responded that the decision on placement of investment is made taking into consideration the quality of corporate governance is a mighty argument in favor of corporate governance reform.

The relationship between corporate governance and company's performance

[8] McKinsey. Investor Opinion Survey, June 2000.

The White Paper on Corporate Governance in South Eastern Europe states that the private sector should understand that a good governance of the corporations not only eases the access to capital, but also may serve as an instrument for improvement of their performance. This provides for more efficient research and control balances in the decision making process, thus increasing the efficiency of the administrative boards and, implicitly, improving the strategic thinking. Finally, this increases the trust of the investors in the respective corporation[9].

Many empirical studies have shown the existence of a direct correlation between the framework of corporate governance and the corporation's performance.

Lawrence D.Brawn and Marcus L.Caylor[10], while studying the correlation between corporate governance and the performance of the company, have stated that companies with weak corporate governance have a low economic performance and are more frequently exposed to risk. These were confirmed by the facts below:

- during 5 years the profitability of the companies with poor corporate governance was 3.95% lower than the industry average, while in companies with more strigent corporate governance a profitability increase of 7.91% was registered as compared with the industry average;
- the profitability of compnies with poor corporate governance is lower than the one of companies with good corporate governance. Also, a low return on assets, own capital and investment is noticed. The companies with low corporate governance have a return on own capital of 4.86% lower than the average on industry, while corporations with good corporate governance show a return on own capital 18.98% higher than the industry average. In addition, it should be mentioned that the low return on assets in companies with low corporate governance originates from low level of net profit margin (NPM in such companies it is 6.38% lower than on the average for industry, while in those with a high quality of corporate governance it is 21.66% higher than the average);
- the risks of companies with higher quality corporate governance are lower, that fact being confirmed by the following:
  a) the volatility (instability) of prices of shares in companies with low corporate governance is 6.20% higher than average prices, while in corporations with good corporate governance it is 5.63% lower than average prices;
  b) the price – to book ratios of shares in companies with weak corporate governance is 0.55 percent lower than industry average, while in those with higher quality corporate governance the respective index os 0.59 percent higher than the average;
  c) companies with poor corporate governance have a lower level of interest repayment, while the flow of operational funds is lower as compared to current liabilities.

Chapter II. Tools for regulating corporate relationships

2.1. Codes for corporate governance

Brief historical note. The need for regulating corporate relationships has emerged along with the emergence in major corporations of the first conflicts of interest between owners and managers, with the history of corporate governance being a chronicle of confrontation between the interests of these parties.

At the end of the 19th century and early in the 20th century the owners of corporations in different countries (US, France, Great Britain, etc.) have extended and diversified their businesses, having to allow managers the right to make both current decisions and strategic ones. Making use of the

[9] White Paper on Corporate Governance in South East of Europe, Stability Pact, Agreement of South-Eastern Europe for reform, investments, integrity and economic growth.

[10] Lawrence D.Brawn, Marcus L.Caylor. The correlation between Corporate Governance and Company Performance, Institutional Shareholder Services.

conflicts between different shareholders, managers have taken control over corporations. Thus, the first stage of corporate governance (the concentration in the same hands of both the right to ownership of property and the right to manage it) had passed being replaced by the second stage – the emergence of a corporate system with strong management and weak shareholders. The managers have limited the role of owners to a minimum and have become the real masters of the companies, carrying out their objectives for obtaining high social status and considerable remuneration.

During the second half of the 20th century, along with the spread of investment activity, the share of institutional investors has grown (insurance funds, retirement funds) along with the share of collective investors (investment funds) in the social capital of corporations, with the growth rates of portfolio investments exceeding those of direct investments. Spectacular growth of portfolio investment in the capital of local and foreign corporations has been registered in OECD countries (in the 80's), as well as in Latin America - Argentina, Brazil, Bolivia, Mexico, Peru and Uruguay (in the 90's)[11]. Portfolio investments of OECD country corporations into the economy of developing countries in the year 2000 have reached a figure of 48 billion US dollars[12].

The interest towards attraction of new sources of capital on international markets and the concern of the investors for the efficiency of the invested funds and for avoidance of eventual risks were and continue to be an objective preliminary condition for development and application of some rules and procedures of corporate governance. The latter may provide to potential investors a complete and clear image of the basic management principles of the company, of its owners and of the effectiveness of its operation. The investors are interested in:

- comparing standards for corporate governance in different companies;
- gaining awareness of the mode in which corporations pursue the interests of shareholders, including minority ones;
- being able to assess their risks;
- being able to understand the features of companies' operation and their level of transparency;
- gaining access to additional information for investment decision-making.

At the end of the 20th century the formalized approach to the various aspects of corporate governance acquired a special significance. The conflicts of interest in the operation of notorious corporations from US, Great Britain and Canada have forced the development and application of the *Code for corporate governance (behavior).*

The Issuers of the Code for corporate governance differ from country to country. Among them are both governmental or quasi-governmental agencies and commissions for securities, exchanges for securities, associations for protection of shareholders' rights, institutional investors, etc. The first codes for corporate governance such as the Cadbury Report in Great Britain[13], General Motors Board of Directors Guidelines in the US and Dey Report in Canada have served as models for other companies, with some of them being recommended to corporations by regulatory authorities as guidelines.

In the *Action Plan of the European Commission* it was mentioned that over the last decade the European Union countries have developed *Codes for corporate governance* at national and

[11]Blommestein H. Institutional investors. Pension Reform and Emerging Securities Markets, Inter-American Development Bank Working Paper Series 329, Washington D.C., November 1997.

[12] World Bank data.

[13]Adrian Cadbury, Chairman of the Administrative Board of the Cadbury Corporation was the first to generalize the aspects of corporate governance and to lay the basis for the first code for corporate governance in Europe. The Cadbury Commission, created in 1991 in view of developing the standards for corporate governance and increasing trust in financial and audit reports, has approved the Cadbury report which served as a model for development of other codes for corporate governance.

international levels aiming at protecting the interests of investors and shareholders. Their objectives were to assure the necessary disclosure of information for fair evaluation of governance performances and practices of corporation, but not to prescribe in detail the desired corporate behavior. Currently there are 35 codes for corporate governance registered in the European Union member countries, the majority of which having been issued after 1997[14]. In Table 2 the respective codes are listed along with their issuers and objectives.

Table 2. Codes for corporate governance in European Union countries

Issuing authority	Name of code, year of issue	Referring to which corporations	Objectives
Governmental and quasi-governmental agencies	Recommendations of the Commission for Finance and Banks of Belgium (1998)	Listed corporations	Increase the quality of Governance
	Recommendations of the Commission for Market of Securities of Portugal (1999)	Listed corporations. May serve as model for other companies	Increase of corporations' performance competitiveness and access to capital
	Guide of the Ministry for Industry and Trade of Finland (2000)	Listed corporations	Increase of corporations' performance competitiveness and access to capital
Securities Exchange Commissions and business associations	Cadbury Report (1992), (UK)	Listed corporations May serve as model for other companies	Increase the quality of Board governance, including stipulating strict requirements to information subject to disclosure
	Peters Report (1997), (the Netherlands)	Listed corporations	Increase the quality of Board supervision
	Hampel Report (1998), (UK)	Listed corporations	Increase the quality of Board governance, including stipulating strict requirements to information subject to disclosure
Business associations	Vienot Report (1999), (France)	Listed corporations	Increase the quality of Board supervision
	Federation for Industry (2001), (Greece)	Listed corporations May serve as model for other companies	Increase the quality of Board governance, including stipulating strict requirements to information subject to disclosure
	Chamber for Commerce, Confederation of Industry and the Employers (1997), (Finland)	Listed corporations	Increase the quality of Board supervision
	Greenbury Report (1995), (UK)	Listed corporations May serve as model for other companies	Increase of governing quality by boards, including stipulating strict requirements to information subject to disclosure
	Berlin Initiative Code (2000)	Listed corporations May serve as model for other companies	Increase the quality of Board supervision
	German Panel Regulations (2000)	Listed corporations	Increase the quality of Board governance and data disclosure to shareholders
	Code of the Institute for Secretaries and Managers (1991), (UK)	Listed corporations May serve as model for other companies	Increase the quality of Board supervision and data disclosure to shareholders
Associations of investors	Committee of Institutional Shareholders (1991), (UK)	Listed corporations	Increase the quality of Board supervision and data disclosure to shareholders
	VEB Recommendations (1997), (the Netherlands)	Listed corporations	Increase the quality of Board supervision and data disclosure to shareholders
	Guide of the Shareholders' Association (2000), (Denmark)	Listed corporations	Increase the quality of Board supervision and data disclosure to shareholders

It is remarkable that among the subjects recommended by the above codes, the establishment of audit committees at a company level (Hampel from UK, similar codes issued in France and the

[14] Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States, Final Report and Annexes I-III, Weil, GOTCHAL and MANGER in consultation with EASD and ECGN, 2002.

Netherlands). In this respect, the audit committee consisting of independent directors is responsible for financial reporting of the corporation and it monitors internal and external audits. Incidentally, the audit committees have become a common feature of European corporations; this fact reflects the tendency for improvement of the governing structure of corporations.

In some EU countries the ethical code is a component of corporate governance, its implementation being similar in manner to the other corporate practices. Such a code is focused on the following criteria: to be adapted as a norm for corporate behavior, to be unanimously accepted by the Board of the corporation and to be articulated in such a way as to comprise ethical rules both for the members of the Board and Executive unit, as well as for shareholders and employees of the corporation.

The legal status of the codes for corporate governance differs from country to country. Thus, in some advanced countries (Canada, Great Britain) the existence of a code is a mandatory condition for Stock and Securities Exchange listing, with the issuers having to publicly announce the reasons for failure to practically observe the provisions of the code. In other countries the codes for corporate governance are just guidelines recommended for application and are applied voluntarily in the business environment. It should be mentioned, however, that although in the US the code is only a recommendation; the strengthening of institutional investors' status allows them to exercise a considerable influence on companies by way of requiring the observance by the latter of the corporate governance principles established in the code.

As far as developing countries are concerned, including transition ones (Eastern Europe and CIS), the need for development and application of codes for corporate governance was realized as late as at the end of the 20th century. Currently in the vast majority of these countries such codes exist or are in the process of development. The respective codes attenuate to the gaps in legislation and pay much attention to the corporate governance principles, including equitable treatment of shareholders, disclosure of information, data related to the owners of the corporations, economic and financial indicators, the procedure for convening general meetings of shareholders, remuneration of managers, etc. (In economically advanced countries these aspects are included, as a rule, in the legal framework of the Securities Exchange)

The approaches to implementing this code used in transition countries are different. Thus, in Mexico, Brazil, and India the observance of the code provisions is voluntary, while in Malaysia, Hong-Kong, and the South African Republic the provisions on disclosure of information of a company's operation are mandatory. In addition, the refusal to observe the provisions of corporate norms when they are voluntary may damage not only the image of the corporation, but also its financial condition. For example, in Russia, the corporations listed on the Exchange have to provide information on observance (or non-observance) of the provisions of the Code for corporate governance (behavior); failure to do so results in de-listing.

Situation in the Republic of Moldova. Until now in our country no code for corporate governance (behavior) has been developed, although its importance was reiterated on numerous occasions: in the *Concept for corporate governance of national economic companies, in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP), etc.*

The importance of development and application of a code for corporate governance in the Republic of Moldova is obvious, being influenced by a number of circumstances, including:

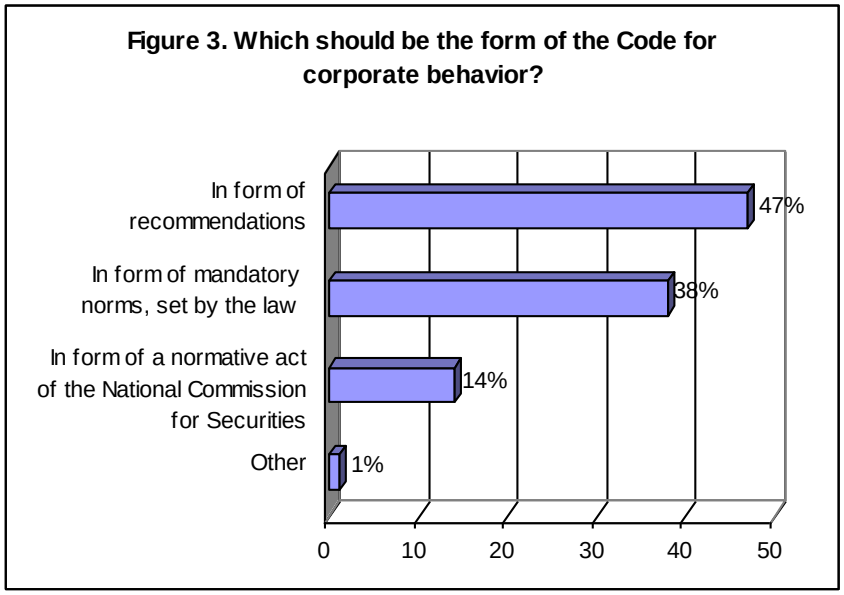
- the integration of the country in the globalization processes, which implies the need for harmonization of the national legislation with the international standards;
- possibility for prevention of eventual corporate conflicts, decrease of authority abuse and decrease of corruption of persons in positions of authority in corporations;
- possibility for application of corporate conflict resolution practices at the company level prior to lawsuit;

- possibility for promotion of a beneficial image of the company among investors and partners;
- possibility for solution to regulatory issues, which are insufficiently reflected in the existing legal framework, based on the Code, etc.

What is the opinion of the managers of Moldovan joint stock companies for the need for development and application of a code for corporate governance? As shown in the results of the social research carried out by Transparency International-Moldova (Annex 2, Figure 5), the majority of the interviewed managers (62%) consider that the existence and application of a Code for corporate governance in their companies is absolutely necessary. However, a third of the respondents have opposite views, which may be interpreted either as a negative reaction towards mandatory observance of an additional regulation, or as lack of awareness of the advantages of such a Code. The three percent of the interviewed which have no definite opinion on the need for such a document may be attributed to persons having a little awareness of the application of corporate behavior codes.

As far as the legal status of such a document is concerned, the opinions of the respondents are divided as follows (Figure 3). About half of the respondents (47%) believe that the Code should exist as a guideline allowing common sense and businessmen prudence with respect to the eventual adoption of a mandatory legal act.

Figure 3. Which should be the form of the Code for corporate behavior?



Still, 38% of the managers believe that the Code should be adopted as law, while 14% opt for a code in form of a normative act of the NCS. The fact that 52% of the interviewed believe in a mandatory code confirms that the tendencies for self-regulation in the business environment are very weak. Even if the businessmen have a poor opinion of the existing legal framework, they still tend to prefer that the "rules of the game" be set by the state. This situation shows the need for development of self-regulating principles in the Moldovan business environment and the need for development of principles and rules for corporate behavior by business representatives that will allow regulation of the corporations' operation along with the legislation.

The fact should be mentioned that the *Concept for corporate governance in national economic companies* states that the code for corporate behavior shall have a guideline status[15], and shall be based on international standards, including the OECD Principles for corporate governance, with due attention to specific features of corporate governance in the Republic of Moldova. Regretfully, the need for a code for corporate governance is addressed only from the viewpoint of improving the image of corporations and development of corporate culture, its importance for prevention of corporate conflict and corruption of persons of authority in companies being ignored.

Still, one of the *EGPRSP* versions stipulated that representatives of the business community (shareholders, mangers, foreign investors, local experts, representatives of the state and civil society) shall be involved in the development of the Code, while the activity would be coordinated by the National Coordinating Council for Corporate Governance.

[15] Government Resolution of the Republic of Moldova on adoption of the Concept for corporate governance of national economic companies No.22 of January 16, 2003 (*Monitorul Oficial al Republicii Moldova* No.3–5 of January 21, 2003).

Currently, we can state, however, that over one and a half years has elapsed since the adoption of the abovementioned Concept and no real actions have been undertaken to carry out the respective plans. In particular, the development of the Code for corporate governance, initiated by the National Commission for Securities (NCS) is at an initial stage. No business environment representatives and no civil society representatives have been involved in the process, while the training of the specialists (managers, accountants, auditors, etc.) and the awareness building of the population in the area of corporate governance are insufficient. In this context the development of a program for improvement of corporate governance to include specific actions and terms for implementation seems timely, including the development of the code for corporate governance, professional training and public awareness building about corporate governance.

In addition to national codes for corporate governance, there are a number of international initiatives in this area, the most significant among them being the „OECD Principles of Corporate Governance".

2.2. OECD Principles of Corporate Governance

In October 1998 the Ministries of Finance of the members of the Group of 7 launched an appeal for transparency, quality, coherence and comparability of data in capital markets. In particular, they appealed with the request that the OECD, in cooperation with the World Bank and with international regulatory authorities, finalize by May 1999 the development of a code of principles for sound management of companies. Wishing to introduce into business "the best practice", the Organization for Economic Cooperation and Development (OECD) member states, with well developed market economies, developed and implemented the concept of corporate governance of joint stock companies. This concept establishes a multitude of principles, rules and norms that assure the governance and management of companies by managers in the interests of investors and, respectively, shareholders' of the company. The OECD Principles were recognized by the Forum for Financial Stability as one of the 12 basic standards for reliable financial systems. They present an important component of the Collection of Standards and Codes made by the World Bank and the International Monetary Fund. These principles were adopted by the International Organization of Commissions for Securities, as well as by private sector organizations, such as, the International Network for Governance of Corporations. OECD Principles have also served as references for the establishment of a large number of national codes on corporate governance[16].

The OECD Principles of corporate governance include[17]:

1. Shareholder rights. Corporate governance shall provide the framework for protection of shareholder rights stipulated in the law and for checking their observance.

A. Basic shareholder rights include the right to: 1) secure methods of ownership registration; 2) Sell or transfer shares; 3) obtain relevant information on the corporation in a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect members of the board; and 6) share in the profits of the corporation.

B. Shareholders have the right to participate in, and to be sufficiently informed about, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorization of additional shares; and 3) extraordinary transactions that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules including voting procedures, that govern shareholder meetings:

[16] White Paper on Corporate Governance in South Eastern Europe, Stability Pact Agreement of South-Eastern Europe for reform, investments, integrity and economic growth.
[17] OECD, Principles of Corporate Governance, 1999.

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
2. Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations.
3. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner:

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.
2. Anti-take-over devices should not be used to shield management from accountability.

F. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

2. The equitable treatment of shareholders. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same class should be treated equally.

1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote.
2. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.
3. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

3. Disclosure and transparency of information and operations. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

A. Disclosure should include, but not be limited to, material information on:

a. The financial and operating results of the company.
b. Company objectives.
c. Major share ownership and voting rights.
d. Members of the board and key executives, and their remuneration.
e. Material foreseeable risk factors.
f. Material issues regarding employees and other stakeholders.
g. Governance structures and policies.

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

D. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.

4. The responsibilities of the board. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should ensure compliance with applicable law and take into account the interests of stakeholders.

D. The board should fulfill certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
3. Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.
4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.
6. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.
7. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.
2. Board members should devote sufficient time to their responsibilities.

F. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

5. The role of stakeholders (employees, clients, creditors, government, the civil society) in corporate governance

The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A. the corporate governance framework should assure that the rights of stake holders that are protected by law are respected.

B. where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. the corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation.

D. where stakeholders participate in the corporate governance process, they should have access to relevant information.

Review of the Corporate Governance Principles of OECD countries. Following the recent failures in maintenance of an adequate corporate governance (case of Enron, Parmalat), a decision was taken to review the Corporate Governance Principles in the context of the current developments in 2002 at the meeting of the Council of Ministers of OECD countries.

Over 2003, the Governing Committee of the OECD countries regarding issues of corporate governance[18] organized numerous consultations related to the review of the existing principles for corporate governance with experts from a number of OECD countries, from round table countries and from non-member OECD countries being involved. Other stakeholders (business sector, national and international level professionals, the union of trade, authorities for standards development) also participated.

As a result of these consultations, in January 2004 a draft document on Principles for corporate governance was issued and published for comment. According to OECD statements, the final version of the Principles for corporate governance was presented in May 2004 at the annual meeting of the Council of Ministers.

The most important issues of the document are as follows:

- the institutional investors shall support adequate corporate governance. In conformity with the new draft Principles for corporate governance, the institutional investors that work based on a fiduciary contract shall disclose information on corporate governance and voting procedures related to their investments. The information shall be disseminated annually with the market of securities. Additionally, the institutional investors shall disclose their procedures and intentions related to ruling material conflict of interest that may affect the rights of majority and minority shareholders;
- the need for an efficient and effective tool with respect to bankruptcy procedures for corporations and, respectively, for adequate application of creditors' rights;
- the recommendations related to audit requirements and to disclosure of financial information, as well as participants' responsibilities, shall be clearly articulated and described in detail;
- for the first time, attention was paid to the responsibilities of the professional market operators (brokers, ratings agents, analysts) that play an important role in decision making by investors. In conformity with the OECD draft, all those that provide analysis or consulting services and that may, by these services, affect the decisions made by investors shall disclose material conflicts of interest that may compromise the integrity of the analyses made or of consultations offered. They shall develop and disclose procedures for settling these conflicts.

2.3. Regulation of corporate relationships in transition countries – some aspects of the legal framework

The tendencies for the development of a market economy in the countries of Central and Eastern Europe and the recent entrance (May 2004) of some of them to the European Union place the problems of corporate governance among the top tasks in the restoration and growth of the economic potential. The post socialist practice shows that along with the progress towards a market economy the need comes for some progressive tools for corporate governance that are capable of safeguarding the interests of the shareholders, investors, creditors and other participants in the process.

[18] The Governing Committee in issues of corporate governance includes representatives not only of OECD countries, but also of World Bank, the Bank for International Supervision and the International Monetary Fund as observers to the group. The representatives of the Forum for Financial Stability, Basel Committee for Bank Supervision and the International Organisation of Commissions on Securities were invited as ad hoc observers.

It is believed that effective corporate governance may be established based on a well developed legal framework and on an active capital market with another option being the concentration of property[19]. The empirical studies carried out in countries with a high level of shareholder rights protection, achieved by increased transparency of corporations, show a higher level and a greater potential for economic development and wider access to internal and external funding sources.

The reforms in the countries that have implemented mass privatization have contributed to a high level of dispersion of the privatized companies' assets. In addition, starting in the second part of the 90-ties, these countries have shown a rapid concentration of property: currently, almost half of the companies of the 12 post socialist countries that have undergone mass privatization and with shares quoted on the Securities Exchange have major shareholders that hold about 50% of the shares[20]. In conditions of property concentration and emergence of major shareholders, the application of efficient tools for corporate governance is needed, in particular, the observance of the requirements for data transparency by managers.

In countries with advanced economies debates under way related to the need for improvement of corporate governance. The OECD and EU member countries, as well as international professional authorities have developed mandatory and voluntary codes of the best practices for corporate governance, aiming at contributing to the operation of the system. The legal framework and the voluntary commitments of these countries could be a starting point for transition countries.

In order to assess the specific features of the corporate governance legal framework of the transition countries, including in the Republic of Moldova and its consistency with the OECD principles, we will proceed to a brief analysis of the legislation related to the following areas: observance of shareholder rights, equitable treatment of all shareholders, and responsibility of management bodies of corporations[21].

Observance of shareholder rights is a fundamental principle for any model of corporate governance. The separation of ownership and control functions of companies may generate different conflicts among their constituents, which increases importance of the decision making right of shareholders during ordinary and extraordinary general meetings. Towards this end, the legal framework shall comprise procedures for timely notification of shareholders about the convening of general meeting, so that they could participate in the decision making process with no organizational or material impediments. Moreover, it is extremely important that the territorial placement of companies does not interfere with the access of the shareholders to general meetings.

The assurance of these rights is inconceivable without maintenance of a book by independent entities (registrars) and without the possibility to vote by correspondence (by post) and by proxy. The respective requirements are an integral part of the legislation of OECD countries, while they are lacking in many of the transition countries (Table 3).

The data in Table 3 show a tendency for harmonization of national legislations and practices in the above listed countries with OECD Principles. Thus, in the majority of countries, there are independent registrars and the possibility exists for voting by proxy (with some differences), as well as the requirement for notification of shareholders about meetings. It should be underlined that in the Republic of Moldova the requirements of the legislation regarding notification of shareholders about general meetings are rather strict and include both a personal notification of each shareholder by letter and a public notification in a newspaper specified in the charter.

[19] Frydman, et al. 1993, Shleifer and Vishny 1997, La Porta, et al.1998 şi 1998.
[20] Grosfel and Hashi 2003.
[21] As a basis for the analysis, the research was used of the Center for Social Economic Studies (CASE) „Legal Basis for Efficient Corporate Governance: comparative analysis of post socialist countries experience", Warsaw, 2004.

Table 3. Legalization of shareholder rights in the decision making process

Country	Keeping a book of shareholders by independent registrars	Voting by correspondence (by post)	Voting by proxy	Notification about the general meeting
Bulgaria	-	-	+	Notification in the "National Newspaper"
Hungary	- [a]	+[b]	+[c]	Notification in a newspaper
Latvia		+ [b]	+ [b]	Notification in mass-media or by letter to shareholders
Macedonia	-	-	+	Public notification or by letter to shareholders
Poland	+	-	+[d]	Notification procedure not specified
Russia	+	+	+	Registered letter or physical presentation of the notification for signature by shareholders entitled to participate in meeting
Romania	+	-	+	Notification in the „Ziarul Oficial (Official Newspaper)" or by letter to shareholders
Slovenia	+	-	+	Notification in the national press or on the Web page of the company
Check Republic	+	-	+	Notification in a national newspaper or by letter to shareholders
Republic of Moldova	**+**	**+[e]**	**+ [j]**	**Notification in press and letter to each shareholder (representative, nominal holder)**

[a] – shareholder book is kept directly by the company.
[b] – in cases stipulated in the charter of the corporation.
[c] – official proxy or a letter signed by two witnesses is necessary (such a letter can be easily obtained).
[d] – only on the regulated market segment.
[e] – general shareholder meeting may not be held by correspondence.
j – the representative or the nominal holder may participate in the general shareholder meeting based on the legal act, proxy, contract or an administrative note.

However, in many transition countries no voting by correspondence is allowed, while voting by proxy, although technically possible, requires the preparation of an official administrative document. Moreover, in some of the analyzed countries the shares are to be transferred on a deposit of a third party for a certain period prior to the general meeting. These limitations reduce the possibilities of participation for minority shareholders and generate possibilities for violation of their rights by holders of control share blocks.

Equitable treatment of shareholders. The OECD principles for corporate governance recommend that all shareholders, minority and major ones, local and foreign, shall have the same rights and possibilities with great importance being paid to the principle „one share – one vote". In practice there is no unique approach to this issue: in the countries that apply the Anglo-Saxon model the owners of shares may influence the decision making depending on the amount of voting shares owned based on the principle „one share – one vote". In other countries, (including in OECD member countries), along with voting shares, another type of shares is used, the "major voting shares", as well as the non-voting shares, etc. Also, voting limitations for major shareholders are applied, which increase the possibilities for minority shareholders to participate in decision making. OECD Principles do not favour certain practices, but the International Corporate Governance Network (ICGN 1999) believes any deviations from the principle „one share – one vote" to be undesirable. In the international practice different methods for shareholder rights protection are applied for minority shareholders *(oppressed minority rule)*[22] which are achieved by:

- the quorum of the general shareholder meeting;
- the right to move and to elect members of the company's Board;
- preferential right to subscribe (automatically) to shares;
- the right to sue mangers of companies for nonobservance of the prudential principle.

[22] The respective list is incomplete, but it comprises the most widely spread methods for protection of minority shareholder rights.

The approaches to equitable treatment of shareholders in the legislation of transition countries are reflected in Table 4.

Table 4. Regulation of equitable treatment of shareholders

Country	One voting share – one vote	General meeting quorum	Qualified majority for taking major decisions [23]	Preferential right to (automatically) subscribe to shares	Right to sue the management	The right of minority shareholders to move Board member candidates
Bulgaria	+	Lacking	67%	+	-	-
Hungary	+	50%	75%	+	+	-
Latvia	+	50%	75%[a]	+	+	-
Macedonia	-	50%	75%	+	-	-
Poland	+[b]	Lacking	67%[c]	-[d]	+	+
Russia	+	>50%	75%	+	+	-
Romania	+	50%	75%	+[e]	+	+[f]
Slovenia	+	Lacking	75%	+	+	-
Check Republic	+[g]	30	67%[h]	+	+	-
R.Moldova	**+**	**> 50%**	**75%[i]**	**+ [k]**	**+**	**- [l]**

[a] – where the decision of the general meeting does not provide otherwise.
[b] – although this provision is a norm for listed companies, there are numerous exceptions.
[c] – also, other important decisions require 75%, 80% and 90% of the number of votes.
[d] – although the legislation does not provide for such rights, the shareholders practically apply the opportunity for preferential purchase of shares of new emissions.
[e] – not foreseen in the law, but may be included in the charter of the corporation.
[f] – it is provided for in the law, but currently it is not applied practically.
[g] – limitations of the voting rights of some shareholders are possible.
[h] – for getting out of the Exchange 75 % of the total number of votes are necessary.
[i] – the resolutions on modification of the social capital of the company shall be adopted with at least three fourths of the votes represented at the meeting, other decisions, such as the ones referring to exclusive authority of the general meeting shall be taken with two thirds of the votes represented at the meeting, while the election of the Board shall be made by cumulative vote.
[k] – depending on the number of owned shares.
[l] – only shareholders that hold at least 5% of the voting shares of the company have the right to move Board member candidates.

As seen from Table 4, the situation in most transition countries is not fully consistent with OECD recommendations. The fact is certain that in these countries actions have been undertaken in view of establishment and improvement of the legal framework aimed at provision of a system equitable for all shareholders. Thus, the principle "one share – one vote" is a mandatory norm for these countries' legislation (except for Macedonia), there are provisions on quorum and qualified majority, the right to preferential purchase of new emission shares, as well as the right to sue the managers of companies. It should be mentioned that only in Poland and Romania the minority shareholders may delegate their own candidate for the Board, but in Romania this right is de facto never used[24]. It should also be said that the legislation of the countries that have recently joined the EU is stricter than that of the other post socialist countries, including that of the Republic of Moldova.

Responsibilities of the Board and the Executive unit, disclosure of information. Many research related to the operation of the management bodies of corporations carried out in OECD countries shows the need for introduction of a requirement for independent Board members (Directors) into the legislation. The latter, while not representing the shareholders, managers or the employees may assume an impartial position in case of conflict of interests. The codes of best practices in corporate governance recommend the inclusion of a reasonable number of independent members into the Board, as well as

[23] The number of votes necessary for taking decisions on increase of social capital of the company, its liquidation, merger, etc. by general shareholder meetings.

[24] Hashi I. Legal basis for effective corporate governance: comparative analysis of post socialist countries experience, CASE, Varşovia, 2004.

the establishment of special commissions (for internal audit, remuneration, staff issues) formed exclusively or to a great extent by independent directors that could supervise nomination of mangers and determination of their remuneration, the accuracy and timeliness of preparation of financial reports, etc. These actions, in the opinion of the experts, could considerably reduce the abuse of authority and corruption of company managers.

Transparency and disclosure of company information can facilitate the control on a management activity. The constituents of the corporate relationships, the shareholders, the employees, the creditors, the state, etc., are interested in obtaining information on the results of the company's operation, the structure of their assets, the ownership interests of the Board members and executive unit members. For this reason, the legislation of many transition countries provides for mandatory publication of financial reports audited by independent auditors, disclosure of data on insiders and shares owned by them, as well as data on majority shareholders, etc. As far as the companies listed on the Exchange are concerned, they shall observe much stricter requirements on contents and frequency of publication of financial reports, specialized reports and other data.

The legal provisions of transition countries related to existence of independent Board members (Directors), the mandatory auditing of financial reports, the frequency of financial reports publication by companies listed on the Exchange, as well as some aspects related to disclosure of corporate data are provided in the Table below.

Table 5. The Board, the Executive unit and the disclosure of information by the corporation

Country	Independent members (directors) of the Board	Representatives of employees on the Board	Independent audit of financial reports	Frequency of financial reports published by companies listed on the Exchange	Threshold for disclosure of data on owners of shares	Threshold for mandatory tender[25]	Data on shares and remuneration of managers	Duration of Executive director's mandate, (in years)
Bulgaria	-[a]	-	+	Quarterly	5%	50%	-	3
Hungary	-[b]	+	+	Twice per year	25%	33 %	-	5
Latvia			+					4
Macedonia	-	-	+	Quarterly	10%	45%	-	6
Poland	-[c]	-	+	Quarterly	5%	50%	+	5
Russia	+[d]	-	+	Quarterly	5%	30%	+	Not established
Romania	-	-	+	Twice per year	5%	50,1% and 75%	-	4
Slovenia	-	+	+	Annually	5%		partially	8
Check Republic	-	+	+	Twice per year	5%	40% and 50%	Partially	5
R. Moldova	**-**	**+**	**-[e]**	**Annually**	**5%**	**> 50% [i]**	**Partially**	Not established

[a] – except for public companies in which one third of the Board members should be independent.

[b] – in companies with over 200 employees one third of the Board shall be elected by the employees.

[c] – although the Code of best corporate practices recommends that at least 50% of the Board should be independent members (directors), Polish legislation requires that the independent directors in the Board of an exclusively state owned company should amount to no less than three fifths.

[d] – although the legislation of Russia does not have mandatory requirements on existence of independent Board members, in respect to transactions in which a conflict of interests exists, there is the notion of ,,independent director''. The code of corporate governance (behavior) of Russia recommends that the share of independent directors in the Board shall be no less than one fourth (or no less than 3 directors).

[e] – starting in 2002, along with the enacting of modifications and completions in the *Law on joint stock companies*, the obligation of open type companies to carry out an external audit has been cancelled, while the decision related to carrying out an external audit shall be taken by the general shareholder meeting.

[i] – in other cases of mandatory tender, especially for purchase of shares by insiders, the threshold for the tender is 5%, while for purchase by the company of its own placed shares, there is no tender threshold established.

As seen from Table 5, the majority of countries have no concept of independent members (directors) in the Board. Only Poland and Russia have recommendations for their inclusion in the Board. The clauses

[25] The mandatory tender procedure for purchase of a control block of shares is meant.

for the opportunity of having the representatives of collective labor on the Board are also rare, they are to be found only in the legislation in Slovenia, Check Republic, Moldova and Hungary (in case of large companies).

Also, the requirements on mandatory independent audits and publication of financial reports are valid almost in all analyzed countries (except for the Republic of Moldova, in which since 2002 the decision for the need to audit is left at the discretion of the general shareholder meeting). The situation on disclosure of information on ownership of shares is similar: in the vast majority of countries companies must disclose information on owners of 5% and greater of the voting shares.

As far as the mandatory tender procedure for purchase of the control block of shares is concerned, its threshold varies from 30% (Russia) up to 50.1/75% (Romania), in some countries such provision being altogether nonexistent. As a rule, this tool allows the small shareholders to avoid the risk of financial loss generated by dominant shareholders. Also, in some countries, for example, Russia, the effectiveness of this tool is reduced because a great number of entities (usually owning shares over 10%) entered on the books are offshore companies, their real owners being unknown. Moreover, cases are known of pyramid like holdings, "cross ownership" that also conceal the real owners of the shares[26].

Top managers of transition country corporations have considerable power: the duration of executive director's mandate is rather long, as a rule, from 3 to 8 years, which exceeds the respective figure for EU (the Cadbury committee recommends 1 to 2-year contracts). In most of these countries the number of shares owned by the managers and their remuneration are partially closed information, namely, only the total amount of compensation and the total number of owned shares is stated).

The legislation of transition countries provides for various measures for prevention of abuse by persons in authority positions, including managers: the manipulation of securities is forbidden in view of destabilization of their rate, the use of the insider information is forbidden for obtaining profit, etc. Towards this end, different penalties exist, starting with fines and ending with imprisonment and interdiction to exercise certain activities. However, in practice, these provisions are not applied: none of the studied countries had had wide scale successful lawsuits in spite of the big number of scandals and abuse of authority (for example, the "tunneling", i.e. withdrawal of funds from companies, which contributed to the financial crisis in the Check Republic, the financial pyramids in Russia, Albania, the Republic of Moldova, etc.). As confirmed by some studies in the area[27], the reduced applicability and effectiveness of the financial regulation is one of the main problems of transition countries (Table 6).

Table 6. Applicability and effectiveness of legislation regulating the financial sphere

Name of country	Applicability of legislation		Effectiveness of financial regulation*		
	1998/1997	2001/2000	1998	2001	2002
Bulgaria	-0,15	0,02	3	3	3
Hungary	0,71	0,76	4	4-	4-
Latvia	0,18	0,29	2	4-	3
Macedonia	*	*	2	2	3-
Poland	0,54	0,55	3	3	3+
Russia	-0,72	-0,87	2	2+	3-
Romania	-0,09	-0,02	3-	3	3
Slovenia	0,83	0,89	3-	4-	3
Check Republic	0,54	0,64	3-	3	3
R. Moldova	*	*	*	3	3-

* - data are lacking.

Note: The index of financial legislation effectiveness is calculated annually by EBRD (Transition Reports) based on a number of parameters and it shows the effective level of regulations in the financial sector. The index is estimated on a scale from 1 "very low effectiveness" to 4 "very high effectiveness".

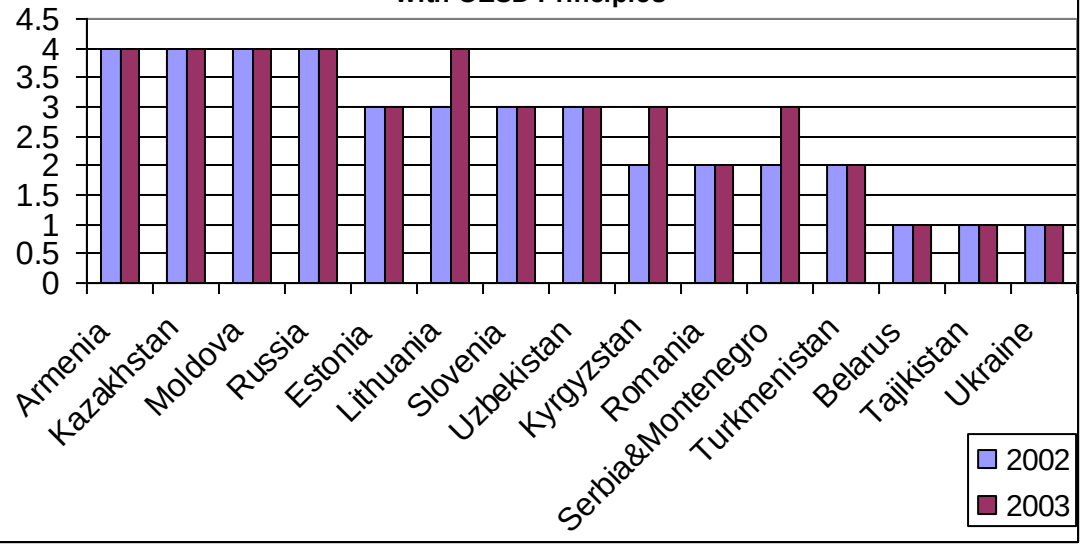
[26] Berglof, E. and Pajuste (2003) Emerging Owners, Eclipsing Markets, in Cornelius, P.K. and Kogut, eds, Corporate Governance and Capital Flows in a Global Economy, Oxford University Press.

[27] Kaufman et al. 2002; Transition Reports - BERD.

Thus, although the legal framework for corporate governance in transition countries has advanced significantly, it applicability is still insufficient. As far as the effectiveness in financial area regulation is concerned, the situation has improved in most countries, this being interpreted as a positive tendency[28]. Still, none of the studied countries has achieved the level of the economically developed countries of 4+.

Some recent EBRD studies confirm the above. The research of this international institution in the area of conformity of corporate governance with the OECD principles („extensiveness" of the law), carried out in the member states of the institution[29], has allowed the compilation of the following rating.

Figure 4. EBRD rating in the area of corporate legislation conformity with OECD Principles



Note: For the realization of this rating, a number of indicators of the legal framework, which are annually evaluated by EBRD, were taken into account. The following levels of conformity of corporate governance legislation with OECD principles were established for the evaluation process:

- „A" level (indicated as „5" in figure) represents a very high level of conformity;
- „B" level („4") – a high level of conformity;
  „C" level („3") – a medium level of conformity;
- „D" level („2") – a low level of conformity;
- „E" level („1") – a very low level of conformity.

In the comments of the EBRD report on the results of the Corporate Governance Evaluation (2003), the fact was mentioned that although the Republic of Moldova has not registered sizable progress in the economic and social areas, it has a relatively good legislation in corporate governance, evaluated as „B" level („4"), which shows a high conformity with OECD standards. However, it was stated that Moldova has significant problems in the area of corporate legislation application, the law having not been transformed into real economic benefits.

The brief analysis of the legal aspects of corporate governance in transition countries allows articulating the following conclusions and recommendations:

- most countries have achieved progress in the establishment of a legal basis for corporate governance and are ready for the implementation of OECD Principles (as guidelines or in the form of a law);

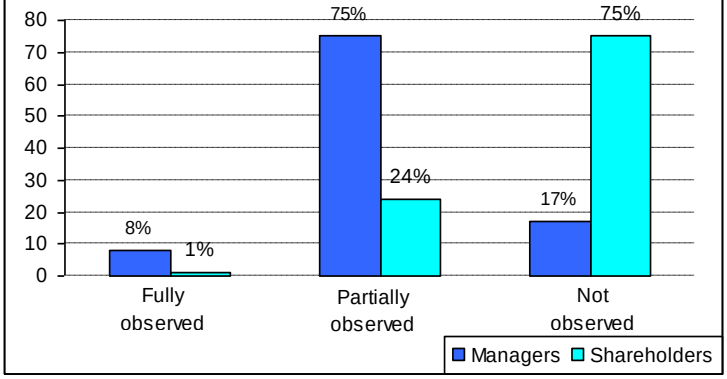
[28] The index of financial legislation effectiveness (EBRD) shows substantial improvement of the situation in 2002 as opposed to preceding years. However, the said improvement is not confirmed by studies of other researchers and by preceding EBRD materials, therefore it requires careful interpretation.

[29] EBRD, Report on Corporate Governance Evaluation Results, 2003, 2004.

- almost all countries (with minor exceptions) apply the German model of corporate governance represented by two levels: *the Board*, responsible for strategic problems of companies and for supervision of management, and *the Executive unit*, that carries out day-to-day operation. The possibilities of shareholders to influence the activity of these bodies are, to some extent, limited: voting by correspondence is not usually applied, while voting by proxy requires much time;
- most countries have no concept of independent Board members (except for the Codes of corporate behavior of Poland and Russia), which calls for the introduction of some legal provisions in conformity with OECD standards;
- the legal framework has no provisions regarding the rights of other constituents of the company (creditors, suppliers, the state, etc.) or regarding their involvement in corporate governance, including by consultations. Exceptions are the employees of companies that may have their representatives on the Board. In this context, the procedures for corporate governance may be improved with no negative consequences for the operation of the management authorities;
- the legislation of transition countries includes a wide range of responsibilities and sanctions in the area of corporate governance, such as for non-observance of shareholder rights, concealment of corporate information, use of insider information for personal benefit, etc. These provisions are very important and necessary, but insufficient for fighting abuse of authority and fraud by persons with positions of authority in companies. The state needs to interfere with specific actions in order to assure the legal authority and its applicability.

2.4. Specific features of corporate governance in the Republic of Moldova

Figure 5. Observance of shareholder rights in the opinion of managers and shareholders (%)



In Chapter 3 of the *Law on Joint Stock Companies No.*1134-XIII of April 02, 1997 the general and additional rights and responsibilities of shareholders are stipulated. Although national legislation has a high level of conformity with international standards in corporate governance (see, paragraph 2.3), there is still a discrepancy between the letter of the law and the real situation. The results of a social research carried out by Transparency International-Moldova in the city of Chisinau has shown that almost 47% of the respondent shareholders are unaware of their rights, 36% know their rights only partially and only 17% are totally aware of their rights. An identical situation is registered also regarding awareness of responsibilities by shareholders: about 59% of the respondents are not aware of their rights at all, while 30 % know them partially (Annex 1, Figures 2 and 13).

The shareholders that are aware of their rights have estimated their observance in practice as follows: the majority (75%) of the interviewed shareholders stated that their rights were not observed at all.

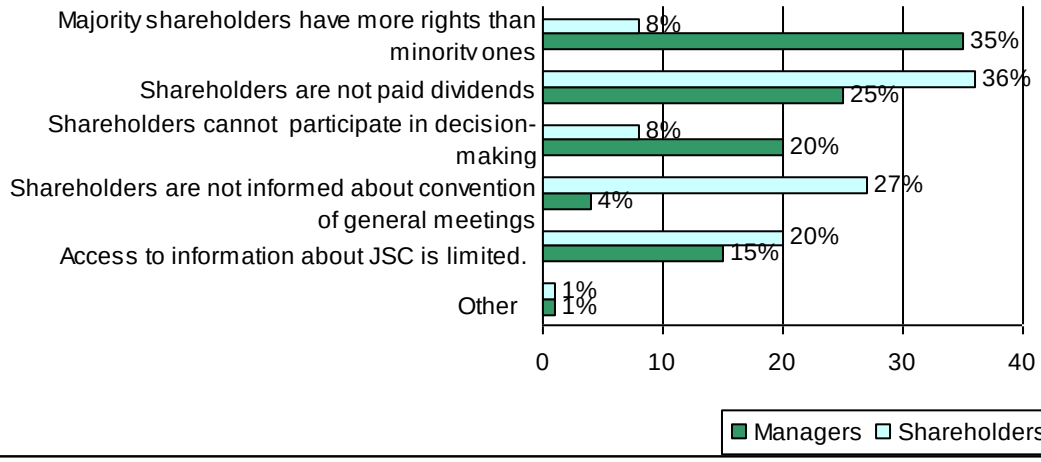
The opinion of the managers interviewed about shareholder rights was totally different. In their opinion the shareholder rights are partially observed (75%) and not observed (17%).

Regretfully, in the Republic of Moldova the participation of the minority shareholders in decision making in joint stock companies is rather low due to a number of reasons: unawareness of shareholder rights and responsibilities; reluctance of the joint stock companies' management to cooperate with the shareholders, especially with the minority ones. Although the question "How is the work with

shareholders organized?" was answered by 57% of the respondent managers (Annex 2, Figure 7) with the statement that there exists a special person or unit responsible for working with shareholders, the reality shows that the functions of these units are limited to the publication of notifications about general meetings, preparation of general meeting programs and monitoring the process of distribution and payment of dividends. Thirty four percent of the interviewed managers organize the work with shareholders through direct telephone lines, while 23% prefer direct meetings and discussions with shareholders.

The management of the corporations should be aware of the fact that cooperation with the shareholders is an absolutely necessary responsibility, because it relates to the observance of their rights. This cooperation could be improved by establishment of units specialized in relationships with shareholders, even where the establishment of such units is not provided for in the regulatory documents.

Figure 6. Most frequently violated shareholder rights (%)



In answer the question „Which of their rights are the most frequently violated?" 36% of the respondent shareholders indicated failure to pay dividends, 27% – not being informed about summoning of general meetings, 20% – no access to information about the company, 8% – nonparticipation in decision making process and another 8% - disadvantages for minority shareholders as compared to major ones.

Also, in the context of access to information, the fact is alarming that only 5% of the respondent shareholders believe to be sufficiently informed about the company in which they hold shares, while 95% of the interviewed shareholders believe to be totally uninformed or insufficiently informed (Annex 1, Figure 11).

The opinion of the interviewed managers differs to some extent from that of the shareholders. About 35% believe that the major shareholders have more benefits than the minority ones, 25% believe that non payment of dividends is a flagrant violation of the shareholder rights, 20% believe that violation of shareholder rights is shown by non participation of shareholders in decision making. It is remarkable, that 15% of the managers also recognize the limitation of the access to information, while 4% mentioned failure to notify shareholders about convening general shareholder meetings.

Unawareness by shareholders of their rights and responsibilities was stated by managers as the main reason for their rights' violation.

Among other reasons stated were that the penalties for violation of shareholder rights were not sufficiently severe, that the Economic Court had insufficient experience in dealing with litigation between companies and their shareholders or stakeholders.

Table 7. Which are the reasons for nonobservance of shareholders' rights?

Reasons	Share (%)
1. Penalties for violation of the shareholders' rights are not sufficiently severe	14
2. The shareholders are not sufficiently aware of their rights and cannot protect them	59
3. The Economic Court has no sufficient experience in corporate governance	14
4. Officials are corrupt	8
5. Other	5

The lack of judges and attorneys specialized and experienced in commercial law is part of the problem. In this context, the court authorities would need to undertake a number of actions (eventually in collaboration with NCS) in order to raise the professional level in the area of corporate conflict resolution through systematic training of judges. On the other hand, private companies, especially small ones, have no resources to sustain long court deliberations, while the lengthy, complicated and expensive litigation procedures encourages the parties to seek private arrangements, thus creating a favorable medium for corruption. Although only 8% of the respondent managers stated the reason for shareholder rights violation to be the corruption of authorities, this is a matter of great concern.

The disclosure of cases and court decisions related to corporate governance could contribute to building awareness in corporate governance problems within the business community.

Participation of shareholders in general meetings shall be encouraged by the company. Only 4% of the interviewed managers have confessed that the shareholders right is being violated by not notifying them about general meetings (Annex 2, Figure 9).

Seventy eight percent of the respondent shareholders stated that they have never participated in the general meetings of their corporation. It was noted that in Chisinau the shareholders, especially shareholders of investment funds, were not notified about general meetings. One of the problems in this area is the existence of a considerable number of shareholders that cannot be located. Most of them are individuals that have received shares during privatization, but have gone abroad, have changed their address or have died. Sixty two percent of the interviewed shareholders showed unawareness about convened general meetings as the main reason for non-participation in them, while 25% could not participate for various other reasons (Annex 1, Figure 6).

During 2003 the NCS had investigated a considerable number of complaints related to violation of shareholder rights in the area of corporate governance. In this respect, NCS participated as a third party in many court proceedings. A number of situations were investigated in which conflict situations dealt with the violation of the law related to the procedure for convening general shareholder meetings and the mode for carrying out general shareholder meetings. As mentioned in the 2003 annual report of the National Commission for Securities, upon controlling of information disclosure related to convening general shareholders meetings for joint stock companies, persons with positions of authority have been warned (126 warnings) about nonobservance of legislation on publication of notifications about convening of general shareholder meetings[30].

The instability of the legislation related to the necessary quorum for carrying out general meetings and the quorum needed for decision making should be mentioned (see modifications to the *Law No.1134-XIII of April 02, 1997; Law No.1401-XIV of December 07, 2000; Law No. 997-XV of April 18, 2002; Law No. 802-XV of February 05, 2002*).

[30] National Commission for Securities, Annual Report for 2003.

Procedures for convening general meetings should be more rigorous, so as to provide to all shareholders relevant and timely data on issues included on the agenda of the meeting.

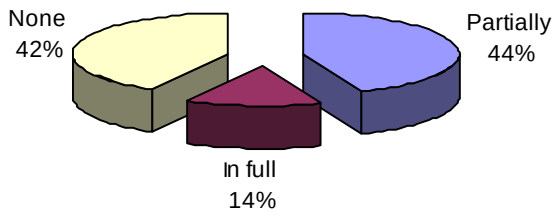
Joint stock companies shall be aware of the fact that general shareholder meetings are an essential tool for establishing trust of the shareholders related to issues of fundamental significance for the society. Even where those in control positions may finally make decisions on any of the issues included in the agenda, the general meetings are a useful practice for the membership and for members of the Administrative Board. General shareholder meetings may contribute to reduction of abuse with respect to minority shareholders, taking into account the fact that the Directors and the members of the Administrative Board have to present information on the performance of the company, its strategy and policies.

Source: The White Paper on Corporate Governance in South East Europe countries.

The framework for corporate governance shall assure the shareholder's right to full access to information on the operation of the company, in which they have investments. Only 35 % of the interviewed shareholders have applied for information about the company in which they hold shares, while 17 % (Annex 1, Figure 8) had intentions to do so but are not aware of the company's address. The fact is alarming that 48 % of the interviewed shareholders have never applied for information to companies in which they have ownership. The passive behavior of the shareholders may denote that they are sufficiently familiar with the companies' situation through the information has been provided by the company (through participation in general meetings, publication of financial reports and other data on companies) or that shareholders are concerned only about dividends.

Only 14% of the shareholders that applied for information had obtained it in full, while 86 % had partial or no access to information (Figure 7).

Figure 7. To what extend have you obtained requested information? (%)



The management's bureaucracy was shown by shareholders as one of the main reasons for limited access to information about the company (57%) (Annex 1, Figure 10). Incompetence, reluctance to disclose information on major operations and conflicts of interests make for absurd situations for shareholders (especially minority ones). These attitudes may be attributed to practices inherited from the past and may be overcome by improving corporate culture and behavior.

The respect for notification procedures and the quality of the information provided to shareholders shall be treated as a most serious issue.

The fact is noticeable that managers use general meetings (89%) and publication of the information in the press (71%) as the most adequate ways for information disclosure to shareholders. Also, the opinions of the managers related to trust in sources of information show high variation (see, Chapter III).

The abuse in respect to minority shareholder rights is still one of the gravest weak points of corporate governance practices in South Eastern Europe. The regulatory reforms along with the efforts for their application also need to focus on actions and remedies to protect minority shareholders from abuse.

Source: The White Paper on Corporate Governance in South East Europe countries.

According to A. Shleifer and R. Vishny[31], problems dealing with inadequate corporate governance, especially violation of minority shareholder rights, are registered in companies with high capital concentration. The major shareholders frequently require no consent of the minority shareholders for approval of certain decisions specifically due to this concentration of assets.

In Moldova certain cases were registered where the company had impeded the participation of shareholders in voting by using certain abusive procedural maneuvers, such as, the requirement for physical presence of the respective shareholders or the requirement to submit documents which are difficult and expensive to obtain. About one third of the managers interviewed in Chisinau believe that major shareholders have more benefits and this violates the rights of the minority shareholders. The NCS could supervise more rigorously the companies with a greater number of shareholders. For example, the shareholder meetings of companies with over 5,000 shareholders need to be carried out under the supervision of the National Commission for Securities.

Where shareholders disagree with the decisions of the company or where they were not allowed to participate in the general meeting, they may require that the company purchases their shares over the following two months[32]. Repurchase of shares shall be done at market prices or in another way stated in the charter of the company. The shareholders have no right to require the repurchase of shares if the company's shares are included in the Exchange listing. This clause may be used by some companies in order to deny the shareholder right to repurchase of shares. In order to observe the legal norms aimed at protection of shareholder rights, especially of minority shareholders, modifications in *Law on joint stock companies* shall be made in respect to assuring repurchase of shares where minority shareholders do not support the decisions adopted by major shareholders.

Disclosure of information presents an extremely important way of protecting minority shareholder rights in case of large transactions. The social study carried out in the city of Chisinau has shown that the effects of information disclosure indicated as positive by the interviewed managers exceed the undesirable effects by 19% as mentioned in the questionnaire. Thirty two percent of the interviewed managers believe that disclosure of information will contribute to improvement of the company's image and will make it more attractive to investors, while 15 % consider that it will increase the effectiveness of the control over management. Also, 40% of the respondents expressed a negative opinion of the need for information disclosure. They believe that information may be used to sweep away the competitors-companies and that it increases expenses of the company (Annex 2, Figure 12).

As a pillars of the best corporate governance can be mentioned a ***clear delimitation of responsibilities*** of the general shareholder meeting, of the Board, Management and internal audit committee.

In Moldovan companies, the opinion is maintained that the main function of the Board members and of the chairman is to consult managers in business and to promote their own interests through the company in which they act as Board chairman or member (the most expressive examples are the experiences of commercial banks that ended in bankruptcy: Bancosind Bank, Guineia Bank, Intreprinzbank, Oguzbank).

According to art. 65 of the *Law on joint stock companies* the board of the company shall represent the interests of shareholders during periods between shareholder meetings and, within their authority, shall carry out general guidance and control over the operation of the company. Thus, the priority functions of the Administrative Board are the determination of company's strategy and supervision of the effectiveness of its management.

The initial stage of establishment of joint stock companies in Moldova was characterized by the lack of a clear delimitation of Board and Management responsibilities. Board frequently not played and do not currently play a strategic role in the company because of lack of independent members. This fail

[31] Shleifer A. Vishny R. A Survey of Corporate Governance, the Journal of Finance, June 1997.
[32] Article 79 of the Law *on joint stock companies* No.1134 – XIII of April 02, 1997 (*Monitorul Oficial al Republicii Moldova* No. 38–39 of June 12, 1997).

has important consequences in the area of abuse of minority shareholder rights and the rights of stakeholders.

The boards of corporations shall be provided support so that they could better play their important role in the determination of a corporation's strategy, control of the management, monitoring of conflict of interest and, generally, protection of shareholder rights. They should also observe their responsibilities as far as disclosure of information is concerned. Towards this end, the members of the Board should realize better their functions and obligations. The regulations and charter of the corporations shall have specific provisions about the function of the board to act in the interest of the corporation and to treat all the shareholders in an honest and equitable manner.

Source: White Paper on Corporate Governance in South Eastern Europe countries.

According to Art. 66 of the *Law on joint stock companies* the shareholders of the corporation shall form the majority of the Board, where the charter does not provide otherwise.

Due to the capital concentration within the company and close connections with major shareholders, the board members represent, in fact, the interests of some shareholders and even directly paid by those shareholders to do so.

The board members need to show their loyalty to all shareholders. The board members shall not represent certain shareholders within the board. Irrespective of which shareholders have recommended them as members, elected them or influenced their election, the board members have the duty to represent the interests of all shareholders as a group.

The *Law on joint stock companies* or other normative acts should state clearly that boards have the duty to honestly carry out their functions in respect to the company and to all its shareholders. The structure of the board should be changed so as to comprise independent members in the boards of corporations and specialized committees should be established to assist the respective boards to carry out their main responsibilities. The boards shall have the necessary resources for carrying out their responsibilities in way of access to information, remuneration and the necessary training. There are cases of abuse during the election of board members. It may be stated that the board member election processes are sometimes corrupted by managers by offering various benefits for the promotion of decisions dictated by the executive body. The problem of Board members corruption by managers is persistent and the need for independent board members in decision making and approval of resolutions shall be highlighted. This aim may be achieved only by appointing honest people with good business knowledge, persons that command the full trust of the shareholders. The work experience and independence of the board members has an obvious impact on the work quality and decision quality of the board. The table below shows the requirements of board members in different countries.

At least one third of the Board members shall be independent members *(Committee for corporate governance of Singapore).*

The majority of Board members shall be independent *(Code for corporate governance of the Institute for Corporate Governance of Brazil).*

The Board of a corporation cannot have less than two independent members.... *(King Report, IOAP).*

It is recommended that the independent members of the Board shall constitute at least 20% of the total number of board members*. (Code for corporate governance of Mexico).*

The shareholders shall form the majority in the board of the company if the charter does not say otherwise. The members of the executive body and other employees of the company may be elected to the board, but may not form a majority in it. *(Art.66 of the Law of the Republic of Moldova on joint stock companies No. 1134-XIII of April 02, 1997).*

The requirements of board members are described in different ways in the codes for corporate governance, but all of them underline such features as: experience, competence, personal traits

(including independence). According to Art. 66 of the *Law on joint stock companies*, board members cannot be persons stated as incapable, or persons convicted for swindling, theft of assets from the owner's property by appropriation, embezzlement or abuse of authority, fraud or abuse of trust, forgery, false testimony, offer or acceptance of bribes, as well as other infringements comprised in the legislation, for which a full penalty has not been served.

There is no unique opinion regarding the notion of independent board member. For example, according to the notion presented by the Institute for Corporate Governance from Brazil, a member is independent in case he/she has no relationships with the company other than the ones as a board member and has shares in the company, has no remuneration other than for being a board member and by distribution of dividends, has not worked as an employee of the company or with some affiliated entity, has not acted as a supplier to the company, has no kinship relationship with persons in positions of authority in the company, managers or control authorities". For comparison, the Cadbury Report presents a simpler definition of independent members. The report argues that the independent members are remunerated as board members and receive dividends; they are independent of the management and of any business relationships that could influence their independent view.

The independent members play an important role in decision making in areas where difference of opinion exist between managers and shareholders: remuneration of the managers, decisions for selection of an audit company, internal control. In addition, they may offer a more objective vision on evaluation of management performance and quality. It is essential for the board members to have adequate training for being aware of the business of the company and in governance practices. It is also essential to provide them with further training during their activity as board members, especially in relation to newly adopted laws, regulations, modification of risks.

A special component, in which Moldovan companies need to focus their efforts for facilitation of transparency and responsibility, is information disclosure on remuneration of board members and managers.

The International Organization for Regulation in the area of Securities (IOSCO) actively encourages companies to disclose information on remuneration for each Board member and for managers. In the USA and Australia the requirements for disclosure of information on remuneration refers only to top managers and board members. In Singapore the disclosure of information is required on remuneration of first five top managers of the company in the belief that it shows to investors a clear image of remuneration distribution among top managers. Also, the guides and codes for corporate governance encourage corporations to use compensation schemes for encouraging managers' interest in the future of the company, such as: participation in the capital of the company, options with shares, but it also requires that the shareholders be adequately informed about the remuneration schemes applied by managers. The codes for corporate governance mention that the remuneration level for Board members and managers shall be sufficiently high to attract qualified specialists and to raise their responsibility, but it also shall be consistent with the results of company's activity.

In the Republic of Moldova the remuneration by shares for employees, managers, and board members is applied more by the commercial banks. Failure to apply this remuneration tool on a large scale may result from the low liquidity of the share market of the rest of the joint stock companies and by the fact that the prices for Moldovan companies' shares are not promptly receptive to the modification of the financial condition of companies. As criteria for remuneration of managers and board members the dependence may be used on the profits of the company, on growth of the securities' capital and on growth of sales.

However, these criteria for remuneration of mangers and board members need additional development and balancing with more up-to-date indicators.

In which way shall the position of the employees be treated? The employees shall be treated not merely as an ordinary group of shareholders whose legal rights should be observed. They need to be considered as participants in the company as shareholders in the sense that they share the risks of the company. Therefore, their participation both in the governance of the company and in the reporting system is very important. In this context, the experience of various countries is different:

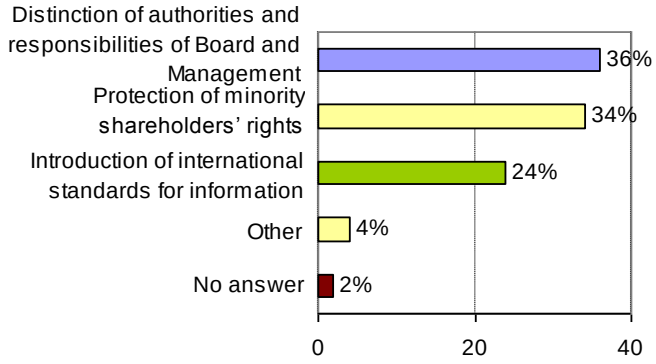
- *in Austria, Denmark, Germany, Luxemburg and Sweden* the employees of the company, irrespective of the size and type of company have the right to elect the members of the company's board;
- *in France,* where the employees hold 3% of the total shares of the company, they have the right to nominate one or more board members;
- *in the Netherlands,* employees have the right to participate in board meetings with no voting rights;
- *in the Republic of Moldova,* the members of the executive body and other employees may be elected to the board of the company, but may not form a majority in it.

The OECD urges adoption of an explicit standard that shall recognize the employees as a group of shareholders that must get involved in all processes of a company's management through their representatives in corporate governance

In the framework of corporate governance a tool shall be developed to include the mode of employee representative participation in all these processes.

The participation of employees' representatives in a company's board is necessary, since it contributes to improvement of company's management activity and to the increase of the employees' level of knowledge in the area of corporate governance. The representatives of the employees should be capable to carry out their responsibilities of analyzing data and of forming clear opinions on the company's condition with specific focus on activities that may affect employees' interests.

Figure 8. Which are the main directions for improvement of corporate governance?



In the Republic of Moldova the implementation of this tool may be difficult due to the immense segment of the "shadow" economy. Some enterprises, firms, joint stock companies and limited responsibility companies do not negotiate individual employment contracts, use double accounting and do not register all the work carried out. Thus, the staff may not be included in the staff book, the respective transfers to the consolidate budget and to the social fund are not paid, while salaries are being paid through double accountancy, that is, a small amount of the salary is included in the book, while the rest of the salary is paid in a separate envelope[33]. It is difficult to believe that under such conditions there is a wide scale involvement of the employees in the governance of the company.

[33] These economic agents violate the Law on remuneration and the Norms for labor protection. Over 2002-2003 the Labor Inspection has found severe violations of labor legislation and has submitted to courts over 8,000 reports. In the opinion of O.Budza, Prime Vice Chairman of the Confederation of Trade Unions of Moldova „Solidaritate" (Solidarity), only 40% of the files have been investigated. Even where the case has been promptly investigated, the effect was null, because the administrative penalties are symbolic, 18 to 36 lei, while in Bulgaria and Romania they amount to 3,000 dollars and if the situation is not corrected, fines may be applied every day. In Belgium the tariff salary is mandatory for all economic agents

Main directions for improvement of corporate governance. The social research carried out in the city of Chisinau has revealed in which main directions (in the opinion of the interviewed managers) need improvement in the first place. The first direction was strict definition of the authorities and responsibilities of governing bodies (36%). The second direction defined with a slightly smaller percentage was the need for improvement in the area of minority shareholder rights protection (34%). The managers have also noted as priority problems those dealing with preparation and enacting of international standards for financial reporting (24%). The experience of the last decade has shown that the lack of corporate governance integrated as a component in the economic reforms seriously endangers the whole agenda of reforms. It is necessary to pay more attention to both the key institutions of the state and to the decision making process at the government level.

The establishment of corporate governance and a market economy shall start with the provision of some regulation of the system which shall be open and fair for all

Creation of some tools for efficient corporate governance in developing countries is a difficult task. The governments of different countries try to promote transparency and responsible principles.

Source: White Paper on Corporate Governance in countries of South Eastern Europe.

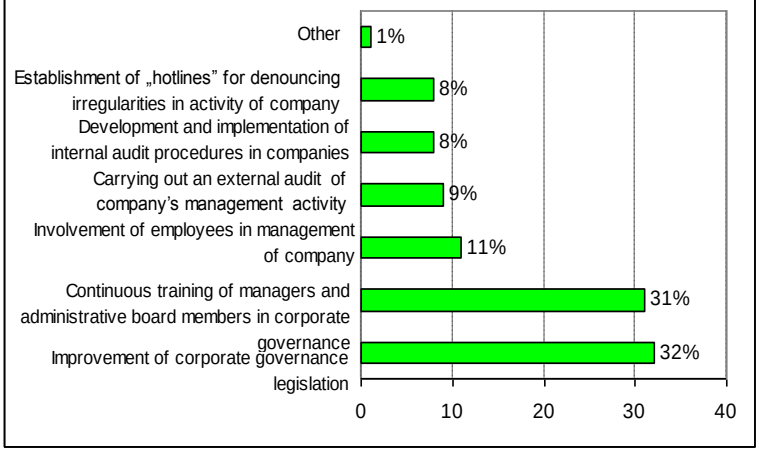
The Government of the Republic of Moldova has approved the *Concept for corporate governance of national economy companies by Resolution No. 22 of January 16, 2003.* The aim of the concept is to improve the existing system for corporate governance, to orient it towards the international principles and requirements which have confirmed their effectiveness in many countries with developed market economies and in countries that form the basis for the market relationships.

The implementation of this concept will:

- improve protection of all shareholders' rights (including of foreign ones) by assuring access to information and its transparency;
- facilitate the processes for improvement of the economic and financial indicators of corporations and for the increase of profits and exports;
- increase the credibility of corporations to foreign investors, which will promote a flow of funds towards the national economy;
- increase qualification and professionalism of a corporations' employees;
- make for an improved corporate governance culture and ethics.

In order to successfully implement the Concept, an action plan would have to be developed aimed at showing the terms and responsible parties for implementation of the primary directions for corporate governance improvement in the Republic of Moldova. It should be mentioned that neither the private sector, nor the nongovernmental organizations, nor the civil society were involved in the development of the concept; while the primary directions for corporate governance improvement have not been

Figure 9. Which are the most efficient actions for improving CG?



(Newspaper „Moldova Suverană" (Soveriegn Moldova) No.30 of February 25, 2004, article „The extent of our well being equals the extent of our discipline").

widely discussed.

The Moldovan managers, when interviewed with respect to the most efficient and applicable actions for the strengthening and promotion of a strong corporate governance practice have stated that the first thing to be done in this area is the improvement of the legislation. The second most important area was stated as being the continuous training of managers and the Board of the company, in fact, confirming the awareness, that it was an efficient method for implementation of adequate corporate governance.

It needs to be mentioned that the corporations of the Republic of Moldova should make a substantial effort to train all the key staff in the area of corporate governance (accountants, auditors, lawyers, board members and executive directors). The training could make for a deeper understanding of good corporate governance practices, it could assist to bring the staff to the same level as the modifications within corporate governance and it could add new experience to the enacting of laws and normative acts. In addition, this will speed up the development and implementation of the international standards.

36% of the respondent mangers have provided four almost uniform groups of answers regarding the most efficient actions for corporate governance strengthening, namely: 1) involvement of employees in the governance of the company – 11%; 2) carrying out an adequate external audit with respect to the activity of the management – 9%; 3) development and implementation of internal audit procedures in companies – 8%; 4) establishment of a telephone „hotline" for denouncing irregularities in companies – 8%. However well known the corporate governance problems may be, new problems emerge all the time which require prompt and correct solutions.

The corporate governance is adequate when:

- the capital market is well developed and regulated;
- the legal framework provides for shareholder rights to property, equitable treatments of all shareholders, procedures for mergers and purchases;
- methodologies and tools are applied for enacting legislation regarding shareholder right's protection;
- there exist laws to protect investors' interests against fraud, the laws work and corruption and bribe cases are penalized;
- self regulatory and supervision bodies for capital markets have been established and are operational;
- there are guidelines on provision of information on the market and access to information;
- associations of investors and managers have been established and operate;
- the audit companies and the accountants are professionals, honest and independent;
- the economic judges and commercial law lawyers are well trained.

Chapter III. Disclosure of information and its transparency

3.1. Disclosure of corporate information

Taking into account that one of the main requirements of corporate governance is disclosure of information and transparency of a company's operation, aimed at contributing to exercising an effective control over the management and at protecting shareholder interests, we will try to assess the situation related to disclosure of corporate information in Moldova, the perceptions of the need for information disclosure by businessmen as well as the sources for corporate information believed to be the most credible in the country.

Provisions of the legal framework and its observance. The legislation of the Republic of Moldova sets mandatory requirements for disclosure of information by open type joint stock companies with them having to submit to shareholders, creditors and other stakeholders a wide range of data and to report on it to the public institutions. A synthesis of the existing legal framework *(provisions of the Civil Code, laws on joint stock companies, market of securities, resolution of the NCS on approval of NCS normative acts related to submission of specialized reports of issuers of securities, etc.)* in the

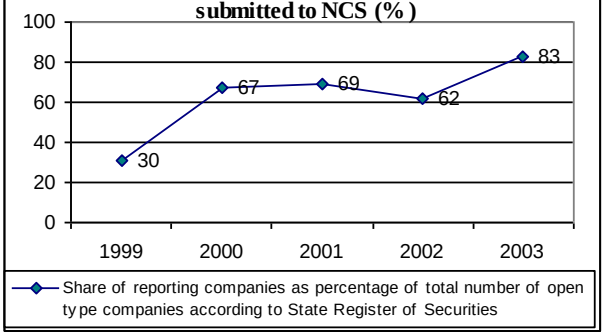
context of corporate information disclosure and ways and means for its attainment is offered in Annex 3.

In addition to general provisions on disclosure of information by issuers, as listed above, there are special requirements for reporting and disclosure of information directly to the participants in the market of securities, especially to investment funds *(Rules on mode of information disclosure by investment funds, approved by Resolution of NCS No. 14/1 of November 26, 1999, Specialized reports of professional participants, approved by NCS Resolution No 4/5 of February 06, 2003, etc.).*

Although the legal framework on information disclosure is rather complete, being to a great extent having been adjusted to international standards, (respective legal and normative acts have been reviewed over the last decade at least three times), and although it has provisions for penalizing persons in positions of authority over issuers and professional participants in the market of securities, the practice of information disclosure shows numerous violations of the law.

Thus, while in respect to reporting an improvement of the specialized and financial reports submission level by open type issuers to NCS[34] is noticeable (Figure 10), the level of publication of summary reports is still unsatisfactory. As a rule, they are published in the press by about 30% of the issuers that submitted the reports to the NCS (in 2001 – 20%, in 2002 – 28%, in 2003 – 26%).

Figure 10. Level of specialized reports submitted to NCS (%)



In addition, the summary reports published in the press are, to a great extent, incomplete; they comprise no data on financial results, no information on persons holding 5% and more of the issuer's voting shares, no data on the auditor, registrar of the company, etc., or they admit errors when compiling the data. These deviations do not result only from the incompetence of a single responsible person; they are admitted purposely due to the reluctance to disclose respective information by managers and major shareholders whose interests they represent. Taking into account that insistent people could legally obtain the information from the company, including by means of an application at the office of the company or by post, the above methods are used to restrict the access to information to written press users.

Along with the violations described above, the issuers also allow other irregularities in disclosure of information: they do not submit information about the company to shareholders and creditors upon request (incorporation document, statutes, regulations of the company, reports of the internal audit commission, etc.), keep major transactions secret, do not notify or inadequately notify shareholders about general meetings, etc.

Although the NCS indicates a decrease of such irregularities[35], their existence shows a low level of transparency, which endangers the interests of shareholders, decreases access to information and creates conditions for corruption of issuers' managers.

The penalties applied for violation of the legislation in the area, especially of provisions of the *Code on administrative contraventions* (CAC), do not always achieve the expected results. Thus, the NCS every year penalizes persons of authority of issuers with fines both for „non observance of reporting formats and their publication terms in mass media" (art.162/6 of CAC), and for „nonsubmission or late submission of reports set by the law to the NCS" (art. 199/4 of CAC). In addition, the amounts of the fines applied by the

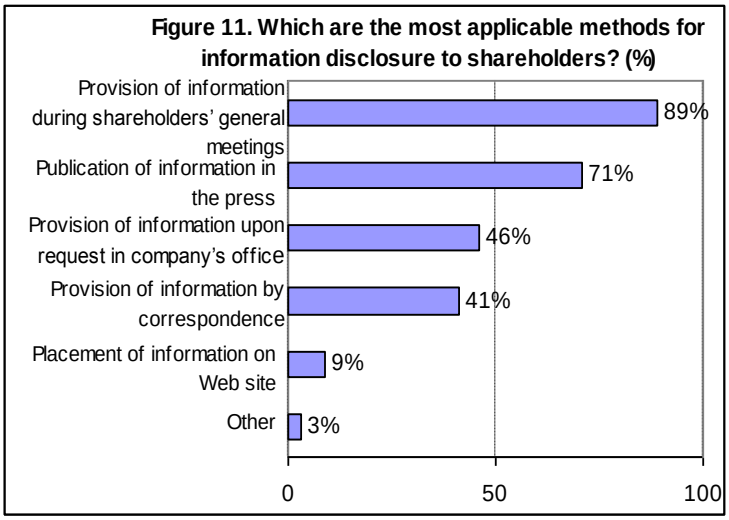
[34] In the calculation carried out based on NCS annual reports data for the years 2000-2003 and based on the *Concept for corporate governance of national ecoonomy companies* (Resolution of the Government of the Republic of Moldova No. 22 of January 16, 2003) the professional participants constituted in form of joint stock companies are not taken into account.

[35] Resolution of NCS on results of annual reports monitoring on securities of open type joint stock companies for year 2003 No. 27/5 of June 30, .2004 *(Monitorul Oficial al Republicii Moldova No.119 –122 of July 23, 2004).*

NCS are rather moderate. In 2003 they amounted to 150 lei on the average, the upper limit for violations listed above being respectively sixty and fifty minimal salaries (1,080 and 900 lei). The freezing of issuers' accounts by the NCS as an action for increasing reporting discipline and improving disclosure of information (one of the rights of NCS stipulated in art.9 para. (1), item c) of the *Law on National Commission for Securities*) is less reasonable; it may aggravate the basic operation of the issuers (some accounts stay frozen for a long time – up to several months) and affect the shareholder interests.

Methods for information disclosure. The international practice shows that corporate information needs to be channeled into two directions: towards the shareholders of the company and towards other stakeholders, each group needing a different approach. The information oriented towards shareholders may be provided in different ways: upon request of the shareholder, during a general meeting, by publication in the press, by post, etc. As far as the information for other users is concerned, the range of information and respective procedures should not be an excessive burden for the companies and should not endanger their position with respect to their competitors.

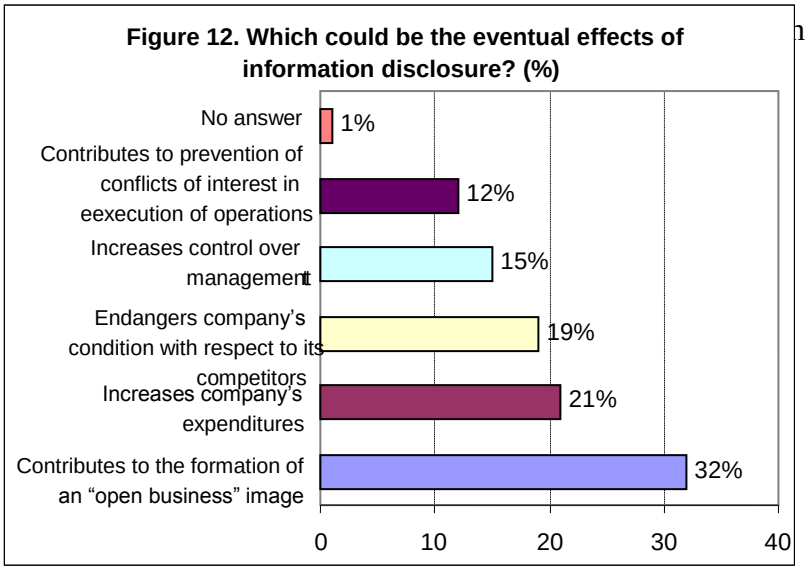
Figure 11. Which are the most applicable methods for information disclosure to shareholders? (%)



Within the research carried out by Transparency International - Moldova the managers of Chisinau joint stock companies listed the most applicable methods for information disclosure for shareholders (Figure 11)[36]. Thus, the first is provision of information to shareholders during general meetings (89%) – one of the most efficient methods for information provision, taking into account the great number of shareholders that may obtain a large range of information during a short time. One of the most preferred methods is publication of the information in the press (71 %), although this source may be doubtful if we take into account the NCS data on publication of summary reports by issuers. Among other frequently used methods, provision of information upon request at the office of the company (46 %) and by post (41 %) were included. And, finally, only 9% of the respondents indicated the method of placing the information on company's web page.

Effects of information disclosure. As disclosure has a great number of positive effects, namely, it improves the skills of shareholders and other stakeholders in corporate governance, it improves the structure of property and the results of the company's activity, it makes the control of the management easier and it increases the investment attractiveness of companies.

Figure 12. Which could be the eventual effects of information disclosure? (%)



The opinions of the local managers with respect to the eventual effects of information disclosure were as follows: 59 % of the respondents

[36] The aggregate number of answers exceeds 100%, because respondents were offered the opportunity to choose more than one answer.

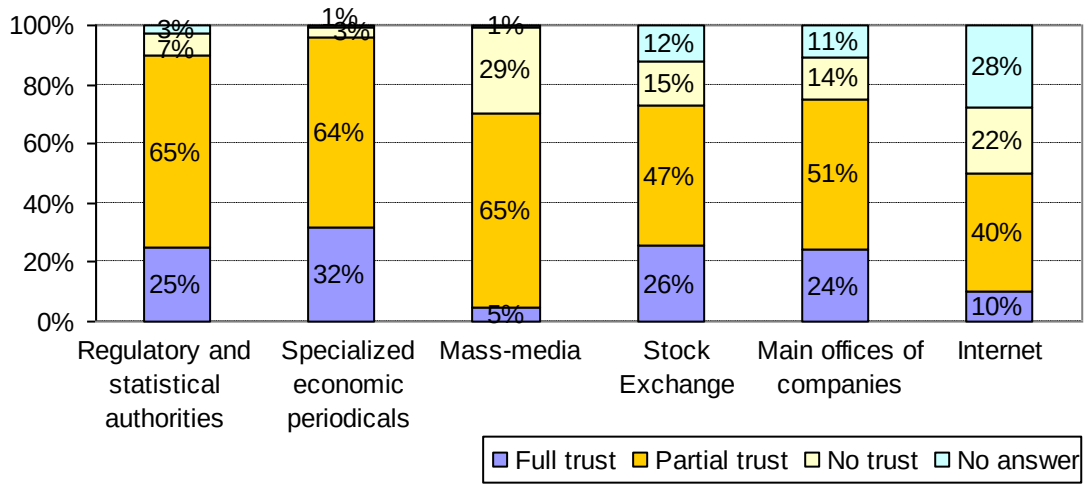
opted for positive effects of the process, in particular, 32% – formation of a good image of the company, 15 % – improved control over management and 12% – prevention of conflicts of interest when carrying out operations. However, 40 % of those interviewed believe that information disclosure generates negative effects, especially cost increases for the company (21%) and endangering the condition of the company with respect to its competitors (19%). The fact should be underlined that the perception of information disclosure, especially in the context of image conscious companies, also confirms the reluctance of managers to see the importance of disclosure for exercising control over the management by shareholders, creditors and other constituents of corporate governance.

Quality of information sources on the activity of joint stock companies. According to the best corporate governance practices, the ways for information dissemination shall meet the following quality criteria: to assure *full, timely, equitable and inexpensive* access of users to compete and truthful information about the company's activity.

Based on the listed criteria the managers of the companies expressed the following views with respect to their trust in different sources of corporate information[37].

The most trustworthy sources are believed to be the ***specialized economic periodicals*** – 96% of the managers have full or partial trust in them. Specialized periodicals have a high professional level in addressing issues; they are oriented towards a relatively narrow and well informed public that is difficult to lead astray as is the case with the general public. For this reason, this source is less frequently engaged in advertising campaigns of companies, which makes it more trustworthy. However, since economic periodicals are few in number[38] and have a narrow specialization, they cannot assure an equitable access to all information users.

Figure 13. How much trust do you have in the following sources of information?



State regulatory and statistical authorities are in second place according to trust level with 90% of the respondents believing them fully or partially trustworthy. However, it should be mentioned that the information provided by state regulatory and statistical authorities does not comply with all quality criteria. Thus, although these sources (for example, the NCS or the Department for Statistics and

[37] The aggregate number of answers exceeds 100%, because respondents were offered the opportunity to choose more than one answer.

[38] In Moldova there are only serveral such periodicals, including „Экономическое обозрение" (Economic Review), „Contabilitate şi audit" (Accounting and Audit), „Profit" (Profit), „Bănci şi Finanţe" (Banks and Finance), „Бухгалтерские и налоговые консультации" (Accounting and Tax consultations), etc., with a monthly circulation varying between 5,000 and about 39,000 copies.

Sociology) may offer *full* corporate information, in fact they provide neither *timely* (the terms for processing initial information and for preparing reports are rather extended and the information is no longer up-to-date), nor *objective* (as a source financial, accounting, specialized reports are used, their data not excluding errors and deviations), *nor equitable* (their costs are high, the public being informed insufficiently about the opportunity for obtaining such services).

Central offices of companies are believed to be a trustworthy source by 75 % of the respondents that qualify it as fully or partially trustworthy. However, we need to be rather cautious regarding the quality of information provided by this source, because the information may not be totally objective; moreover, the access to such information is not equitable, there are rather complicated procedures to obtain it; the management delays the examination of applications or even refuses to provide information to applicants saying that information is for internal use, etc. Still, companies in the future may become one of the most efficient sources for provision of information to shareholders where the management will fully comply with the transparency principle and the principle of equitable treatment of all shareholders.

Seventy three percent of the respondents trust the information provided by the ***Securities Exchange.***. Is it remarkable, that although the exchange information is more or less up-to-date, it is less efficient for potential users because it is either *incomplete* (it includes a small range of data: amount of transactions, quotations, etc.), or *more complete, but less accessible* (detailed information such as the structure of the companies' assets, list of management staff, with access to financial reports being practically denied).

Mass-media in general is believed to be an information source with a lower degree of trust: 70% of the respondents trust it, including 5 % – full trust and 65% – partial trust. This attitude is easily understandable taking into account the low professionalism in the area of business, involvement in advertising campaigns of companies and impossibility of checking the correctness of disseminated data. Still, due to the accessibility of mass media, it may be assessed as an additional source of information for all types of users.

Finally, the lowest level of trust as an information source was chosen as the ***Internet*** – 50 % of the interviewed trust it, with 10% having full trust in it and 40 – partial trust, 22% have no trust at all, while 28% expressed no opinion related to this source. This situation is easily explained: the access of the population to Internet is limited, only a few number of joint stock companies have their own web pages (only 9% of the interviewed companies[39]); practically no advertising of the web pages is made; the web pages of the regulatory authorities are incomplete and rarely up-dated with the requested information being provided for pay, etc.

As mentioned above, the observance of the transparency principle is a component of the corporations' success – the higher its level, the more prosperous is the company, the more chances it has to attract new investors. The situation in the area of transparency and corporate information disclosure in Moldova shows numerous violations of the legislation, which poorly represent national corporate governance; it negatively affects shareholder rights and decreases the interest of investors. What actions are needed for the improvement of the situation? In this context a combination of more than one action is necessary, starting with educational ones: building awareness of the positive effects of information disclosure and observance of the transparency principle in the business environment; raising the level of awareness of procedures for information disclosure and in responsibility for nonobservance of information disclosure for the public, including shareholders, as well as more severe sanctions for nonobservance of requirements for information disclosure. Among the main activities capable of contributing to the achievement of the above actions are the following:

- Improvement of the legal framework by including the provisions for establishment of special committees responding to the boards of the joint stock companies named

[39] All banking institutions, some investment funds and companies with foreign capital have web pages.

responsible for development and application of regulations of policy for information disclosure;

- Establishment of some public information centers for shareholders with the support of the regulatory authorities, participants in the securities market, civil society, external donors, etc.;
- Extension and improvement of updating the information base of the NCS on the activity of joint stock companies, search for opportunities for free access to it by all applicants;
- Organization of seminars and trainings with issuers, shareholders, representatives of the civil society, etc. related to transparency and information disclosure with greater focus in localities;
- Development and publication of information materials (flyers, leaflets, etc.) on shareholder rights and responsibilities aiming at a professional approach to the problems in the respective area by the public.

The problems related to the content of information to be disclosed and its comparability with similar information of other companies, are directly connected with the application of international standards for information disclosure, including accounting and auditing standards.

3.2. Financial reports, internal control and audit systems

***Financial reports and accounting*.** Over the last years the international and regulatory financial institutions have turned towards corporate governance, transparency, disclosure of information, responsibilities and implementation of international standards for financial reporting. The importance of a system for accounting complying with international standards should be mentioned. In the Republic of Moldova the process for transition to modern accounting policies has started along with the adoption in 1995 of the *Law on accounting,* which was followed by preparation processes and the development of national accounting standards, their implementation having begun in 1999. Over the period 1998 – 2004 29 National Accounting Standards (NAS) have been developed, with another 16 being under development. It should be mentioned that some of the NAS which have been implemented are in need of modification in order to comply with the international[40] and EU acts and normative. Many of the provisions of the International Accounting Standards (IAS) were not taken into consideration when developing the national standards which leads to difficulties in interpretation of reports and increases the cost by carrying accounting in both standards. For example, due to the discrepancies existing between NAS and IAS, commercial banks prepare and submit to the NBM financial reports in compliance with both standards, which require carrying accounting in both standards.

In the opinion of the World Bank experts in order to achieve the objective of NAS harmonization with the EU standards it would be necessary to require that the companies listed on the Exchange for Securities, as well as public interest companies, prepare aggregated financial reports in compliance with International Standards for Financial Reporting (ISFR), while the financial reports of the small business companies could be simplified and brought into compliance with EU directives and regulations[41].

The operation of a reliable accounting and information system is a key component of an effective internal audit.

Internal control means the methods and procedures applied for supervision of assets and other resources and assurance that the assets shall be used according to the directions drawn up by the managers and in compliance with the effective legislation. The control systems assist the managers of

[40] NAS 5 has not been modified to reflect the modifications included in NAS 1" Submission of financial reports".
[41] Report No. 27425 Moldova Country Financial Accountability Assessment, September 12, 2003.

companies to identify risks encountered by companies in their activity and to assure a framework for their monitoring. In addition, the internal control systems aim at prevention and minimization of exposure to risks which may emerge as a result of some unauthorized or improper actions, fraud, theft, error or corrupt acts.

It is necessary to make a distinction between the *internal control* and *the internal audit.*

The internal control refers to certain permanent tools to control the company's activity both at the level of central authorities and at the level of department/division. These tools are governed by managers with the purpose that internal control assures the achievement of the company's objectives. The internal control estimates the conformity with the effective legislation, the execution of regulations, internal policies and guidelines. It should be stated that adequate internal control improves the companies' capacity and firms' capacities for preparation of fair and reliable financial reports.

The internal audit it the process by which the implementation of the internal control is tested through continuous review by managers of control and reporting operations on the efficiency of the internal control. The internal audit reports to the board of the company and at the general shareholder meeting.

The objectives of the internal audit are:

- a*uthorization* – the internal audit should check whether all transactions are duly authorized by responsible persons prior to their registration in the book;
- *integrity of operations* – the internal audit checks whether invalid transactions have been excluded from accounting books;
- *accuracy* is an objective aiming at assuring that all valid transactions be exact and precise, consistent with original data of transactions and registered on time;
- *validity* is an objective assuring that all registered transactions fairly represent accomplished economic events, that they are legal and executed in conformity with the managers' authorization;
- *security and physical safeguarding of assets* is the objective assuring that access to physical assets and information systems of the company are strictly controlled by the authorized staff;
- *manipulation of errors*. This objective assures that errors found at any stage of processing have been promptly reported to managers and corrected;
- *segregation of staff functions*. This objective assures that the functions have been allocated in a manner that does not allow for one person to operate and control both processes, the registration and processing of the transactions.

The annual report of the internal audit and the annual report of the external audit need to be included on the agenda of the general shareholder meeting.

The mission of the internal auditors is to inform the board of the company and shareholders about any improper, unauthorized actions and about irregularities admitted by managers or employees. It is obvious that the internal auditors must not report to executive directors (management) of the company, because they have the final and exclusive responsibility for preparation of financial reports and for the maintenance of an adequate internal control system for finding out fraud and irregularities. In some countries the auditors report on the observance of corporate governance behavior principles with that information being included in the annual report of the company.

Systems for internal control

The systems for internal control include plans, actions and methods adopted by the company for supervision of assets, control of accounting data accuracy, promotion of operational efficiency and encouragement of adherence to standard managerial policies, assistance of the management of the company to achieve its objectives and assuring and controlling whether:

- affairs are conducted in a correct and effective manner;

- assets are supervised;
- fraud and errors are prevented and found timely;
- managers' policies comply with the effective legislation;
- accounting books are completed in accurately;
- financial data are timely registered.

The internal control may be:

- detective (provides for finding out errors and irregularities);
- correctional (provides for the correction of errors and irregularities found);
- preventive (aimed at the prevention of errors and irregularities).

The internal control consists of five components: environment of the control, evaluation of risks, control activity, information and communication and monitoring. These components are an integral part of the management process and they are included in the procedures for internal control.

What are the possibilities of an internal control system?

The internal control system may assist the company to achieve its objectives and to avoid dangers and failures by helping the company operates with fair financial reports and to comply with the effective legislation. However, the internal control cannot assure the success in this area, taking into account the fact that it is directed by managers and that human error and other external factors may not be fully prevented by internal control systems. Adequate internal control systems are reasonable assurances for achievement of objectives, but no guarantees.

Who is responsible for the implementation of an adequate and efficient internal control?

An erroneous opinion exists that the responsibility for the implementation and management of the control system lies to a great extent with the financial directors of companies, internal auditors or managers. The involvement of all staff is needed for an effective internal control. All employees are responsible for reporting identified operational problems, deviations from established standards, violation of company policies or laws.

What are the limitations of an internal control system?

There are several limitations in implementing an adequate control system:

- *human factor*. The efficiency of the control system may be limited by decisions made by managers based on data that sometimes may be erroneous.
- *disintegration of the internal control system.* Even where the control system operates normally, it may be disintegrated. The employees may in some cases make errors when they do not understand procedures and guidelines. Errors may emerge upon implementation of new informational technologies and the difficulties inherent in these new systems.
- *violations by managers.* Sometimes the top managers do not observe existing rules and procedures when pursuing personal interests.
- *a plot by the employees*. The control system may be influenced by a coalition of the employees. It is rather difficult for the internal control to identify modification of data and errors in submitted information when a plot exists by the employees exists which created it.

The necessary costs should be taken into account for the determination and establishment of an adequate control system. Excessive control is expensive and unproductive. Too little control presents risks. All advantages and disadvantages should be considered in order to achieve a balance.

What may happen when the internal control is weak or nonexistent?

The decision makers frequently argue that there is insufficient staff for implementation of the internal control and an internal audit, that it is very costly or that managers trust their trained staff and the implemented informational technologies, and that the internal control is not necessary. However, these arguments are „traps" for managers that are confident in their capacities for managing and controlling all the processes in the activity of their company. Each of the above arguments needs its own solution. As far as the cost for the implementation of an adequate control system is concerned, it should be compared to the cost of the frauds and distraction that may occur when the control is lacking.

By analyzing the issue of trusting the employees, is should be mentioned that most of the employees trust each other and this factor is very important for team work. However, the experience shows that employees in which managers trust most are the ones that commit fraud.

A situation of concern related to weak internal control is registered in companies with state capital. The practice shows that in some of the companies the internal control system and the internal audit system are absolutely nonfunctional, because the same violations occur year after year, irrespective of the fact that new persons were appointed or elected to positions of authority.

The reports published by the Court of Accounts show that the most frequent violations of the *Law on accounting* No. 426-XII of April 04, 1995 found by the control authorities were the following:

- underreporting of taxable income by companies;
- the inventory of assets is not carried out and the accounting is not maintained (accounting policy is lacking, synthetic accounting and the Ledger are lacking);
- the reconciliation of liabilities in the book of analytical accounting with the primary accounting documents and the ones from the annual reports is not done;
- the annulment of assets is done in violation of the Regulation on used up assets.

The Court of Accounts, upon analysis of the management of the state property, lists the following factors which negatively affect the economic and financial condition of state companies[42]:

- freezing of circulating funds, including by maintenance of liabilities;
- undervaluing of net assets of companies subjected to privatization from the time of transformation into joint stock company until privatization[43];
- nonobservance of the Regulation on the Register of public property, lack of accounting of the public property provided for rent and for fiduciary management;
- inefficient utilization of funds for reconstruction, capital and current repair of fixed assets of companies;
- in some of the completed contracts the buildings to be repaired are not named, the requirements of the repair quality are not specified in violation of provisions in Art. 9 of the *Law No. 134 of June 03, 1994 and the Resolution of the Government No. 798 of December 27, 1993;*
- there are cases when the labor cost were paid in advance in the amount of 100%;
- the selection of entrepreneurs for execution of repair and building works was not done in a transparent manner, by tender or contest, but based on a decision by the company manager;
- in many cases the documents of acceptance of works are not signed by the respective commissions, but by the management of the company;
- there are violations of the law related to calculation of salaries for the staff and managers;

[42]Monitorul Oficial al Republicii Moldova No. 3 – 5 of January 21,.2003
Monitorul Oficial al Republicii Moldova No. 159 – 160 of November 29, 2002
Monitorul Oficial al Republicii Moldova No. 170 – 172 of December 13, 2002
Monitorul official al Republicii Moldova No. 190 – 197 of December 31, 2002
Monitorul Oficial al Republicii Moldova No. 87 – 89 of May 28, 2004.

[43]Report of the Court of Accounts on management of public funds (1999, 2000, 2001, 2002, 2003).

- the expenses dealing with receptions not confirmed by the necessary documents (the orders by the manager are lacking, there are no reports on expenses, etc.).

The fact is certain that the quicker the internal control and internal audit tools are implemented in the public and private sectors, the better will the resources of the state, of companies and of individual firms be managed and supervised.

Internal control is frequently confused with the system for risk management

Risk management includes analysis, evaluation, management and monitoring of risks, while the adequate internal control assures the implementation of procedures for risk minimization and avoidance.

The situation in the Republic of Moldova. The internal audit in the pubic and private sectors is underdeveloped. As remarked in the report of the World Bank on evaluation of financial responsibilities by the country prepared in 2003 „...the current internal audit should move from control after the realization of the operation (ex-post) and from inspection activities to an audit model that will support the improvement of the general control environment. Upon corresponding consultations with the relevant ministries and other subdivisions of the public sector, the Ministry of Finance should establish a framework for the internal audit in the public sector[44]". The situation in this area is no better in the private sector.

The Law on joint stock companies has no clear provisions on the need for internal audit in companies. The international experience shows the importance of the internal audit and its contribution to the efficiency of the internal control system and to finding and preventing of irregularities. Thus, it is necessary to review and to harmonize the *Law on joint stock companies* with the international and EU requirements in this area.

When asked „Who is responsible for the internal audit?" 55% of the interviewed managers said that their company had separate subdivisions or persons responsible for the internal audit, 19% stated that the internal audit functions were carried out by the revision commission, 16% – by the audit committee, 7% – by the audit company (Annex 2, Figure16).

In some countries the codes for corporate governance include recommendations on establishment of audit committees at the company level. The audit committee, composed of independent members should take upon itself the responsibility for the major aspects dealing with financial reporting of the company, and should maintain the connection with its internal and external audit. Actually, the audit committees have become a common feature for Western companies. This evolution reflects the tendency of the international business community to improve its management structures. Currently the popularity of the audit committees has extended to other parts of the world. For example, the rules established by the authorities for regulation of exchanges in the markets of Singapore and Thailand comprise specific provisions dealing with the existence of audit committees.

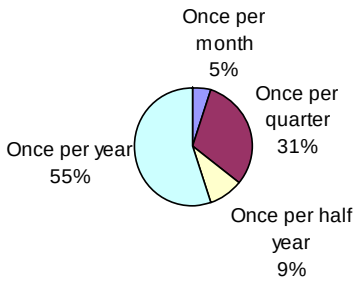
There are some opinions that for companies in the Republic of Moldova there is no need to establish audit committees with functions almost identical with those of the revision commission. The legislation of the Republic of Moldova clearly stipulates the functions of the revision commission and the requirements of its members. The difference between them is that the requirements to all the members of the audit committee include their complete independence, while *Art. 71* of the *Law on joint stock companies* states that the revision commission members shall be shareholders, except for the experts in accounting. *The Law on joint stock companies* does not provide for the responsibility for monitoring and carrying out the connection between the internal and external audit of the company in the activity of the revision commission. It should be mentioned that in Moldovan companies the revision commissions are elected by major shareholders and they do not play an independent role in the protection of minority shareholder rights, while the general shareholder meeting may delegate the

[44] Report No. 27425 Moldova Country Financial Accountability Assessment, September 12, 2003.

authorities of the revision commission to an audit company. There are experiences (for example, in Romania) where the revision commission has been annulled. Taking into account the above, it is necessary to review the effective legislation and to harmonize it with EU requirements.

The situation in the area of the internal audit is described by the results of the social study of the interviewed managers in Chisinau. Sixty nine percent of the interviewed managers have responded in the positive to the question whether the internal audit is carried out in their company. The frequency of control by internal auditors differs from one company to the other.

Figure 14. How frequent is the internal audit carried out?



Approximately 55% of the respondents stated that in companies they represented the internal audit was carried out once per year, 31% - once per quarter, 9% - once per half year and 5% - once per month. It should be mentioned that the high frequency of the internal audit controls increases the probability of finding out fraud, embezzlement and corrupt acts in their early stages and prevents companies from taking major risks.

External audit. The role of the external auditor is vital in the process of corporate governance. The large international companies have applied for the professional services of external auditors much earlier than when it became a mandatory requirement because they realized that in the financial and capital markets they would enjoy greater trust after having been subjected to independent examination and certification.

Although the *Law on audit* provides for the methodology of carrying out the audit and the national audit standards present a transcription of the international standards, there are still gaps in this area[45] (in particular, the objectives of the audit are not brought into conformity with EU directives 4 and 7). It should be mentioned that initially the *Law on joint stock companies* included a mandatory external annual audit for joint stock companies with greater than 50 shareholders. The subsequent modifications of the legislation, having poor audit services provided by local audit companies, resulted in Art. 89 of the *Law on joint stock companies* stating that the external audit was optional[46] for joint stock companies and it was to be carried out at the requirement of the shareholders owning no less than 10% of the voting shares of the company (the audit services are to be paid by these shareholders); at the requirement of the NCS; based on a court decision.

The external audit shall be carried out in compliance with International Audit Standards, which guide the external audit in its evaluation of the quality of the internal audit activity. The activity of the external audit is focused, primarily, on the system of financial accounting, especially, if based on the submitted documents, the auditors may express an independent and fair opinion in conformity with National Accounting Standards (in case of commercial banks the conformity is necessary with International Standards for Financial Reporting).

The external audit needs to comprise a test based examination of primary documents which serves as basis for financial statements and to evaluate the accounting policies applied and the significant estimations made by the management of the audited company, as well as to evaluate the general state of the financial condition. When forming its opinion, the external auditor needs also to make an evaluation of the internal control system of the company.

There are several international audit companies operating on the Moldovan market, that are mainly involved in carrying out external audits for commercial banks and companies with foreign investors.

[45] Report No. 27425 Moldova Country Financial Accountability Assessment, September 12, 2003.
[46] The banks and the insurance companies have the mandatory responsibility to have an audit of their financial reports.

The responsibility of the auditors with respect to third parties is not clearly stipulated in the law. The employees of the audit companies need to be independent and to conduct audit activity with no interference through relationships, benefits or other factors that may affect their impartiality. The audit companies shall be subject to rotation. In compliance with the new international requirements of audit companies, (they should be taken into account and included in the legislation of the Republic of Moldova), the audit companies and their employees are not allowed to provide consulting services to companies in which they simultaneously carry out an audit.
It is necessary to reintroduce into the effective legislation of the Republic of Moldova the mandatory status of the external annual audit for joint stock companies, irrespective of their size, and to harmonize the national legislation with EU requirements. In the Republic of Moldova the Chamber of Accounts plays the role of external auditor for the public sector. The report by the World Bank comments on the need for improvement of controls carried out by the Chamber of Accounts, stating that „The Court of Accounts needs to additionally focus its audit activities rather on consulting for systems improvement and risk reduction actions than on identification of errors. They do not provide assessments of issues such as economy, efficiency, performance, and accounting and internal control systems. The reports appear unstructured, rather long and detailed which make them difficult to understand, not only in terms of facts but also, and more importantly, in terms of implications for the state of the public sector financial accountability framework. Thus, the utility of the CoA audit as a means to strengthening the public financial accountability framework is limited."[47].

The National Bank of Moldova has set in its *Regulation on the mode for preparation and presentation of audit results* the criteria and requirements for audit companies which carry out audits of commercial banks and has formulated requirements of audit reports. When a contract is concluded with an independent audit company, the company presents to the bank with a license for audit activity along with the quality certificate of the banking auditor issued by the evaluation commission of the NBM. A positive factor is that the requirement of methods for auditing should conform with the International Audit Standards and with the National Accounting Standards, while the letter to the manager in compliance with the international accounting standards should include the audit of internal control procedures and the „operation procedures of the examined bank over the year".

Such requirements need to be developed by authorized bodies for all the other entities and the audit methodology needs to be reviewed so as to comply with the international standards.

Finally, we conclude that the major problems that affect the quality of the audit carried out in the companies in the Republic of Moldova and which need urgent addressing and resolution are as follows:

- conformity by the legal framework of the Republic of Moldova related to audit and accounting standards with international standards and with EU directives;
- review of the *Law on joint stock companies* in the part regarding to the need for an internal and external audit;
- development of a manual for internal control procedures;
- implementation of new tools for monitoring and licensing of auditors at the level of international requirements to audit;
- continuous training of the staff, accountants and auditors in internal control and internal audit. Organization of seminars, lectures, round tables, conferences in internal control and internal and external audit;
- implementation of a transparent process for testing of auditors;
- extending of the requirement for audit to companies listed on the exchange and to companies with state capital;

[47] Report No. 27425 Moldova Country Financial Accountability Assessment, September 12, 2003.

- increasing the responsibility level of accountants and auditors for incorrect bookkeeping and concealing of valid information.

Chapter IV. Capital markets and their role in corporate governance

4.1. General aspects of capital markets in transition countries[48]

As mentioned earlier, empirical studies confirm the existence of a direct connection between the level of corporate governance and the performance of companies. Moreover, such studies carried out in countries with a high level of corporate governance show a higher level of economic growth and a higher potential for it as well as greater access to internal and external sources of funding.

It is believed that effective corporate governance may be achieved based on a well developed legal framework and on a prosperous capital market. Taking into account the legal framework for corporate governance in some transition countries, including that of the Republic of Moldova which is believed to be rather high[49], a brief evaluation of the situation in their capital markets would be useful.

At the onset of the transition to a market economy most of the former socialist countries established stock markets with a strong technical and legal infrastructure. Being conceived specifically as tools for privatization (initial transactions were dealing with the redistribution of state property), these markets have become operational only early in the 90's.

Currently the stock exchanges of the transition countries have two or more listing categories. The capitalization and amounts of transactions carried out on the exchanges originate from the most flexible market segments, while the transparent conditions imposed by the legal framework allow for some comparison of the related statistical indicators. Also, according to some studies[50], the exchanges in these countries remain underdeveloped; they have weak capitalization and low liquidity, with a great number of small operations being carried out in them. In conditions of such capacities, the viability of market operations is doubtful while the data on capitalization may lead astray. Moreover, a good part of the transactions take place outside the exchange which creates transparency problems with respect to the market price of operated securities.

This underdevelopment of the capital markets originates from a number of problems, the first of them being the supply. The stock exchanges lack large companies with substantial free-floating shares. Upon privatization, an excessive number of companies had been created and listed; the listing was frequently made forcefully with no advantages. In certain cases, the securities listed at low prices during privatization programs denoting the residual governmental titles of some unattractive companies. The best and most attractive companies were either not privatized yet, or privatized for cash.

There are several reasons why companies are reluctant with respect to the exchange listing. First, the conditions for the listing are frequently perceived as useless and costly, the companies being concerned about bureaucratic obstacles in the form of high fees and lengthy processing of documents. Second, since there is no liquidity, the cost of the capital is higher than in the case of private placement. Moreover, companies do not wish to be exposed to the risk of price fluctuation of securities or even manipulation caused by weak development of local capital markets. In addition, companies have reticence related to disclosure of information.

The limited supply in the stock exchange with good titles is intensified by the lack of demand. There are very few new investors in these markets, while the titles are operated mainly between existing participants. The exchanges are frequently described as internal games by the brokers.

[48] In this context the transition countries of South Eastern Europe are meant.
[49] The EBRD rating in corporate governance for 2002–2003 placed the Republic of Moldova at level „B" („4") (see paragraph 2.3 of this book).
[50] The White Paper on Corporate Governance in South Eastern Europe. OECD, 2002.

In addition to a general slowdown on the international markets which highlights the problems of the transition countries, the investors also contribute to their capital markets due to a lack of legal protection for minority shareholders in our market. Some foreign investors suffered losses in this respect and they are trying to give up these markets.

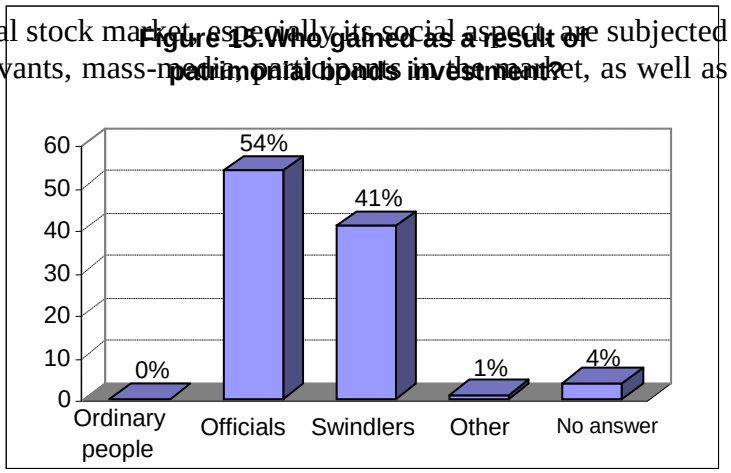
Consequently, the capital markets, especially stock exchanges in transition countries, face difficulties in playing their traditional role of organizers and discipliners of the participants' activity. However, these roles do not serve to increase the trust in the quality of information and evaluation of companies. The stock exchanges may also be considered inefficient in the sense that the prices established by them are, to a great extent, volatile, and are much lower than the calculated net value of the assets, not reflecting their true value or at least a reasonable value of these companies.

In order to improve the situation in some capital markets, actions are undertaken for selection and attraction of companies appropriate for listing, for introduction of new exchange instruments, in particular, derivatives of securities, extension of the circle of participants, focusing on retirement funds. In view of increasing liquidity, cooperation with more highly developed stock exchanges is undertaken which could contribute to the harmonization of rules, increase of opportunities for a dual listing, formation of direct connections between different stock exchanges or establishment of some common platforms for negotiation.

4.2. The market for corporate securities in the Republic of Moldova

Over the last years the problems of the national stock market, especially its social aspect, are subjected to severe criticism on the part of the civil servants, mass-media, participants in the market, as well as ordinary people. It is easy to understand that mass privatization, in which a number of 3.1 million people (89% of the patrimonial bonds owners[51]) have participated directly or through investment funds or fiduciary companies, has been carried out in conditions of insufficient transparency and low awareness by the population with respect to the respective process, while its results have decreased to a great extent the trust in the stock market.

Figure 15.Who gained as a result of patrimonial bonds investment?



A recent study by Transparency International - Moldova carried out among Chisinau shareholders has shown that 0.3% of the respondents believe that ordinary people came to gain as a result of investing patrimonial bonds, while, 53.8 % and 41.3% believe that the people to gain were persons of authority and swindlers, respectively.

Currently, actions are undertaken to improve the situation in the stock market, especially towards reorganization of the investment funds. However, the proposed actions cannot achieve their objectives when the level of awareness and understanding of the population in the area is unsatisfactory. Ten years have elapsed since finalization of mass privatization, while the vast majorities shareholders do not know their rights, are unaware of the basic notion of the capital market, do not know where to apply in case of a rights' violation, etc.

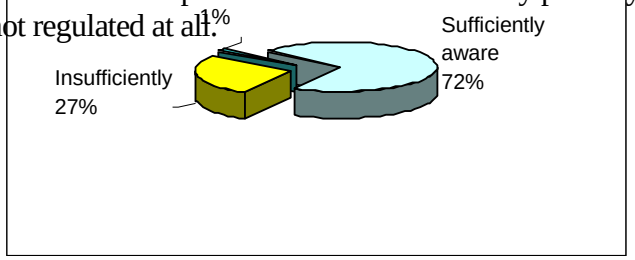
[51] Resolution of the Government of the Republic of Moldova No. 305 of June 10, 1996 *(Monitorul Oficial al republicii Moldova*, 1996, No.45).

The stock market[52] in Moldova is one of the newest and most complex segments of the national economy. As in other transition countries, it was conceived along with the initiation of the mass privatization process and has contributed to rapid denationalization of the economy, including through investment funds and fiduciary companies. Currently, the market has a legal framework, infrastructure and a system for regulating the respective activities.

The legal framework of the stock market includes *the Civil Code, laws on joint stock companies, stock market, National Commission for Securities, investment funds, etc.* Additionally, there are numerous normative acts, primarily those of the NCS, which regulate different aspects of the activity of professional participants, disclosure of information, procedures for securities' issue, processing tender bids, etc. The legal framework of the stock market has many common features with the regulatory framework for corporate governance, which along with the above listed laws comprise *the laws on entrepreneurship and companies, on limitation of monopolistic activity and development of competition, on financial institutions, financial-industrial groups, bankruptcy, etc.*

According to the social survey carried out by Transparency International Moldova, most of the managers of joint stock companies (72%) believe that they are sufficiently aware of the legal framework of corporate governance and the stock market. However, 27% of the respondents estimate their knowledge as insufficient, while 1% do not know the legal framework at all (Figure 16). When asked to what extent the legislation of Moldova regulated corporate governance, 84% of the respondents stated that it is only partially regulated, while 4% of the respondents said that it was not regulated at all.

Figure 16. To what extent are you aware of the legal framework of CG?



The situation, in which the vast majority of the respondents thus estimate the legal framework in the area, denotes, on the one hand, the existence of multiple gaps in the effective legislation, on the other hand, the existence of problems in the practice of corporate conflict resolution in cases where different judicial authorities take opposite decisions in the same case.

Also, in the opinion of some experts, including managers of Moldovan companies, the legal framework for the stock market is excessively regulated and it is restrictive and forbidding in nature and it does not promote the activities in this area. The low level of law adherence is also obvious and is confirmed by numerous irregularities in the activity of professional participants in the stock market and of the issuers of securities.

The regulatory authority of the stock market is the National Commission for Securities. It was established in 1992 and was operating until 1994 under the Government of the Republic of Moldova, being later separated into a special authority (the State Commission for Securities). Since 1999, along with enacting of the *Law on the National Commission for Securities*, the status and authority of this body were changed. The NCS has become an autonomous authority of public administration which carries out regulatory, supervision and control functions in the stock market, has decision making power as well as power to dispense, forbid, intervene, control, and impose disciplinary and administrative penalties in conditions of the law. Since 2000, the network of territorial agencies of the NCS is operational and it aims at reducing time needed for control of distant issuers and professional participants, monitoring of the local press and working with shareholders on site.

[52] Generally, *the stock market* is a sector of the economy, in which the issue and sale-purchase of securities takes place. Through this market, its professional participants (the stock exchanges, investment funds, the brokers, the dealers, etc.) attract funds from physical, legal persons and from the state and invest them in the productive and nonproductive spheres of the economy. The *primary market of securities*, where issue and primary placement of securities occur, distinctly differs from the *secondary market*, where operations with issued securities and their derivatives take place.

It should be stated that, in the opinion of some experts in this area[53], the exercising of such functions as licensing, control, penalization of participants in the stock market, development of law drafts (especially when the law drafts need no comments by the Ministry of Justice) by a single public institution not only decreases its efficiency, but may also generate conflicts of interests and create conditions for corruption of its staff. An eventual solution of this situation lies in the reduction of NCS functions to supervision and control of law observation on the stock market, with the licensing functions being transferred to the Chamber for Licenses, the development of law drafts to the Government and the penalization of the participants in the market to judiciary authorities.

The infrastructure of the stock market is represented by the following professional participants[54]:

Professional participants	**01.01.2001**	**01.01.2002**	**01.01.2003**	**01.01.2004**
Investment funds	22	19	14	14
Fiduciary companies	6	6	6	6
Organizations for investment management	15	16	16	14
Brokers	32	30	30	26
Dealers	3	3	3	4
Independent registrars	20	20	20	19
Underwriting companies	-	-	-	1
Evaluation companies	4	6	6	6
Depositors	9	8	9	9
Self regulatory organizations[55]	1	1	1	1
Audit companies	7	7	7	7
Stock exchange	1	1	1	1
National Depository	1	1	1	1
Total	**121**	**118**	**114**	**109**

As shown by the above data, the number of professional participants in the stock market has slightly decreased, being affected by the reduction of the number of investment funds.

Brief comment on the main indicators of the stock market in Moldova. The state of the stock market usually reflects the general economic condition of the country. According to official statistics, over recent years, the Republic of Moldova has registered certain progress in economic development: in 2001 – 2003 GDP growth rates were 6.1%, 7.8% and 6.3% per year, respectively, the amount of industrial production has grown by 13.7%, 10.8% and 13.6%, the investments in fixed assets - by 11%, 11%, and 16%. An increase was registered both for the internal consumption (final consumption), imports and exports, as well as for the inflation rate. However, the independent experts are rather reticent to comment about the positive results in the belief that the respective growth is not a high quality one and are due, to a great extent, to the increased consumption by the population. Does the stock market really follow the general tendencies of the economy? In order to answer this question, the evolution of the main indicators of this market shall be presented.

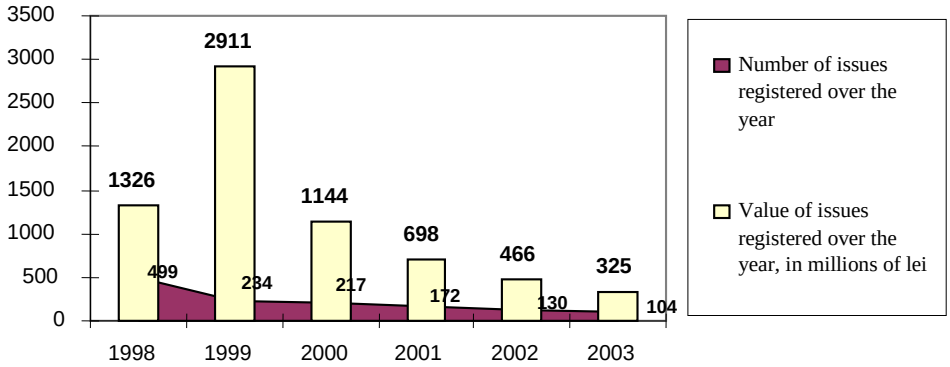
The primary market. Starting in 1999, the total number and total value of the emissions of securities has been steadily decreasing (Figure 17)[56].

This tendency is generated by a number of factors: finalization of concentration of control blocks of shares, lack of interest by the major shareholders of joint stock companies for modification of the capital structure and attraction of new shareholders; complicated and lengthy procedures for issuing securities with high additional costs; the need to prepare and submit numerous reports (including financial and specialized reports), the need for their publication and for submission of a wide range of data to

[53] «Что за комиссия создатель...», «Аргументы и факты», ("A Creator of Commissions" in weekly newspaper "Arguments and Facts"), 2004, no. 24.
[54] According to NCS reports for 2001 – 2003.
[55] National Association of Organizations for Management of Investments.
[56] The data were calculated based on the information provided in the NCS report for 2003 (diagrams 3 and 4, page 8).

shareholders, etc The issue of corporate securities allowed mainly for placement of shares: with the vast majority as nominative shares and fewer as preferential shares: for example, in 2003 out of the 112 issuers that obtained the authorization for placement of securities, 106 have placed ordinary nominative shares and 6 – preferential shares.

Figure 17. Evolution of the number and value of securities issued



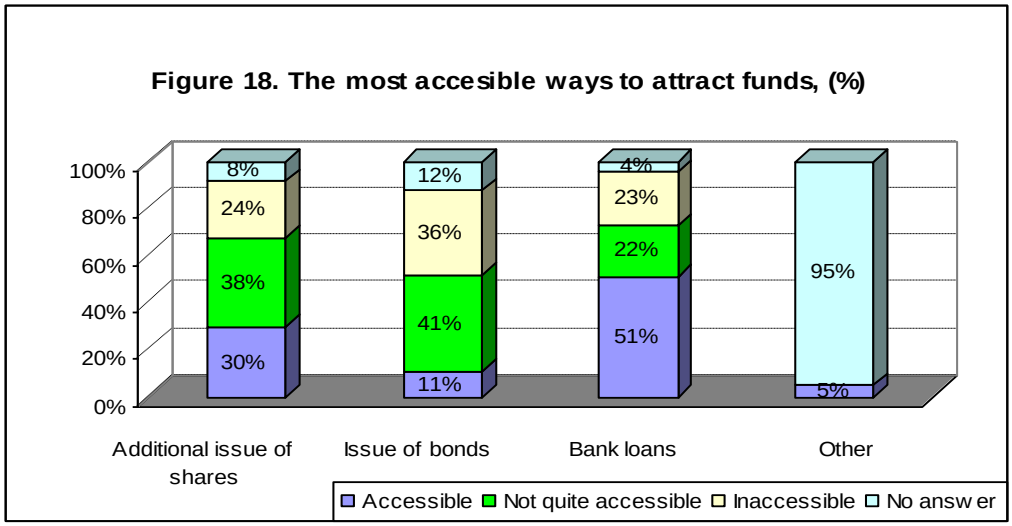
The majority of securities issued (both in number and in value) are represented by additional issues – their weights are double as compared to that for the incorporation shares.

As far as the listing of other securities is concerned, only several issues of obligations were made over 1997 – 2004, including that of "Elat" JSC, four companies of the „DAAC-Hermes" group and the attempt of „Flautex" JSC being unsuccessful.

In this context the opinions of Chisinau managers of their interest for attracting additional funds for business development are significant. Most of the interviewed managers (60%) were interested in attracting funds, 28% – not very interested and only 11% – are not interested at all (Annex 2, Figure 17). As far as the accessibility of ways for attraction of funds is concerned, it was evaluated as follows (Figure 18).

Bank loans are of primary importance – 51% of the respondents believe them to be the most accessible. It is easy to realize that businessmen prefer simple, rapid and transparent procedures for obtaining bank loans, even where their processing might be relatively more expensive. The reason for a more reticent attitude towards *additional issue of shares* – which 30% of the respondents believe to be accessible, lies really in the intentions of the major shareholders and of managers that represent them to maintain their positions of control and to avoid the risks of dispersing the property and attracting new owners. The fact is relevant that only 11% of the interviewed believe the *issue of obligations* to be accessible. A number of reasons contradict these claims such as: complicated and lengthy procedure for issuing obligations and high costs for their processing which, implicitly, make the obligations less attractive.

The secondary market. In economically advanced countries the capital circulation on the secondary market (total annual value of transactions with securities) is 10–20 times greater than on the primary market (total value of incorporation and additional issues). In the Republic of Moldova during the period of mass privatization, the value of the primary market was considerably exceeding that of the secondary market. Over the last years the proportion between the secondary and primary markets has changed and it achieved in 2003 the ration of 2.6 to 1, respectively, the tendency resulting both from the decrease of the value of the registered issues and from the increase of the turnover of transactions with securities.



As mentioned earlier, the secondary market is divided in exchange and offexchange markets. The centre of the exchange market is the *Stock Exchange***,** a specialized institution which provides the place for transactions with securities, offers clearing and information services related to transactions with securities, charges commissions for services and sets restrictions on transactions with securities. In other words, the exchange is an organized market in which the offer and demand for securities are concentrated, their rate is determined and the transparency of transactions is assured. The *Stock Exchange of Moldova (SEM)* was established as a closed type joint stock company by the end of 1994, while the first negotiations on the exchange took place in June 1995. In 1998 the SEM founded the *National Depositary for Securities* (NDS), which nominally holds all the securities admitted for negotiation, except for the securities of the investment funds.

Currently, the shares of 25 joint stock companies are registered with the exchange (8 of them being commercial banks), each of them having been attributed a certain level of listing – level I, II or III. The issuers of these securities comply with certain conditions and requirements set by the SEM, the relationships with the exchange being confirmed by a contract on registration and maintenance of the securities at the rate of the exchange. Simultaneously, the securities of over 1,000 issuers that either do not comply with the qualification criteria for the three listing levels or do not wish to adhere to the conditions established for registration and maintenance of securities at the rate of the exchange, are admitted for exchange transactions under „non-listing" conditions.

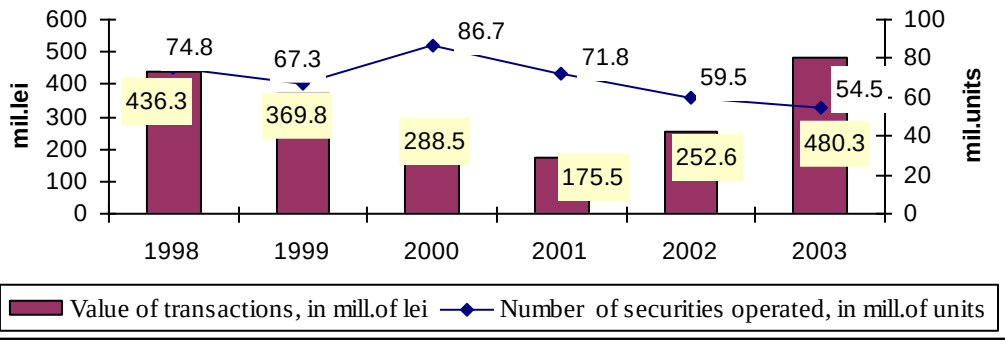
As confirmed by the statistical data on exchange transactions, during 1998–2002 a steady tendency was seen in their decrease (Figure 19)[57]. Starting with 2002, the situation has changed, resulting in some regulation actions (de facto – limitation actions) of transactions on the offexchnage market *(Resolution of the NCS No.32/9 of September 07, 2000).* In 2003 the amount of exchange transactions has reached the maximal figure of 480.3 million lei and out of that 167.6 million lei pertained to the transaction with the securities of „Vitanta Intravest" JSC (currently „Efes Vitanta Brewery" company). If we are to ignore the abovementioned transactions because of its unique nature (such transactions take place once in 10 years), the exchange market has registered in 2003 a growth rate of 123.8% as compared to the preceding year.

Of late, the structure of the exchange transactions has also changed (both in number and in value of transactions), with the greatest share being attributed to sale-purchase operations. Thus, in 2003 the greatest share in the number of operations consisted of sale-purchase transactions in the interactive market – 76.3%, followed by REPO operations *(sale of securities with their subsequent re-purchase, a mode of loan provision through exchange instruments)* – 16,3%, SWAP operations – 2.8% and transactions by tender bids – 2.6%.

[57] Report of the NCS for 2003, page 14.

From the viewpoint of transactions value, their structure has changed in 2003 and it corresponded to the following: purchase-sale transactions – 54.08%, tender transactions – 35%, REPO and SWAP – respectively 8.27% and 2.24%.

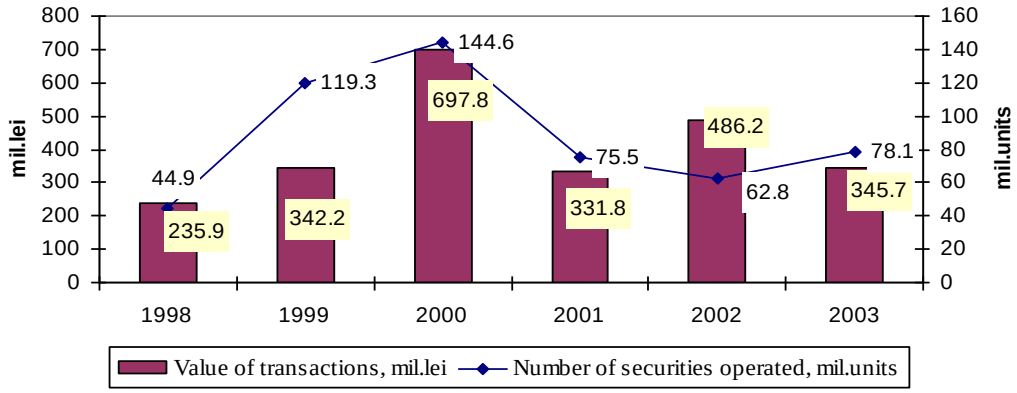
Figure 19. Evolution of exchange transactions value and number of securities operated on SEM



It may be stated that the exchange market has overcome the period of share blocks concentration which featured specific exchange transactions, and a new stage of property division has started, with its transfer from the professional market participants who have concentrated share blocks (investment funds, fiduciary companies) to companies specialized in the production of commodities and provision of services. The specialists forecast a further decrease in the number of transactions and an increase of the share of large transactions as well as increase of tender offers and activation of operations with bank shares[58].

Exchange index NCS-32. As is well known, the exchange indices aim at facilitating the monitoring of prices and assuring transparency on the exchange market. The national exchange index NCS-32[59] has been calculated based on a sample of securities of 32 issuers and it shows their average price change *(the index is calculated as a ratio, expressed in points, between the exchange capitalization of the 32 issuers included in the index portfolio at the end of each week and the exchange capitalization of the issuers included in the index portfolio in the base period).* The issuers of the securities which are taken into account for calculation are selected by indicators such as economy, liquidity, amount of social capital, and the total number of issued securities of a certain class. In case a security no longer corresponds to the eligibility criteria, it is replaced by a similar one. The initial (base) value of NCS-32 is 100 points and it represents the average price index for securities as of January 01, 2000. The growth evolution of the NCS-32 index over 2000-2003 from 100 to about 300 points is due, to a great extent, to the tendencies for concentration of control share blocks over 2000-2003. In addition, NCS specialists believe that subsequent growth of the

Figure 20. Evolution of value and number of transactions on the offexchange market



[58] «Надо только выучиться ждать», «Экономическое обозрение» (Article „We only need to wait long enough" in weekly newspaper „Economic Review" No.11 of January 16, 2004.

[59] Resolution of NCS No.14/1 of April 27, 2000 „On approval of the mode for NCS-32 exchange price index calculation" *(Monitorul Oficial al Republicii Moldova* No. 75-76 of June 29, 2000*).*

average price of securities of the issuers from the index portfolio is improbable because portfolio investors will tend to reinvest the obtained income[60].

Although a certain livening up of the national exchange market may be inferred, is it not the case to overestimate the evolution, especially taking into account that its parameters do not correspond to the tendencies of developed markets, in which the growth rates of exchange markets out pace by about 7-fold the general growth rate of the economy.

Offexchange market. From 1998 until 2000 the offexchange transactions have shown steady growth (Figure 20)[61], the spectacular growth in 2000 is due to the transaction for purchase of electric networks by „Union Fenosa" company at the price of 245 million lei. Starting in 2001, the evolution of offexchange transactions reflect the consequences of the NCS limiting actions undertaken in order to make the sector more civilized and to increase its transparency.

The major share in the structure of the market transactions belongs to sale- purchase, inheritance operations, REPO, donation, transactions with participation of the Privatization Department, etc.

From the above, a certain activation of the national market for securities may be inferred, including of the exchange market. Currently official sources praise a level of performances of the stock market in Moldova such as: high amount of transactions with securities, growth of the foreign investments in the secondary market, growing evolution of capitalized shares in the GDP, etc. [62]. Some of the arguments in favor of the spectacular growth of the national stock market seem rather confusing, taking into account its rather modest indicators as compared to the indicators of capital markets in Romania, Poland, Check Republic, Hungary, etc. In our opinion, for the estimation of the stock market and especially of the exchange market, a much wider range of indicators must be considered, including promptness, profitability of transactions, diversity of exchange instruments, etc. Regretfully, many of the statistical indicators of the stock market are not being evaluated in our country (while their eventual calculation might prove our very modest achievements), the timeliness of operations is without criticism, the range of operated securities is limited to shares, the risk of transactions being suspended by NCS is still great, etc.

All the above issues are consistent with the conclusions of the White Paper on Corporate Governance in South East Europe that observe an underdeveloped level of capital markets in the region. Therefore, some success of the stock market in Moldova need not be overestimated, (especially taking into account the fact that its parameters do not come close to the regular patterns of the developed markets, in which the growth rates of exchange markets out pace by about 7-fold the general growth rate of the economy); what needs to be done is the removal of obstacles and creation of real conditions for its development.

We will further consider some aspects of the activity of the participants in the stock market which are of special significance both for the sector and for the national economy in general, the joint stock companies[63] and the investment funds.

Joint stock companies. The evolution of the quantitative and qualitative indicators of joint stock companies in Moldova determines, to a great extent, the capacities and prospects of the stock market and influences some aspects of shareholder rights, among them the right to dividends.

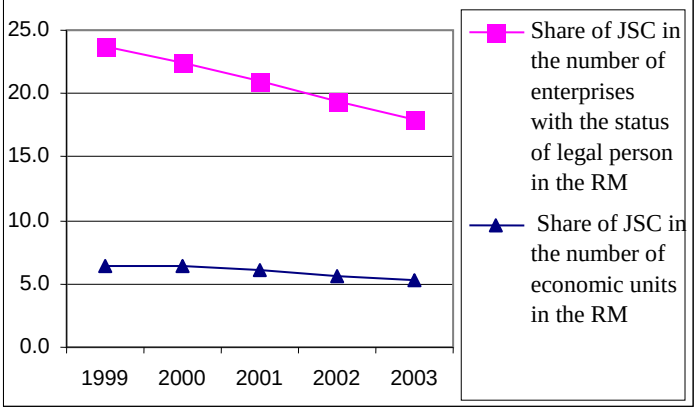
Those most interested in obtaining dividends are, usually, the small shareholders. As shown by the results of the survey on observance of shareholder rights (see, Chapter on principles for corporate governance), a great part of the interviewed shareholders believe nonpayment of dividends to be one of the most frequent violations of their rights. However, as is well known, only profitable joint stock companies may pay dividends and that only when a decision has been made by the relevant authority (general shareholder

[60] Report of NCS for 2003, page 18.
[61] Report of NCS for 2003, page 19.
[62] Report of the NCS for 2003, page 4.
[63] Joint stock companies of the open type which are not professional participants in the market for securities, that is companies that operate in the production sphere, in area of services, trade, etc., are meant.

meeting – for payment of annual dividends, the Board of the company – for payment of intermediary dividends).

How well have the joint stock companies in Moldova been operating over the last years and what are the prospects for payment of dividends? How reasonable and efficient are the legal initiatives to oblige joint stock companies to pay dividends to their shareholders?

Figure 21. Evolution of the joint stock companies, (%)



A great part of the existing joint stock companies had been established during mass privatization, especially in 1995–1997, when the majority of the state companies were transformed into joint stock companies. Starting with 1998, the share of the joint stock companies in the total number of economic agents in the Republic of Moldova registered with IREAM *(Interadministrative Register of Economic Agents of the Republic of Moldova)* is continuously decreasing (Figure 21)[64]. The reason for the tendency is rather plain – as long as the operating procedures in the stock market, including those for the issue of securities, stay complicated and cumbersome, while the related expenses are rather high, the potential entrepreneurs will avoid organizing their businesses in the form of joint stock companies, while the existing issuers (small and medium sized, as a rule) will tend to reorganize into companies with another legal status (in particular, to limited responsibility companies), these tendencies affecting the general potential of the stock market. The statistics on the operation of joint stock companies over the last years shows certain amelioration of their economic and financial situation[65].

Thus, the issuers' assets balance growth with their value growing at the rate of 116.6% and 132.4% for 2002 and 2003, respectively. The tendency for increases of current disposable assets is also remarkable, which contributed to improving a companies' liquidity. Total net assets of issuers also show a slight growth, with the rates for the last years at 105.5% and 121%, while the social capital, as part of the net assets, and have grown respectively by 104.3% and 116.7%. However, the existence of about 20 % of the total joint stock companies, in which the value of net assets is lower than the social capital (in some issuers this respective situation is maintained for two consecutive years) is of great concern, a fact detrimental to the property rights of shareholders in case the respective joint stock companies are liquidated.

Within the total of companies that have submitted reports to the NCS, a transition is seen from a totally negative financial result (loss) to a positive one (profit) (Table 8).

Table 8. Financial results of joint stock companies' activity, in millions of lei

Indicators	2001	2002	2003
Total value of profit of joint stock companies	364	720.6	1051,9
Total value of loss of joint stock companies	-536	-700.1	-360.9
Total financial results of joint stock companies (profit+/loss-)	-172	20.5	691,0

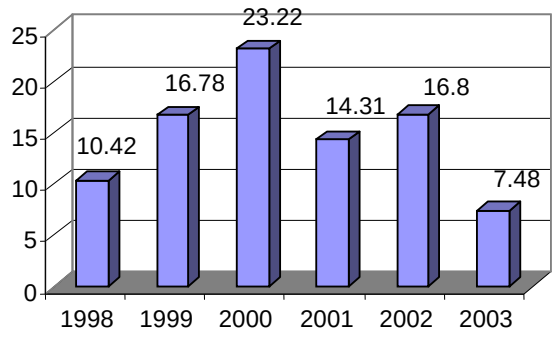
*About 80 percent of losses are generated by the monopolistic companies"Moldova gaz", "Termocom", Chisinau Central Electricity Networks.

The growth of total financial results is due both to an increase of total profit in profitable companies and to a decrease of total loss by companies that had losses. Also, according to the NCS data, when aggregating the total financial results for 2003 with the results of the preceding years, un-remedied loss is found in the amount of 2, 196.7 mill. lei.

[64] Moldova în cifre, Departamentul Statistică şi Sociologie, 2003.
[65] Report of NCS for 2003.

According to statistics, there is no well defined tendency for dividends announced by profitable joint stock companies. Their value has shown a slight fluctuation over the last period and it achieved its peak in 2000 (Figure 22)[66]. However, if we allow that the growth of this indicator in 2002 is due to a unique case, the declaration by "Efes Vitanta Moldova Brewery" JSC of dividends in the amount of 10 million .lei (as a rule the greatest dividends declared amounted to about 1 million .lei), starting in 2000, a gradual decrease of declared dividends may be inferred.

Figure 22. Dividends declared by joint stock companies, in mill. of lei



As far as the average value of dividends per one share is concerned, it is still rather low, with the dividends range fluctuating around the figure of 12 lei per share with a narrow margin.. However, it exceeds the value of dividends per share of investment funds[67].

Also, even if in the area of profitability some issuers have registered progress in profitability, it is difficult to forecast a rapid growth of dividends for the future. The reason for this may be the intention of some issuers to maintain their position in the market, or to extend it, which demands reallocation of some part of the profit for renovation and/or purchase of production technologies, creation of respective reserves, etc.

In this context the eventual resolution of the dividends problem through approval of a legal initiative to direct mandatory 30% of the company's profit to dividends, is not only a limitation on the business, but also an inefficient populist action, because the practice shows that the dividend amounts are derisory, while the expenses for their obtaining (transportation, bank commissions) usually exceed the amount of dividends themselves.

Investment funds[68] are severely criticized both by the current management in the country and by their predecessors, with the negative view of them being conditioned by the social impact of their activity. The expectations related to the performance of the investment funds proved to be exaggerated. The funds are accused of inefficient management of property and low profitability, as well as numerous violations of the legislation, etc.

The fact is certain that both positive (due to rapidly carrying out mass privatization, concentration of the share blocks with their subsequent sale to strategic investors, education of managers of the new system, development of a corporate culture, etc.), and negative (irregularities in notifying shareholders and convening general meetings, violation of the legislation in transactions of securities, etc.) events were observed in the activity of investment funds.

What is the current situation of investment funds and which actions are proposed for remediation of their activity?

According to the situation as of January 01, 2004, out of the 43 investment funds registered during the privatization period, only 14 were trading on the stock market. The number of shareholders of these funds exceeds 1.5 million people which own 544 million shares. (the funds, in their turn, own shares in 1,200

[66] Report of NCS for 2003, page 37.

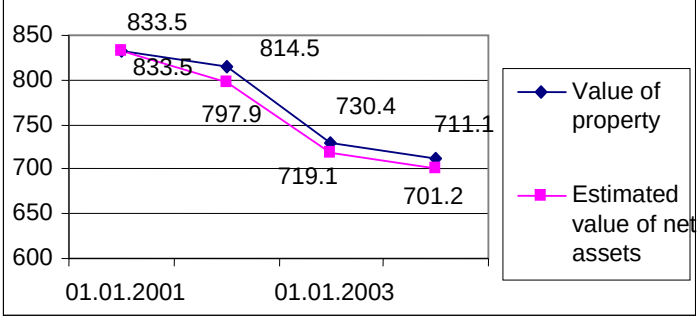
[67] „Dividendele rămân un vis", „Profit", („The dividends are still a dream", in „Profit" newspaper), 2004, nr.5 .

[68] According to the *Law on investment funds No*. 1204-XIII of June 5, 1997, investment funds are open type joint stock companies, professional participants in the stock market, which attract funds through placement of own shares and in which the share of other issuers' securities in the balance of assets amounts to at least 35%.

companies). The average block of shares held by one shareholder is 340 shares and according to the value of assets it amounts to 472 lei[69].

The total value of investment funds property over recent years has been decreasing, to a great extent through the initiation of liquidation procedures of their portfolios by some joint stock companies. The value of net assets has reduced; moreover, 10 funds out of 14 have registered negative values of net assets. The decrease of these indicators was affected by the liquidation process of some investment funds.

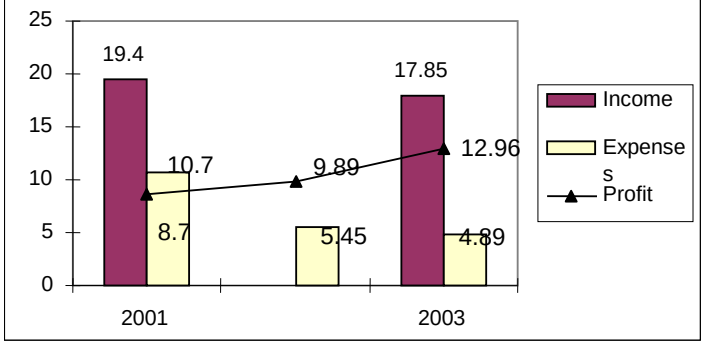
Figure 23. Movement of investment funds property and net assets, in mill. of lei



The balance sheet value of investments of the investment funds is also steadily decreasing, which is affected by the fact that sales of securities are exceeding purchases (the average rate of this indicator's decrease over the last four years is 3% per year). The investment structure of the funds as of January 01, 2004 shows that corporate securities make for the greatest share in the investment portfolio (94.2%), with other components amounting to an insignificant share: participation in the capital of limited responsibility companies – 2.72%; state securities – 0.46%; bank deposits – 1.85%. The estimated value of investment fund investments is also decreasing, which is affected by the modification of market prices of securities in the portfolios of the investment funds.

The evolution of the income, expenses and conse e satisfactory situation (Figure 24). It should be said that the major part of the income of the investment funds originates from the sale of assets: in 2001, 2002, 2003 their share was respectively 75.8%, 74.4% and 87.9%, with the balance represented by income coming from dividends, interest, etc. As far as the expenditures are concerned, they show a steady decreasing tendency, with the share of expenses for the remuneration of funds' management decreasing over 2001–2003 from 65.7% to 49.3%.

Figure 24. Evolution of income, expenses and profit of investment funds, in mill. of lei



Taking note of the fact beginning in 2000 the effective legislation[70] requires the investment funds to allot for payment of dividends at least 50 % of the net profit, they have declared dividends over recent years: in 2000 the declared dividends amounted to 2.1 million lei, in 2001 – 3.3 million lei, in 2002 – 5.9 million lei, and in 2003 – 4.6 million lei. However, this disciplinary action has not accomplished its objective. The amount of dividends calculated by the average per shareholder is derisory, equaling in 2002 and 2003 respectively 4.2 and 3.3 lei. Since the expenses for obtaining the dividends exceed the amount of dividends (transportation, bank transfers, etc.) and since many shareholders are not aware of the activity of the funds through which they have invested their patrimonial bonds (they do not know that dividends have been declared or do not know the address of the fund), the discrepancy between the amount of stated dividends and the amount of dividends paid to shareholders is rather large. Thus, early in 2003 the investment funds had arrears to shareholders in the total amount of 6.64 million lei. Taking into account the amount of dividends declared in 2003 (4.6 mill.lei) and the amount of

[69] Resolution of the Government of the Republic of Moldova No. 1630 of December 31, 2003 *„On the Concept for Improvement of Stock Market".*

[70] Article 7 paragraph (7) of the *Law on investment funds* No. 1204-XIII of June 05, 1997.

dividends paid in that year (2.63 mill.lei), the balance of arrears to shareholders as of January 01, 2004 equaled 8.6 mill. lei.

During over 6 years the liquidation procedure is executed with respect to some investment funds as their licenses having been revoked by the NCS. As of January 01, 2004 there are 18 funds with a total number of shareholders of 211,000. The value of property of the funds which are under liquidation is estimated at 80 million lei, the value of their net assets is about 78 million lei, and while the funds accumulated by sale of shares and participation quotas is only 8.4 million lei. Until now, none of these funds have reached the end of the liquidation procedure while the shareholders' rights to property are ignored.

It should be mentioned that according to general meetings of investment funds shareholders regarding results for 2003, five other of the 14 existing funds decided to liquidate themselves. Taking into account historical liquidation practices, the process may be assumed to last for several years and only the most persistent and the most thoroughly informed of the shareholders will gain anything from the process.

Taking into account the fact that the problems of the market for securities in Moldova are currently addressed with respect to investment funds activity, the amelioration in the area is seen through their reorganization. Thus, in the *Concept for remediation of the stock market* approved by the Resolution of the Government of the Republic of Moldova No. 1630 of December 31, 2003 the impossibility of efficient activity by the investment funds under conditions of the existing legal framework was stated and the improvement of the situation was prescribed through the following actions: exchange of the fund shares for shares of companies included in their portfolios, repurchase by investment funds of shares held by shareholders, the right of the shareholders to stay shareholders of the investment funds being ignored.

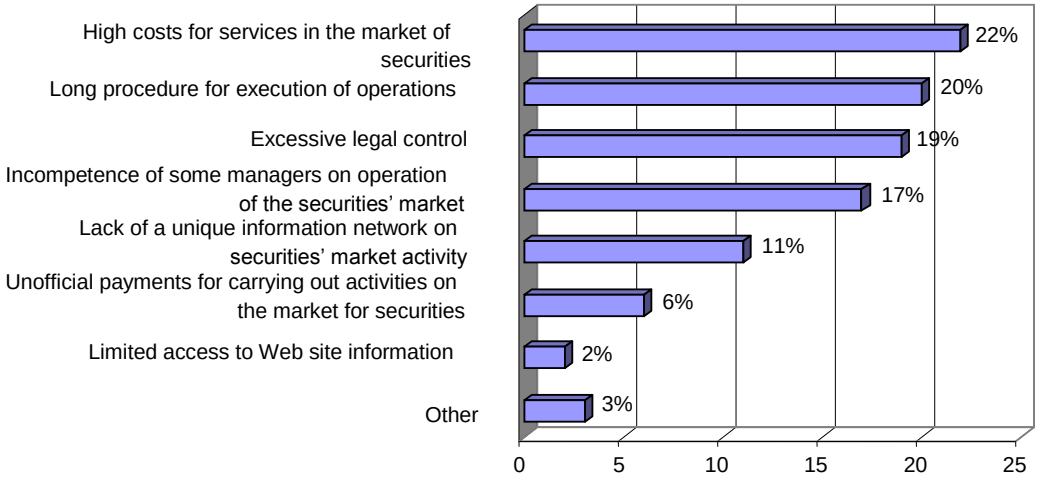
The above listed actions are currently debated in the parliament as law drafts for modification of the *Law on investment funds* (a law draft was prepared by the Government and an alternative one by a group of members of Parliament). A number of aspects will have to be decided including reorganization methods, conditions for repurchase of investment fund shares; in particular, the repurchase price (which equals the nominal value of one share and which as 1 leu, as a rule; 0.5 of the nominal value of one share, etc.). In any event, by the end of 2004, the problem of the investment funds will find a legal solution while its practical solution will need the observance of transparent principle and prompt notification of all shareholders.

However, the problems of the stock market should not be limited to the social aspects. The fact is certain that reorganization of investment funds and the prospects for shareholders are very timely issues, especially taking into account the future elections in parliament. But there are other, no less important problems, dealing with the stock market.

The managers of joint stock companies of the open type in Chisinau have estimated the obstacles to development of the stock market in the Republic of Moldova as follows.

The high costs for services in the market were noted as one of the greatest impediments by 22% of the respondents. This is a strong argument, since in September 2002 the official fees for operation on the stock market have grown considerably (the fee for registration of new securities has grown more than twice and it amounts to 0.5% of the value of the issue, the fees for carrying out exchange or offexchange operations has grown 10 times amounting to 0.1% and 0.5% respectively of the value of the operation), the fees for broker, registrar and other market agents' services also stay rather high. It is regretful that a part of the NCS income (especially in the form of percentage fees for exchange transactions) directly contributes to the increase of expenses for the participants in the market. The attempts to introduce additional fees to be paid to the NCS budget, including that from issuers (the so-called annual tax proposed to be collected at the beginning of the year along with the submission of specialized reports to the NCS) are of great concern.

Figure 25.The main barriers to development of the stock market in RM



Another important barrier is the *lengthy procedure for carrying out transactions*, which was mentioned by 20% of the respondents. The duration for a transaction with securities on the SEM lasts from one week up to several months, while abroad – it takes only several minutes or even seconds. It is obvious that this does not contribute to an increase of the stock exchange turnover but promotes offexchange transactions, which are much quicker and cheaper, but less transparent.

The excessive legal regulation in the opinion of 19% of those interviewed is a serious barrier for the development of the stock market. It needs to be said that the legal framework for this area is rather rigid, as well as restrictive and prohibitive in nature, while the chances for the development of the stock market, as seen by experts, lie in its updating, simplification and liberalization.

However, 17% of the respondents believe that a part of the blame for the current situation belongs to some *incompetent mangers* that manage national companies, and that the requirements for the professionalism and experience of managers should be more rigorous, while the procedures for their recruitment, their responsibilities and their remuneration should be much more transparent.

The lack of a unique informational network of the activity on the stock market is estimated as a barrier in the way of market development by 11% of those interviewed. The databases of the NCS and SEM on the activity on the market for securities provides some statistical and analytical data, however, the whole range of requested information cannot be provided for objective reasons. However, as stated above, the information which can be provided, does not comply with all the requirements (it is incomplete, rarely updated, some information is provided for pay). The current and future investors want prompt and up-to-date information on the financial condition of the issuers, releases on large scale economic events, notifications on irregularities found in the activity of the participants in the market, lists of prices for services provided by professional participants, etc.

Although *unofficial fees for carrying out activities on the market for securities* were mentioned as a problem by only 6% of the respondents, their existence has a negative impact on the stock market, because it conditions an increase in price of the market services and decreases the trust in regulatory authorities.

Many of the problems listed above have been shown in ideas, concepts and programs for improvement and development of the stock market approved over recent years. A special chapter on the development of the stock market has been included in the concept for corporate governance in the Republic of Moldova. However, as confirmed by the results of this study, most of the problems remain still where they were before, while the actions towards their solution are deliberately delayed. Finally, the size of the stock market in the Republic of Moldova is still very modest; it lacks many of the most necessary instruments and operations, while the stock market itself remains unknown to most of the potential national investors and unavailable, to a great extent, to foreign investors.

Conclusions and recommendations

Taking into account the fact that corporate governance is regulated by the legal framework and promoted voluntarily, the Republic of Moldova needs to work in two directions: improvement of the legislation in the area and undertaking actions for building awareness and applying the best corporate governance practices. In view of the establishment of an adequate framework for corporate governance in Moldova, we believe the following sets of actions to be reasonable:

- ***Improvement of the legal framework in corporate governance*** – introduction of amendments to the existing legal framework for corporate governance, development of normative acts related to the following issues:
  - Development along with the representatives of the business community and civil society of a code for corporate governance and dissemination of the process through mass media,
  - Development of recommendations on best practices in corporate governance, including the concept of independent board members and development of the procedure for their inclusion in the Board, development of a tool for including the employees in the Board and assuring their participation in governance, creation of special committees alongside the Board that will be responsible for development and application of regulations for information disclosure, accounting policy, auditing policy, etc.,
  - Review of specialized reports of the open type issuers regarding their completion and compliance with international standards, especially on information disclosure related to remuneration of Board and Management, transactions with conflict of interest and the structure of the governing bodies,
  - Increase the responsibilities of top management of the stock market participants, especially of open type issuers, for ignoring the requirements of information disclosure,
  - Make the audit requirements for joint stock companies comply with international standards and EU directives, especially the restoration of the legal provision for obligatory external and internal auditing of joint stock companies,
  - Continuous harmonization of the National Accounting Standards with the International Standards for Financial Reporting and with the European Union Standards,
  - Increase the responsibility of accountants' and auditors' for errors in bookkeeping, frauds and concealing information about a companies' activity,
  - Liberalization of legal framework for the stock market through simplification of procedures for transactions with securities on the stock exchange market and the offexchnage market. Reviewing of limitations for circulation of securities on the offexchange market and establishment of some reasonable fees for provision of services on the market, etc.,
  - Elaborate the calculation methodology for the stock market and statistical indicators. Establishing the statistics on activity of the stock market participants and issuing of informational bulletins.
- ***Training and awareness building in the area of corporate governance*** **–** contribution to awareness building by managers of companies, their employees and shareholders, other stakeholders of the importance of corporate governance; improvement of experience of courts in the problems of corporate conflicts; involvement of the civil society in public education various aspects of corporate governance by means of the following activities:
  - Organize the seminars and trainings for civil servants, especially courts officials, to improve their training in corporate governance areas,
  - Elaborating and teaching the corporate governance topics for university students,

- Organize of training courses for managers, accountants and auditors in various issues of corporate governance, including information disclosure and financial reporting data, internal auditing report, etc.,
- Implementation through TV and radio of the corporate governance training program for general population in different domains including shareholders' rights and responsibilities, role of stakeholders in corporate governance,
- Organize of TV and radio programs, public debates of issues of corporate governance, especially on development of a Code for corporate governance with the participation of the representatives of the state, the business community and civil society,
- Development of a series of information materials (guides, flyers, leaflets, etc.) on shareholder rights and responsibilities and their publication promoting a professional approach to corporate problems by the population;

- ***Increase of transparency and access to corporate information*** – assuring observance of stakeholder rights and rights of the general public to access to information on the activity of corporations in Moldova, informing the population about corporate conflicts and other events that may affect their property rights through the following actions:

- Establishment of public information centers for shareholders with the support of the regulatory bodies, participants in the stock market, civil society, external donors, etc.,
- Completion and improving the updating capacity of existing NCS databases and databases of other institutions on the stock market activity and delivering these information,
- Preparation by authorized public agencies the materials about corporate conflicts and the results of their resolution and publication on Web of the respective institutions,
- Encouraging joint stock companies to establish and manage their own web pages,
- Publication of information related to the corporate governance legislation violation, including those affecting the property rights of the shareholders,
- Establishment of telephone „hotlines" for communicating cases where the rights of the participants in corporate relationships have been violated.

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Annex 1

OBSERVANCE OF SHAREHOLDERS' RIGHTS IN JOINT STOCK COMPANIES

(SOCIOLOGICAL STUDY CARRIED OUT IN THE CITY OF CHISINAU)

RESEARCH METHODOLOGY

- Sample volume: 300 shareholders of joint stock companies, investment funds and fiduciary companies of the city of Chisinau.
- Sample: probabilistic, multistaged
- Randomization stages:
    1. Street: the streets (30) have been randomly selected from all the five districts of Chisinau map.
    2. Building (house): the building has been identified by a random route method, using the statistical step 3. Ten buildings were selected in each street. If the street had no sufficient numbers to carry out the required number of interviews, the numbering of the buildings was continued in the first street to the right from the end of the initial street.
    3. Apartment: in two storied houses apartment number 3 was the first to begin with, while in buildings with 3 and more stories, apartment number 5 was the starting one. In both cases the statistical step 3 was maintained. Only one person was interviewed in each building.
    4. Person: the person to be interviewed was selected using the method of the closest birthday. If the person identified in such a way had no shares, the next person in the family was interviewed. If no shareholder was identified in the family, the interviewer moved to the next apartment according to the established statistical step.
- Interviews were carried out at subjects' residence by interviewers of the Center for Urban and Rural Sociology (CURS)
- Period for data collection was June 25 through July 7, 2004
- The interviewing on site was carried out in Romanian and Russian languages according to respondents' preferences.

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QUESTIONAIRE FOR SHAREHOLDERS

Transparency International - Moldova is implementing this sociologic study in order to study the practice of observance of shareholders' rights in joint stock companies of the Republic of Moldova and to develop recommendations in view of improving the situation. The questionnaire is anonymous. Your answers will not be transmitted to other persons, therefore the request is to be as frank as possible.

We thank you in advance for your cooperation

1. Where have you invested your patrimonial bonds?
1. You have invested them in investment funds or fiduciary companies; 47 %
2. You have invested them directly in joint stock companies; 53 %

2. To what extent do you believe that you are aware of your shareholders' rights?
1. Fully aware 17 %
2. Partially aware 36 %
3. Unaware 47 %

3. To what extent do you believe that your shareholders' rights are observed?
1. Fully observed 1 %
2. Partially observed 24 %
3. Not observed 75 %

4. If you believe that your shareholder's rights are not fully observed, which of them do you believe is violated the most frequently? (up to 2 answers)
1. You have had no access to information about the company (charter, financial and specialized reports, data on major operations, conflict of interests, etc.); 20 %
2. You were not informed about convention of general meetings; 27 %
3. You could not participate in decision-making; 8 %
4. You were not paid dividends; 36 %
5. Majority shareholders have more rights than minority ones; 8 %
6. Other, please specify _____ 1 %

5. Have you ever participated in a general meeting of shareholders?
1. Yes 22 %
2. No 78 %

6. If you have not participated in general meetings, which were the reasons?
1. You did not know that the meetings were convened; 62 %
2. You had no possibility to participate in meetings; 25 %
3. You were not interested in participation; 8 %
4. Other, please, specify _____ 5 %

7. Has the joint stock company every paid any dividends to you?
1. Yes 37 %
2. No 63 %

8. Have you ever applied for information to your joint stock company in which you have shares?
1. Yes, I have applied; 35 %
2. No, I have never applied; 48 %
3. I wanted to apply but could not find the telephone and the office of the company; 17 %

9. If you applied for information, have you obtained the requested information?
1. In full 14 %

2. Partially 44 %
3. No, I have not obtained 42 %

10. If you have not obtained the requested information in full, which were the reasons?

1. Refusal of the joint stock company that stated the information to be of internal use; 17 %
2. Procedures for obtaining information are complicated; 16%
3. High costs for information copies; 1%
4. Bureaucracy of the management; 57 %
5. Cessation of company's activity 3 %
6. Lack of information about company's address 2 %
7. Other, please, specify _____ 4 %

11. How well informed you believe you are about the activity of the joint stock company, in which you hold shares?

1. Sufficiently informed 5 %
2. Insufficiently informed 20 %
3. Not informed at all 75 %

12. If you believe that you are not sufficiently informed, which are the reasons?

1. The information about company's activity is incomplete; 10 %
2. The information is not truthful; 6 %
3. The joint stock company does not publish information about its activity; 69 %
4. You are not interested, you have lost trust 7%
5. You do not know the address of the company 3%
6. Other, please, specify _____ 5 %

13. To what extent are you aware of your shareholder's responsibilities?

1. Fully aware 5 %
2. Partially aware 30 %
3. Unaware 59 %
4. No answer 6 %

14. What do you intend to do with your shares?

1. You want to sell them; 21 %
2. You want to keep them as your property; 27 %
3. You do not know what you could do with them; 48 %
4. Other, please, specify _____ 4 %

15. Who has gained the most, in your opinion, from investment of patrimonial bonds?

1. Ordinary people; 0 %
2. Officials; 54 %
3. Swindlers (charlatans); 41 %
4. Other, please, specify _____ 1 %
5. No answer 4 %

Figure 1. Where have you invested your patrimonial bonds?

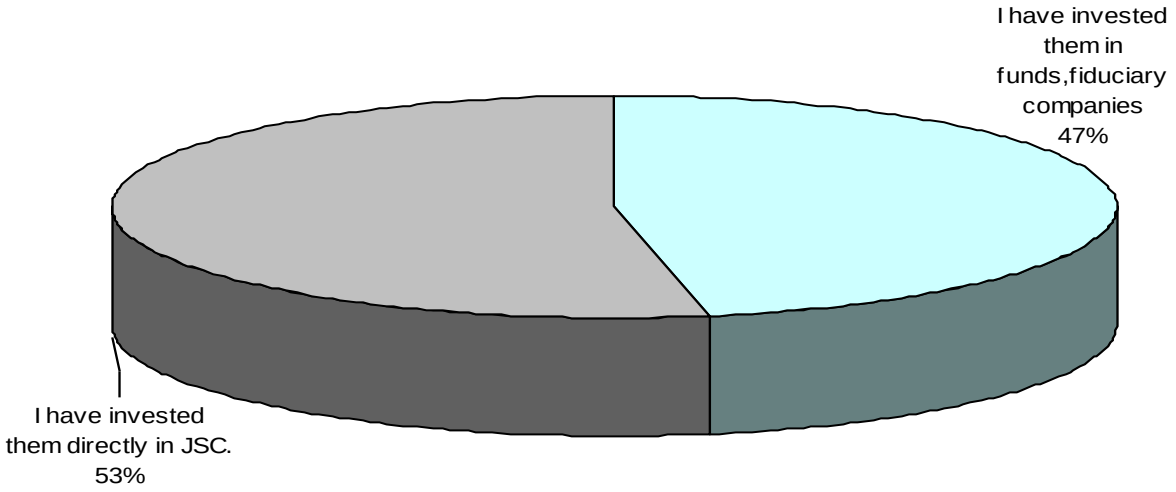


Figure 2. To what extent are you aware of your shareholders' rights?

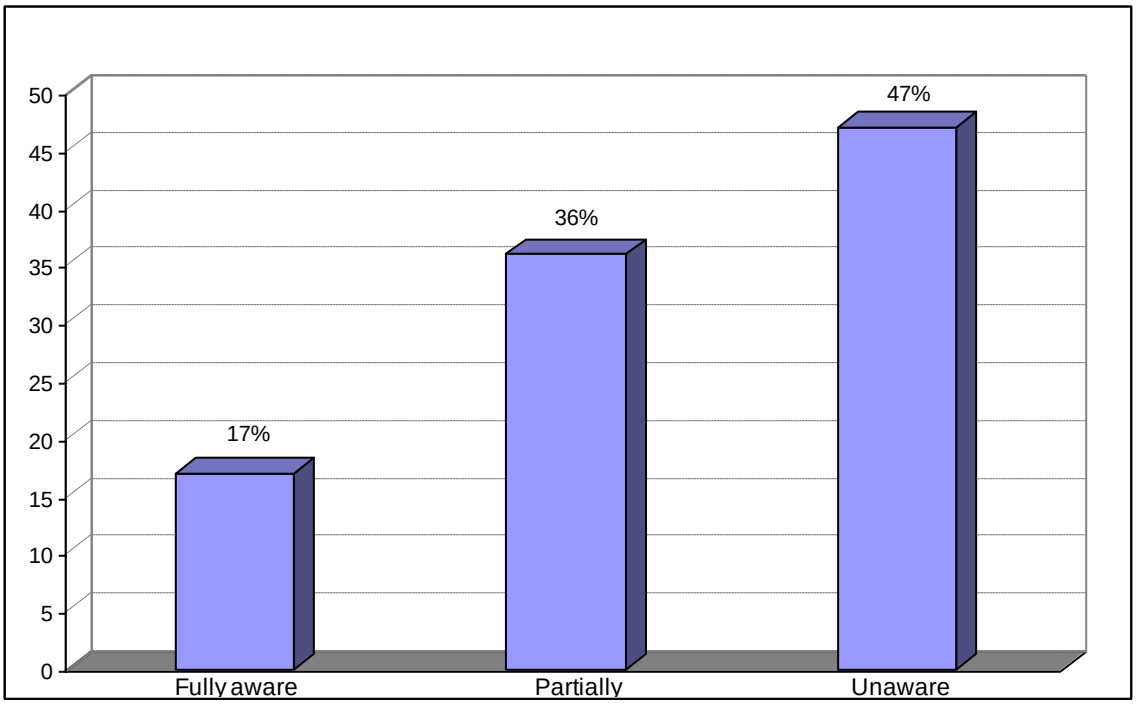


Figure 3. To what extent are your shareholders' rights observed?

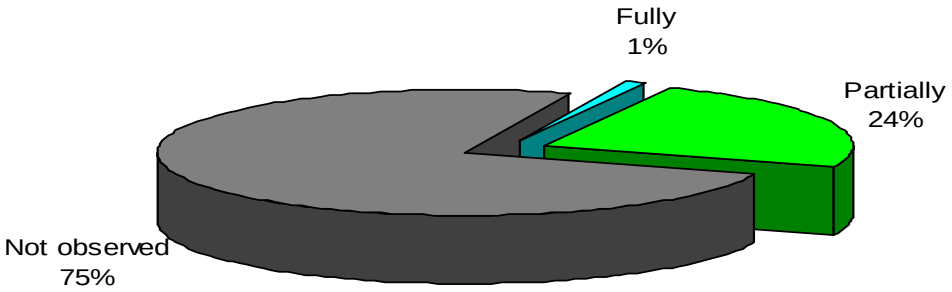


Figure 4. Which of your shareholder's rights is violated the most frequently? (%)

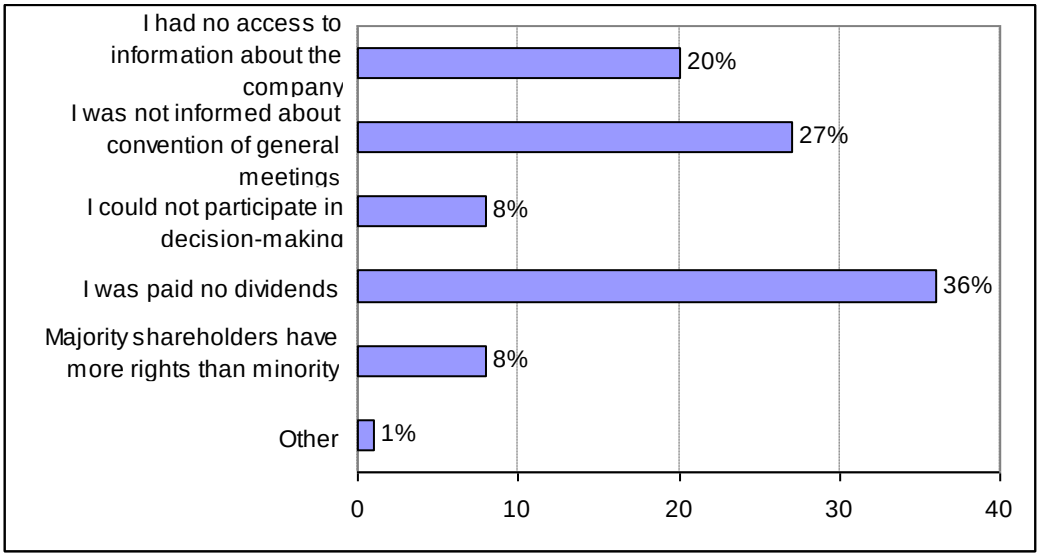


Figure 5. Have you ever participated in a general meeting of shareholders?

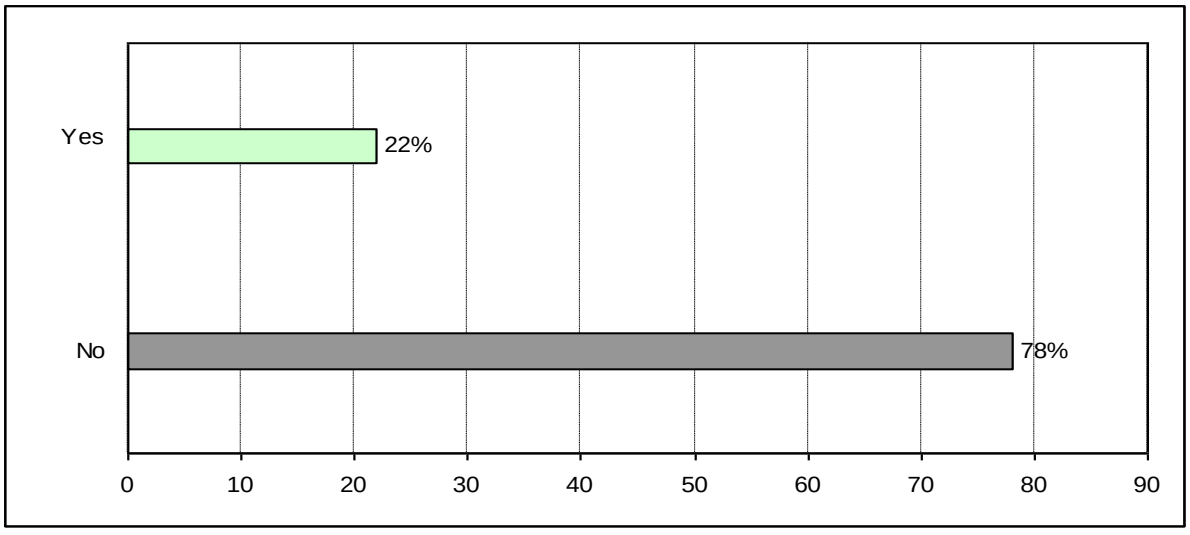


Figure 6. If you have not participated in general meetings, which were the reasons?

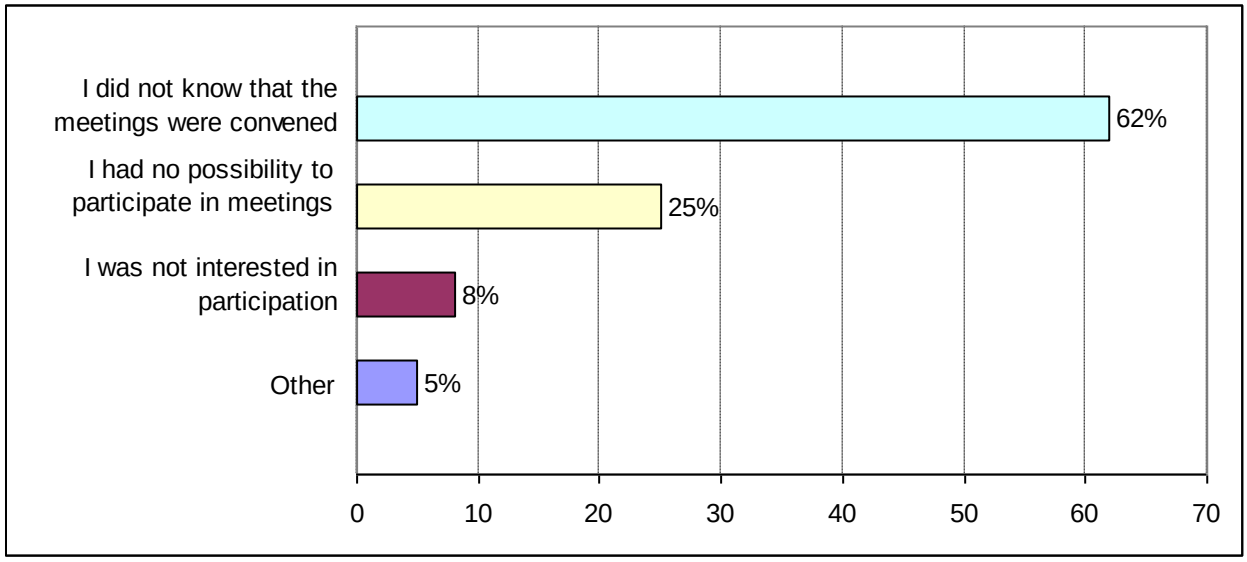


Figure 7. Has the joint stock company every paid any dividends to you?

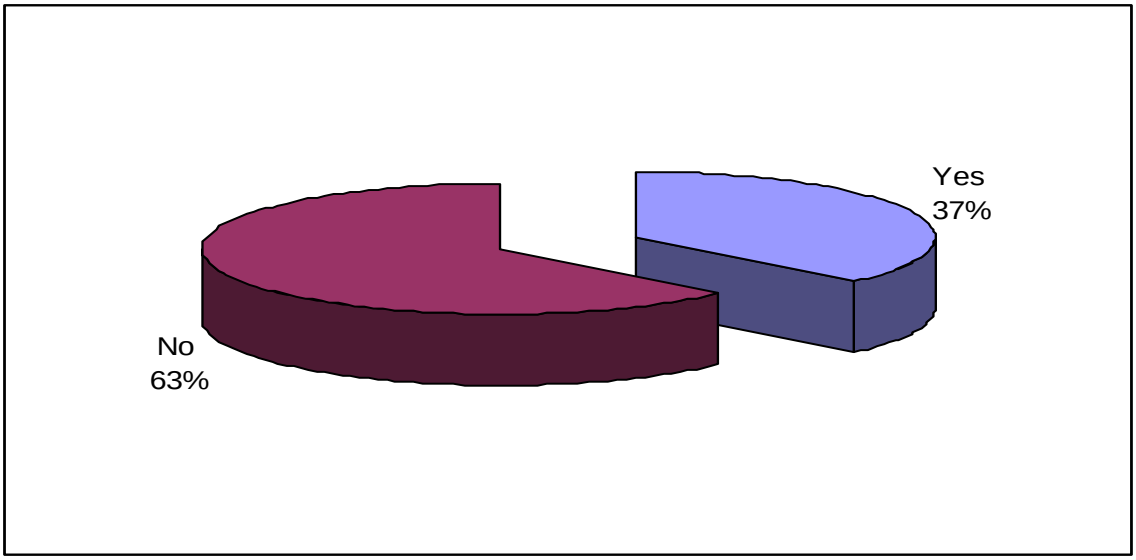


Figure 8. Have you ever applied for information to your joint stock company in which you have shares?

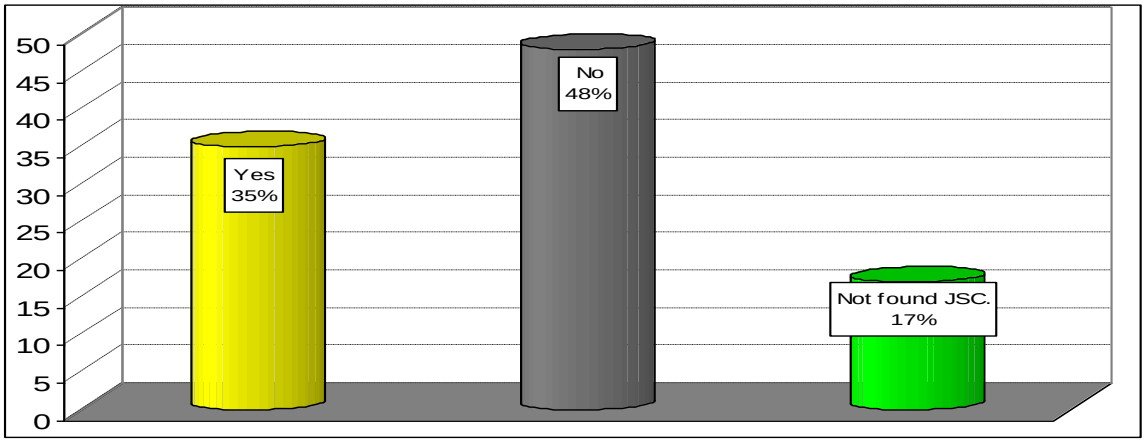


Figure 9. To what extent have you obtained the requested information?

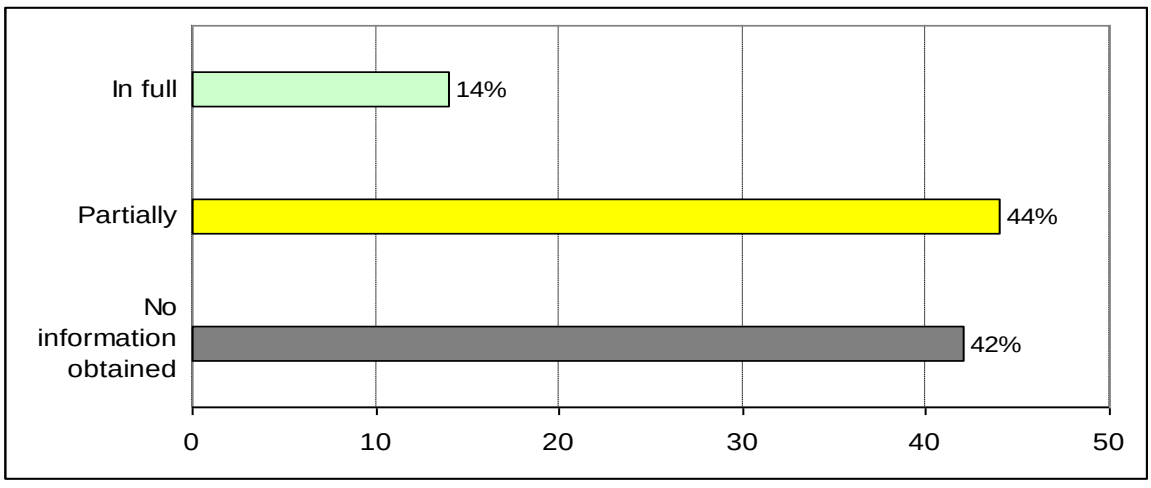


Figure 10. If you have not obtained the requested information in full, which were the reasons? (%)

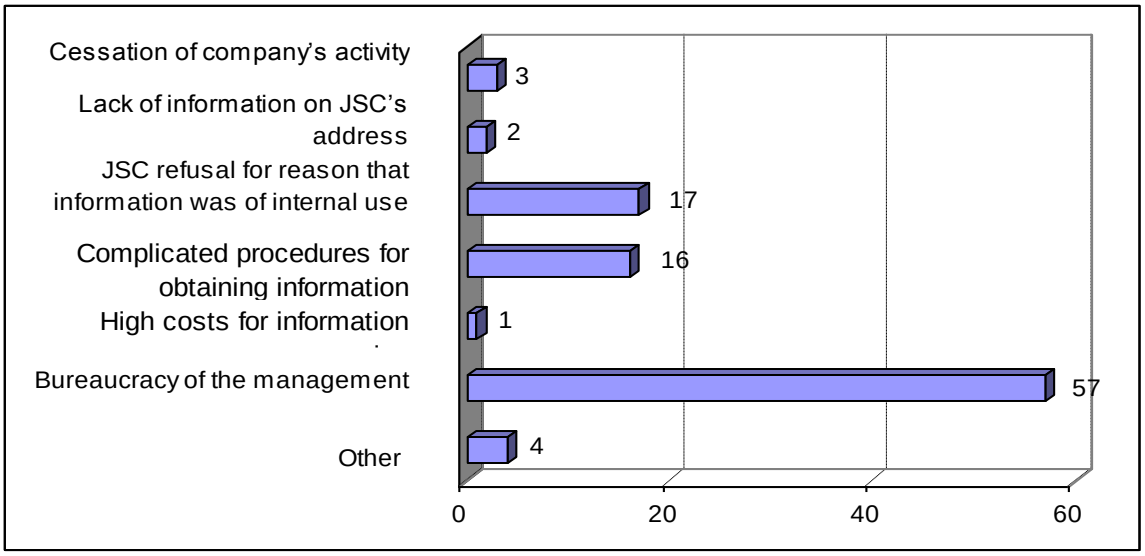


Figure 11. How well informed you believe you are about the activity of the joint stock company, in which you hold shares?

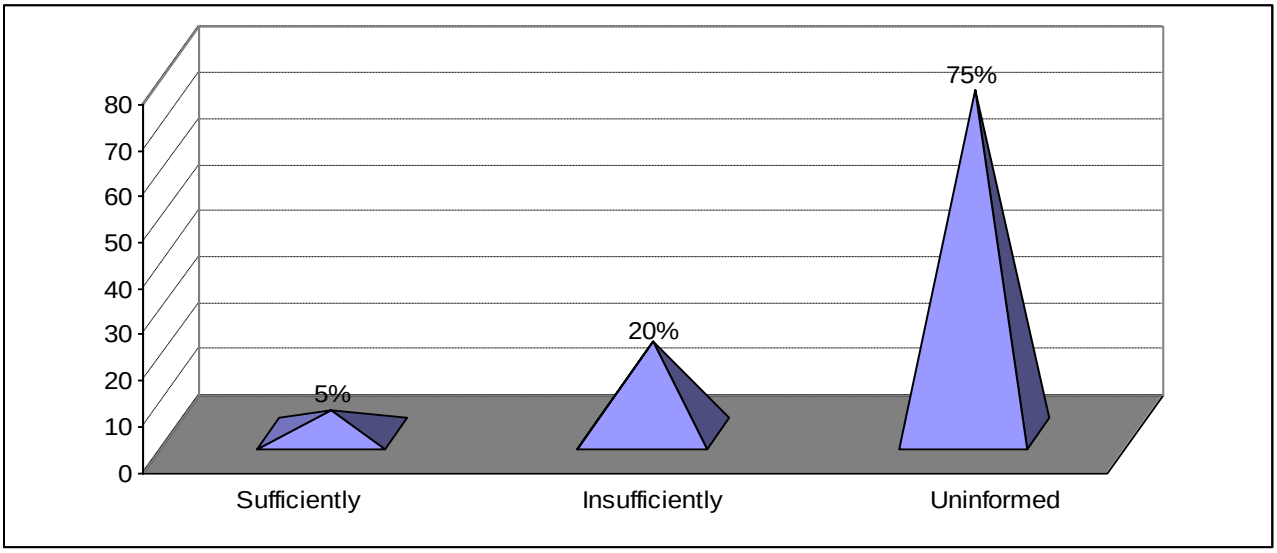


Figure 12. If you believe that you are not sufficiently informed about company's activity, which are the reasons? (%)

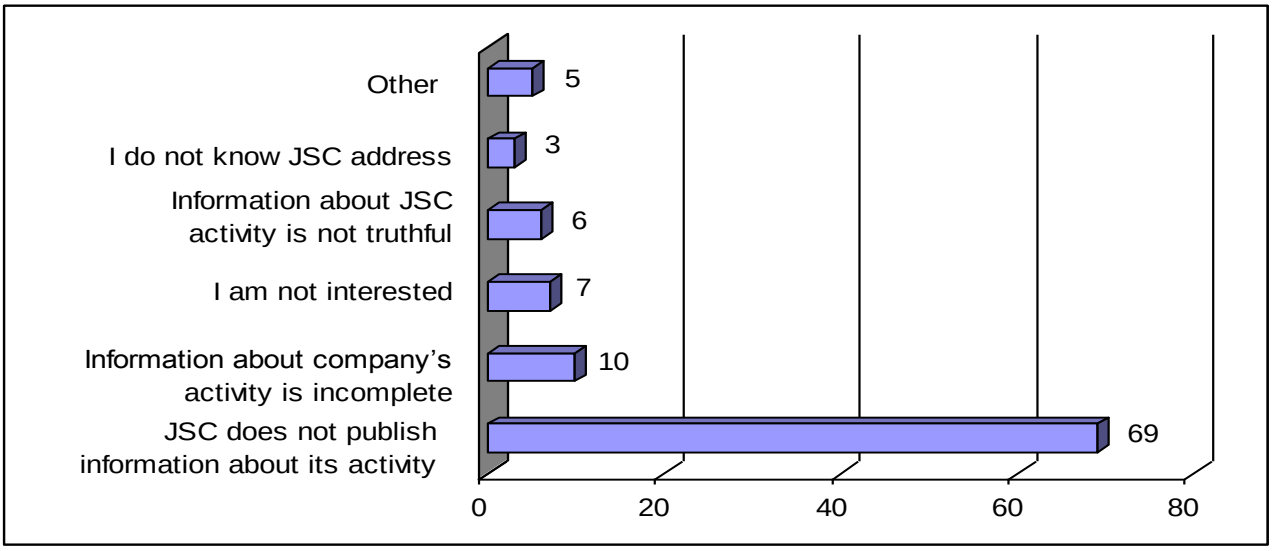


Figure 13. To what extent are you aware of your shareholder's responsibilities?

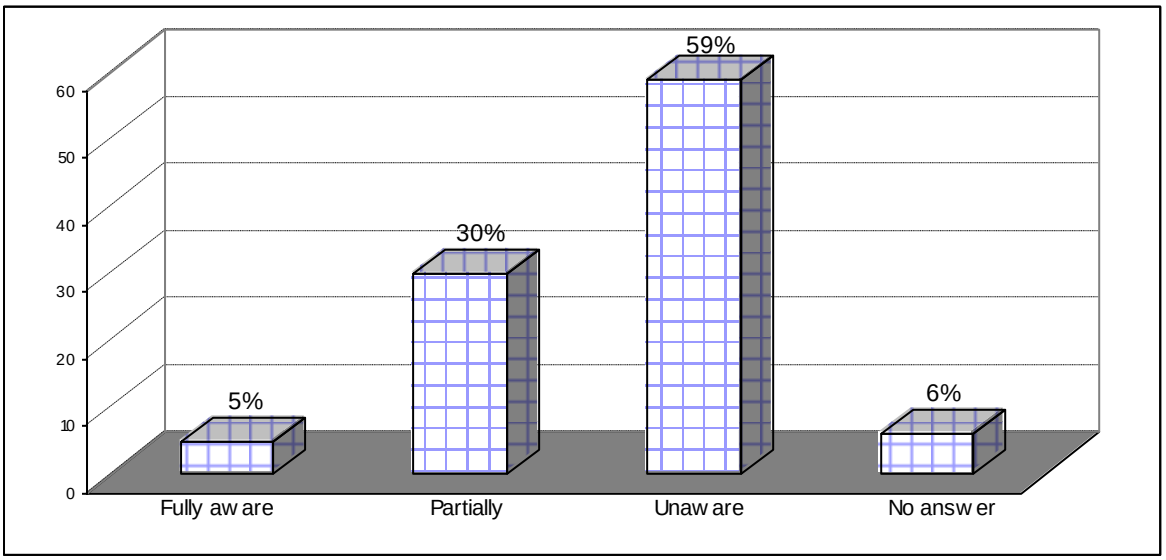


Figure 14. What do you intend to do with your shares?

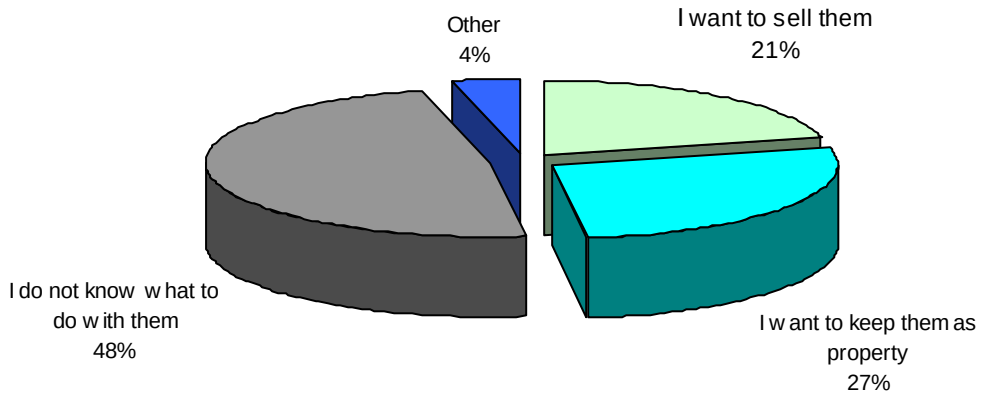
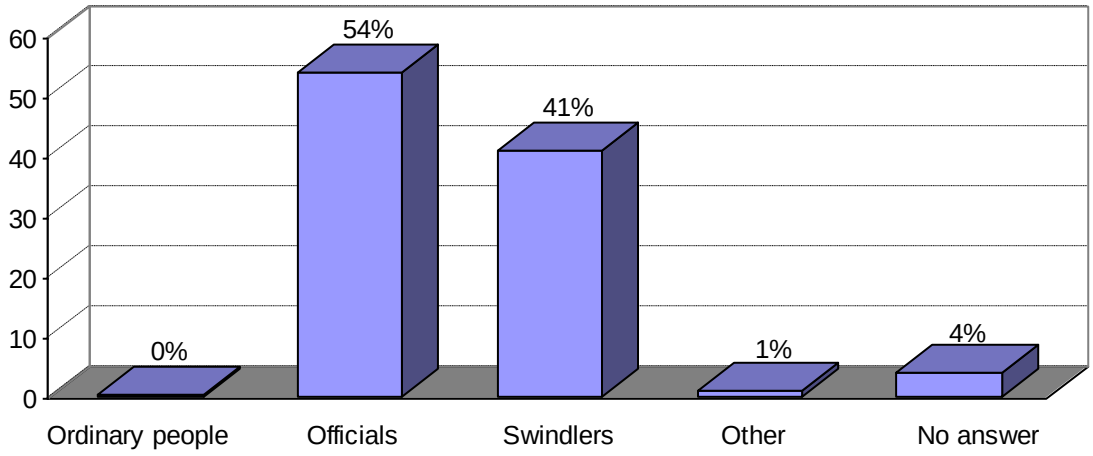


Figure 15. Who has gained the most, in your opinion, from investment of patrimonial bonds?



Annex 2

PROBLEMS OF CORPORATE GOVERNONCE
(SOCIOLOGICAL STUDY CARRIED OUT IN THE CITY OF CHISINAU)

RESEARCH METHODOLOGY

- Sample volume: 150 managers of open type joint stock companies of the city of Chisinau.
- Sample: probabilistic, multistaged
- The sample was designed based on an alphabetic the list of open type joint stock companies. In order to select the joint stock companies to be interviewed the statistical step 2 was used. Thus, the sample has included every second open type joint stock company of Chisinau.
- Interviews were carried out in the offices of the joint stock companies mangers by interviewers of the Center for Urban and Rural Sociology (CURS)
- Period for data collection was July 8 through July 23, 2004
- The interviewing on site was carried out in Romanian and Russian languages according to respondents' preferences.

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QUESTIONAIRE for managers of joint stock companies

Transparency International – Moldova is implementing this sociologic study in order to assess the perceptions of the joint stock companies' management in respect to the problems of corporate governance (hereinafter CG), to identify eventual problems and to present proposals in view of improving the situation. The questionnaire is anonymous. Your answers will not be transmitted to other persons; therefore the request is to be as frank as possible.

Thank you in advance for cooperation.

I. Awareness of the corporate governance principles

1. **To what extent are you aware of the legal framework on corporate governance (laws on joint stock companies, market of securities, entrepreneurship and companies, National Commission for Securities etc.)?**
   1. Sufficiently aware **72 %**
   2. Insufficiently aware **27%**
   3. Unaware **1 %**

2. **To what extent does the effective legislation of the Republic of Moldova control the corporate governance, in your opinion?**
   1. Fully **12** %
   2. Partially **84** %
   3. No control **4** %

3. **Which areas of corporate governance need to be improved first in your opinion?**
   1. Protection of minority shareholders' rights; **34 %**
   2. Strict distinction of authority and responsibility of Board and Management of companies; **36 %**
   3. Introduction of international standards for information disclosure by joint stock companies; **24 %**
   4. Other, please, specify _____; **4 %**
   8. No answer **2 %**

4. How frequent are the following types of corporate relationships in your company:

Type of relationship	Frequently	Sometimes	Never	No answer
Manager- shareholder relationship	**48 %**	**44 %**	**8 %**	**0 %**
Manager – employee relationship	**82 %**	**13 %**	**5 %**	**0 %**
Manager – creditor relationship	**33 %**	**46 %**	**20 %**	**1 %**
Manager – supplier relationship	**55 %**	**30 %**	**13 %**	**2 %**
Manager – local authorities relationship	**35 %**	**56 %**	**8 %**	**1 %**

5. **Do you believe that your company is in need of a Code for corporate behavior?**
   1. Yes **62 %**
   2. No **35 %**
   8. No answer **3 %**

6. **If the answer to the above is "Yes", which should be the form of the Code?**
   1. In form of recommendations **47 %**
   2. In form of mandatory norms set by the law; **38 %**
   3. In form of a normative act of the National Commission for Securities; **14 %**
   4. Other, please, specify _____. **1 %**

II. Cooperation with the shareholders and observance of their rights

7. In which way is the work with shareholders organized in your company?

1. There is a special responsible unit / person in the company; **57 %**
2. There is a direct telephone line for shareholders; **34 %**
3. Meeting with shareholders are organized **23 %**
4. Information is provided by post, press **3 %**
5. Other **3 %**

8. To what extent are the rights of the shareholders observed in Moldova, in your opinion?

1. Fully observed **8 %**
2. Partially observed **75%**
3. Not observed **17 %**

9. Which rights of the shareholders are most frequently violated?

1. The access to information about the company (charter, financial and specialized reports, conflict of interests, data on major operations, etc.) is limited; **15 %**
2. The shareholders are not informed about convention of general meetings; **4 %**
3. The shareholders cannot participate in decision-making; **20 %**
4. The shareholders are not paid dividends; **25 %**
5. The majority shareholders have more rights than the minority ones; **35 %**
6. Other, please specify _____. **1 %**

10. Which are, in your opinion, the main reasons for non-observance of shareholders' rights in Moldova?

1. Penalties for violation of the shareholders' rights are not sufficiently severe; **14 %**
2. The shareholders are not sufficiently aware of their rights and cannot protect them; **59 %**
3. The Economic Court has no sufficient experience in corporate governance; **14 %**
4. Officials are corrupt; **8 %**
5. Other, please, specify _____. **5 %**

III. Transparency of information

11. Which methods for information disclosure (opening) for shareholders does you company use most frequently?

1. Provision of information upon request in company's office; **46 %**
2. Provision of information by correspondence; **41 %**
3. Provision of information during shareholders' general meetings; **89 %**
4. Publication of information in the press; **71 %**
5. Placement of information on the Web site; **9 %**
6. Other, please, specify _____. **3 %**

(The aggregate answers exceed 100%, because the respondents had the opportunity to select more than one option).

12. Which are the main effects of information disclosure for your company?

1. It contributes to the formation of an "open business" image; **32 %**
2. It increases control over management; **15 %**
3. It contributes to prevention of conflicts of interest in execution of operations; **12 %**
4. It endangers company's condition with respect to its competitors; **19 %**
5. It increases company's expenditures; **21 %**
6. Other, please, specify _____. **0 %**
7. No answer 1 **%**

13. How much trust do you have in the following information sources?

Information sources	Full trust	Partial trust	No trust	No answer
1. Regulatory and statistical authorities (NCS, Dep. for Statistics)	**25 %**	**65 %**	**7 %**	**3 %**
2. Specialized economic periodicals	**32 %**	**64 %**	**3 %**	**1 %**
3. Mass-media in general	**5 %**	**65 %**	**29 %**	**1 %**
4. Stock Exchange	**26 %**	**47 %**	**15 %**	**12 %**
5. Main offices of companies	**24 %**	**51 %**	**14 %**	**11 %**
6. The Internet	**10 %**	**40 %**	**22 %**	**28 %**

14. Does your company carry out internal audits?

1. Yes **69 %**

2. No **31 %**

15. If the answer to the above is "yes", how frequently it is carried out?

1. Once per month; **5 %**
2. Once per quarter; **31 %**
3. Once per half year; **9 %**
4. Once per year. **55 %**

16. Who is responsible for the internal audit in your company?

1. The audit committee; **16 %**
2. The special unit / person of the company; **55 %**
3. The revision commission **19 %**
4. An audit company **7 %**
5. Other, please, specify _____. **3 %**

IV. Joint stock companies and the market of securities

17. How interested are you in attracting additional funds?

1. Very high interest 6**0 %**
2. No much interest **28 %**
3. No interest at all **11 %**
4. No answer 1 **%**

18. How accessible are the following ways of attracting funds for your company?

	Accessible	Not quite accessible	Inaccessible	No answer
1. Additional issue of shares	**30 %**	**38 %**	**24 %**	**8 %**
2. Issue of bonds	**11 %**	**41 %**	**36 %**	**12 %**
3. Bank loans	**51 %**	**22 %**	**23 %**	**4 %**
4. Attraction of investments	**5 %**	**0 %**	**0 %**	**95 %**

19. Which are the main barriers that interfere with the development of the market of securities in Moldova?

1. Excessive legal control; **19 %**
2. High costs for services on the market of securities (fees of broker /dealer, registrar; fees for registration of securities' issue, Exchange tax); **22 %**
3. Long procedure for execution of operations; **20 %**
4. Lack of an unique information network on securities' market activity; **11 %**

5. Limited access to Web site information (the information is provided against pay, it is rarely updated, it is incomplete); **2 %**
6. Unofficial payments for carrying out activities on the market of securities; **6 %**
7. Incompetence of some managers on operation of the market of securities **17 %**
8. Other, please, specify _____ . **3 %**

20. Which are the most efficient actions for improvement of corporate governance?

1. Improvement of corporate governance legislation; **32 %**
2. Development and implementation of internal audit procedures in companies; **8 %**
3. Carrying out an adequate external audit of the activity of company's management; **9 %**
4. Continuous training of managers and administrative board members in corporate governance; **31 %**
5. Involvement of employees in the management of the company **11 %**
6. Establishment of a „hotline" for denouncing irregularities in the activities of the company by shareholders, employees, creditors, the civil society, etc.; **8 %**
7. Other, please, specify _____. **1 %**

21. General data on the company

1. Position of the respondent	1.Director/Vice Director **57 %**	2. Financial Director **21 %**	3. Other **22 %** _____	
2. Duration of maintaining the position	1. Up to 5 years **35 %**	2. 5 to 10 years **29 %**	3. Over 10 years **36 %**	
3. Number of employees	1. Up to50 people. **51 %**	2. 51 to 100 people. **14 %**	3. 101to 500 people **28 %**	4. Over 500 people. **7 %**
4. Number of shareholders	1. Up to 50 **25 %**	2. 51 to 100 **10 %**	3. 101 to 500 **33 %**	4. Over 500 **32 %**
5. Year of company's establishment	_____ **year**			
6. Mode of company's establishment	1. As a result of privatization **72 %**		2. In other ways (newly founded, reorganized companies, other). **28 %**	

General data on the company – Year of company's establishment

	Frequency	Valid Percent
1986	1	0,7 %
1989	5	3,5 %
1990	2	1,4 %
1992	7	4,9 %
1993	21	14,6 %
1994	31	21,5 %
1995	48	33,3 %
1996	15	10,4 %
1997	1	0,8 %
1998	2	1,4 %
1999	5	3,5 %
2000	4	2,8 %
2002	2	1,4 %
Total	144	100.0 %

Figure1. To what extent are you aware of the legal framework on corporate governance?

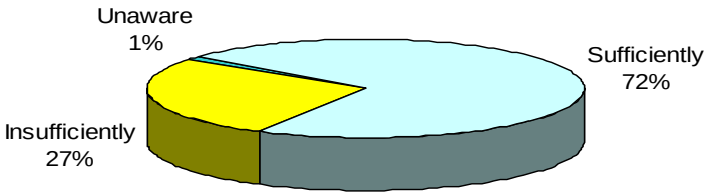


Figure 2. To what extent does the effective legislation of the Republic of Moldova control the corporate governance, in your opinion?

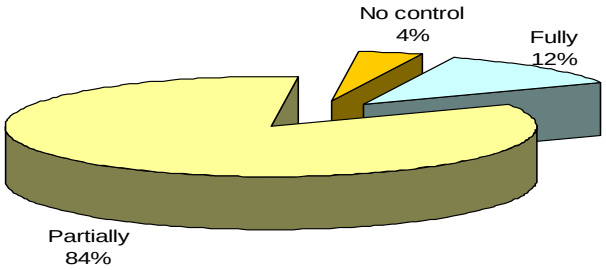


Figure 3. Which areas of corporate governance need to be improved first in your opinion?

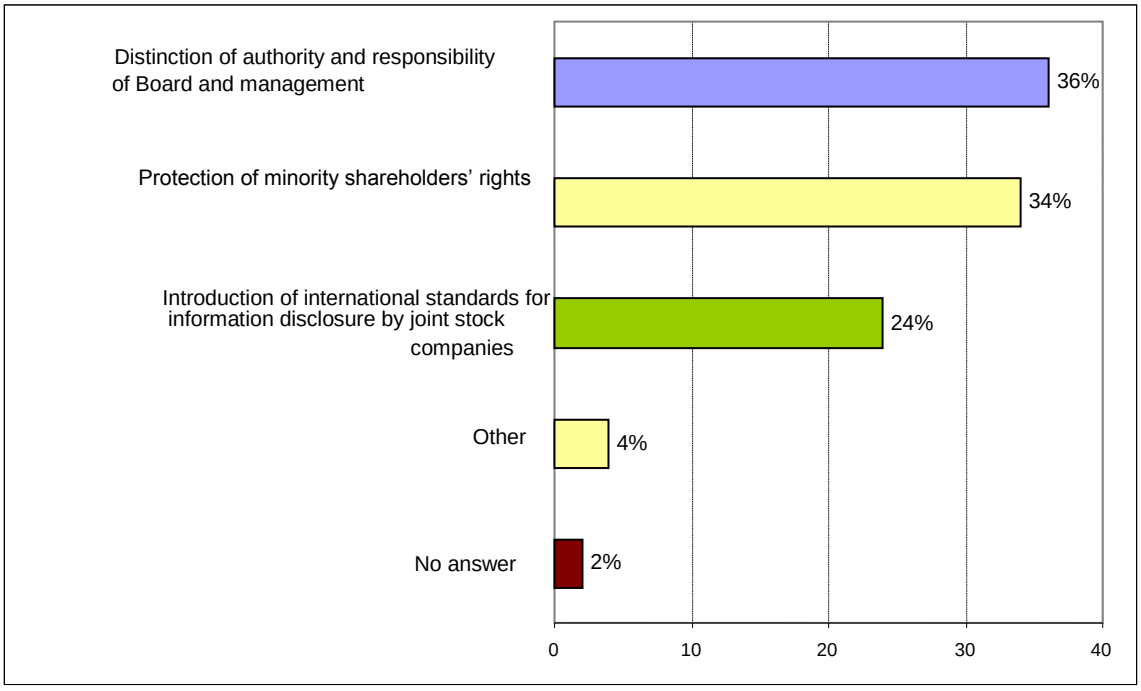


Figure 4. How frequent are the following types of corporate relationships at your company?

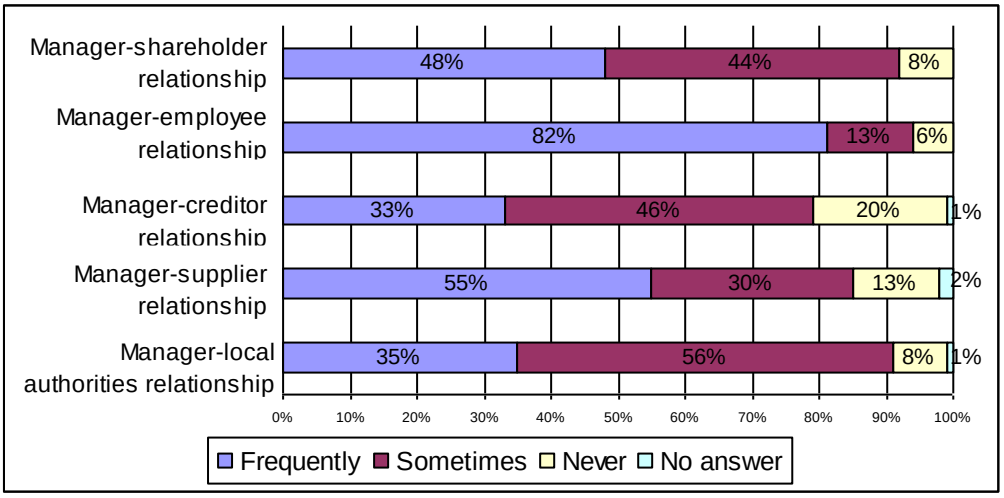


Figure 5. Do you believe that your company is in need of a Code for corporate behavior?

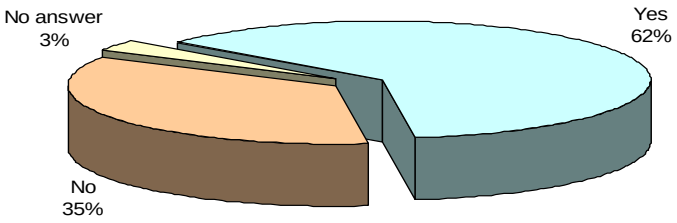


Figure 6. Which should be the form of the Code for corporate behavior that your company needs?

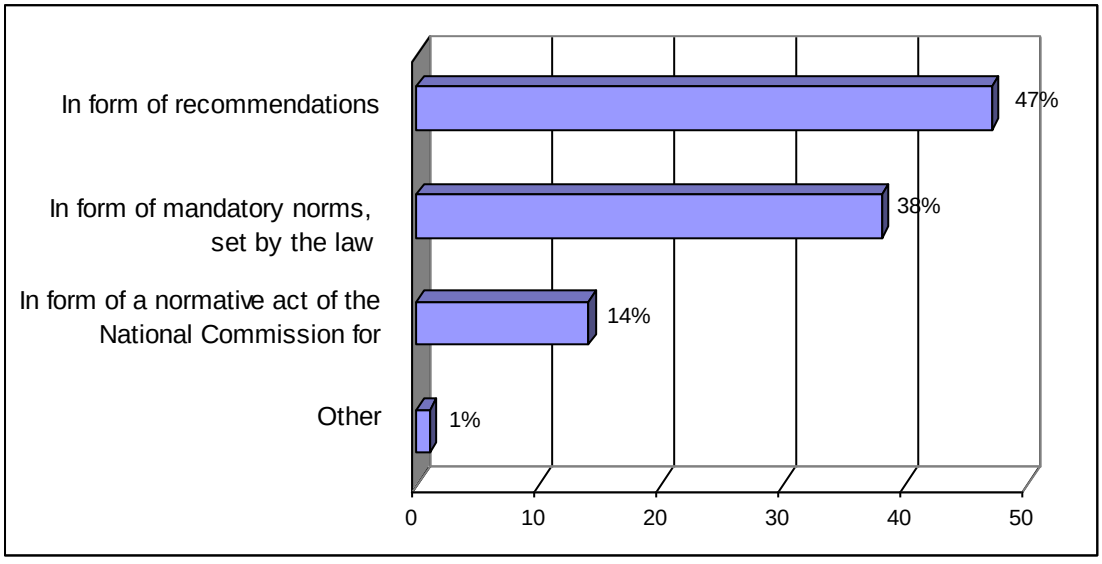


Figure 7. In which way is the work with shareholders organized in your company?

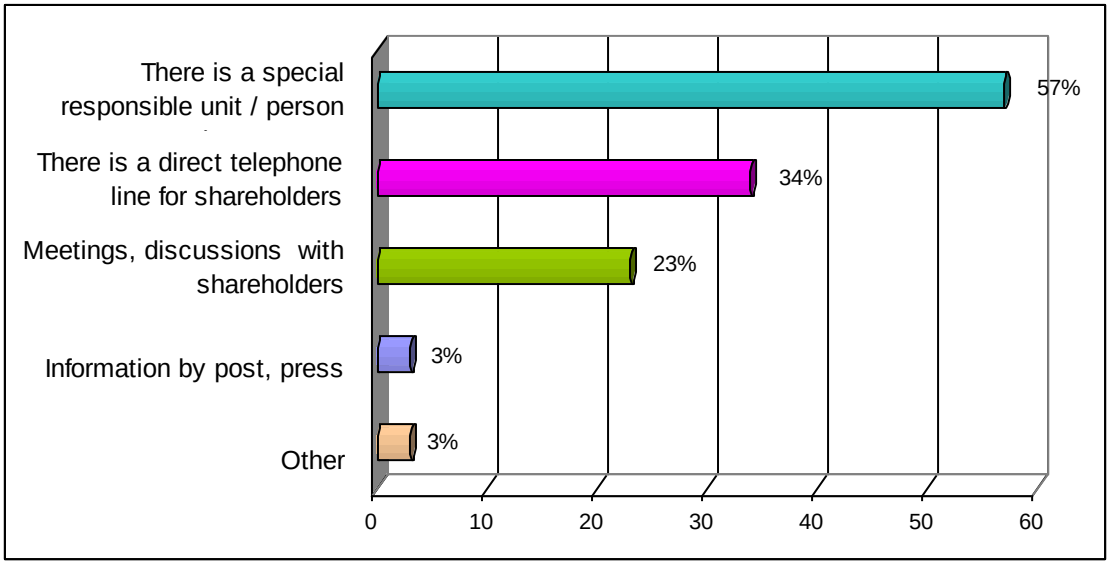


Figure 8. To what extent are the rights of the shareholders observed in Moldova in your opinion?

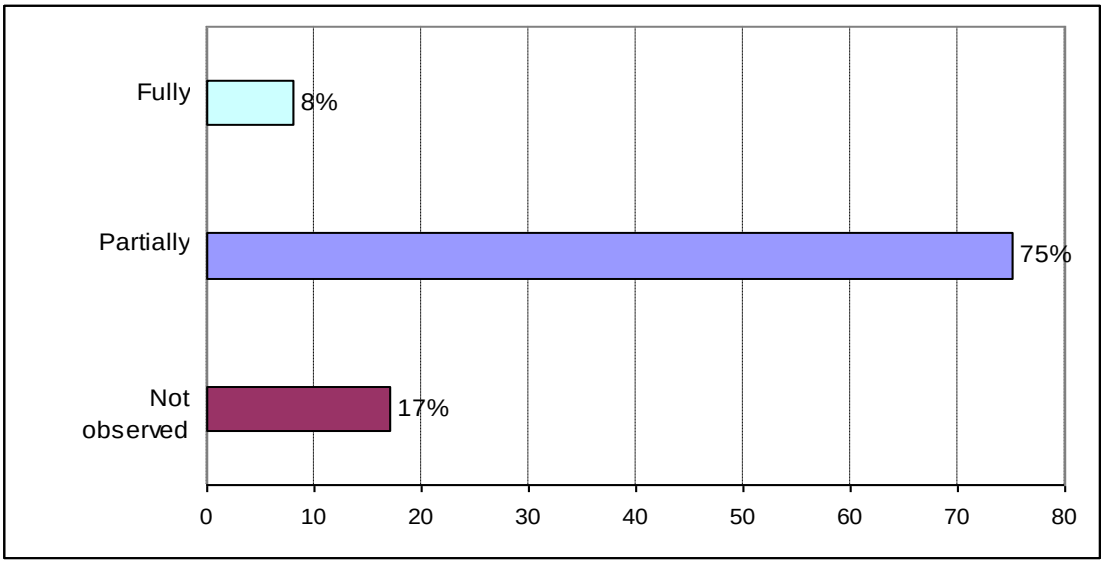


Figure 9. Which rights of the shareholders are most frequently violated?

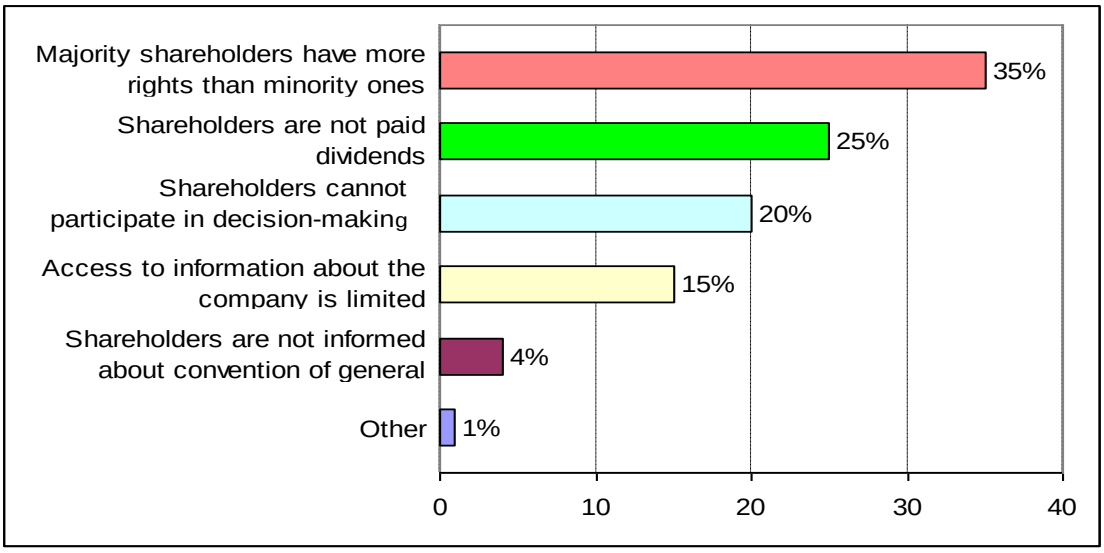


Figure 10. Which are the main reasons for non-observance of shareholders' rights in Moldova?

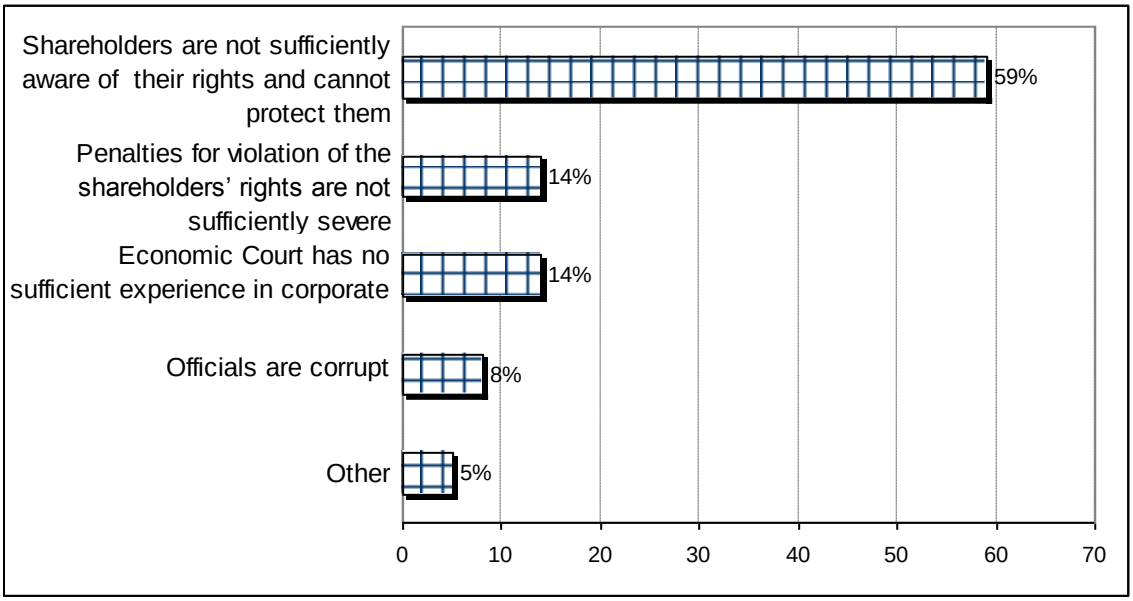


Figure 11. Which methods for information disclosure for shareholders does you company use most frequently?

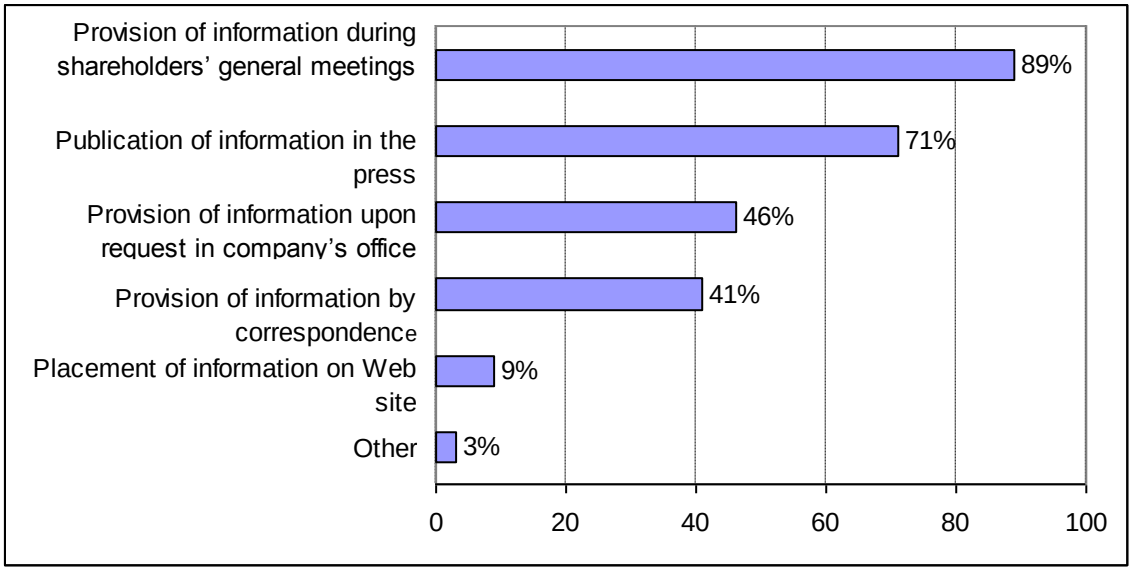


Figure 12. Which are the main effects of information disclosure for your company?

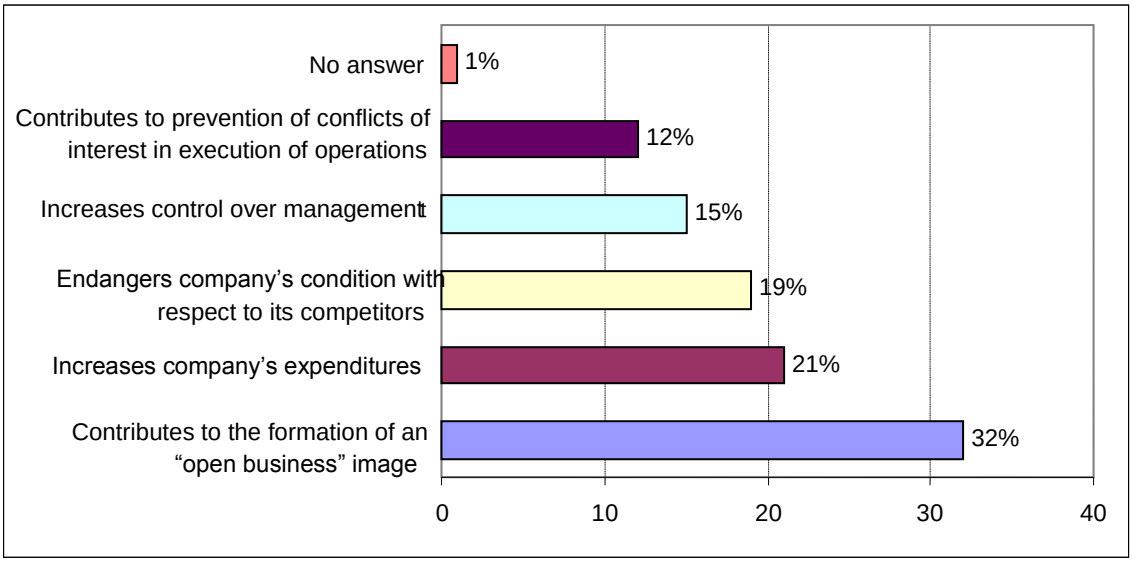


Figure 13. How much trust do you have in the following information sources?

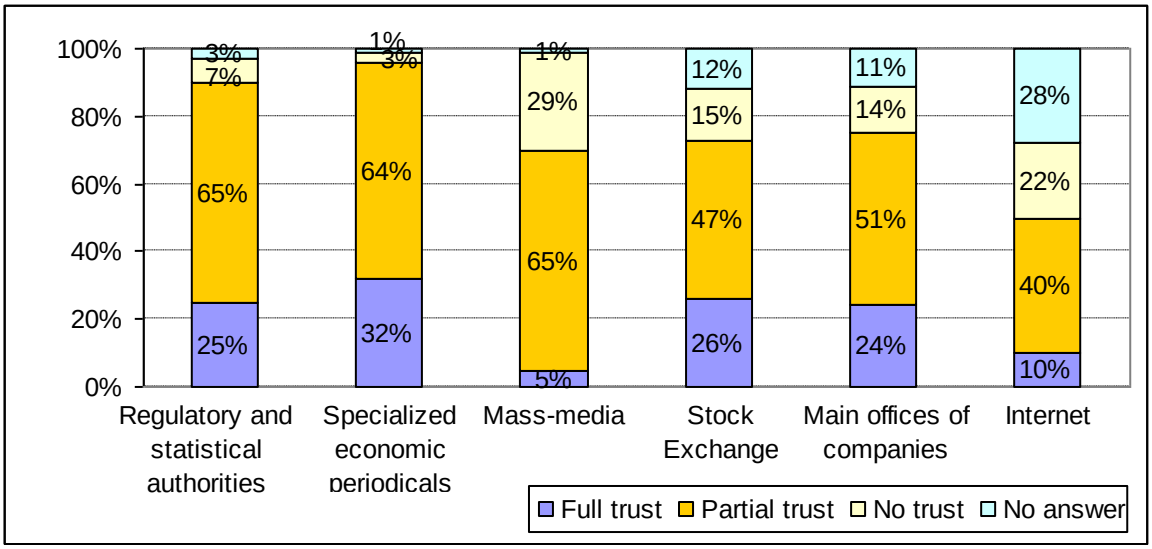


Figure 14. Does your company carry out internal audits?

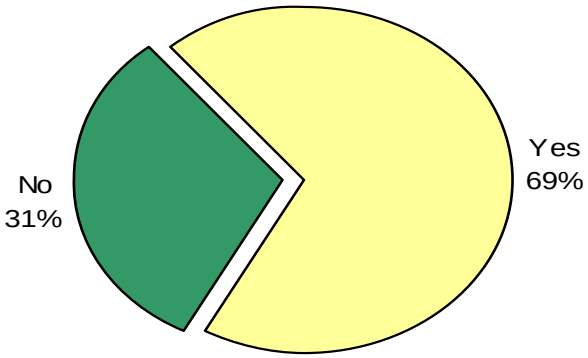


Figure 15. How often?

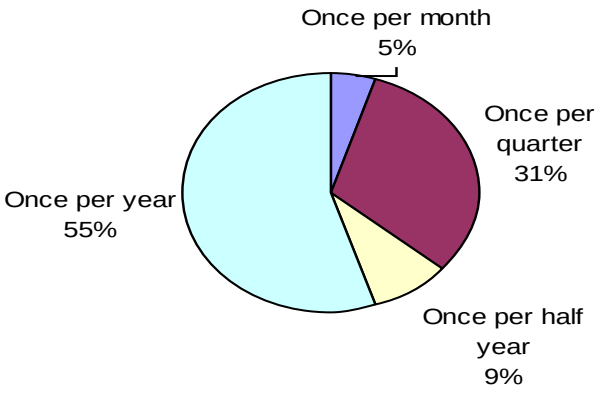


Figure 16. Who is responsible for the internal audit in your company?

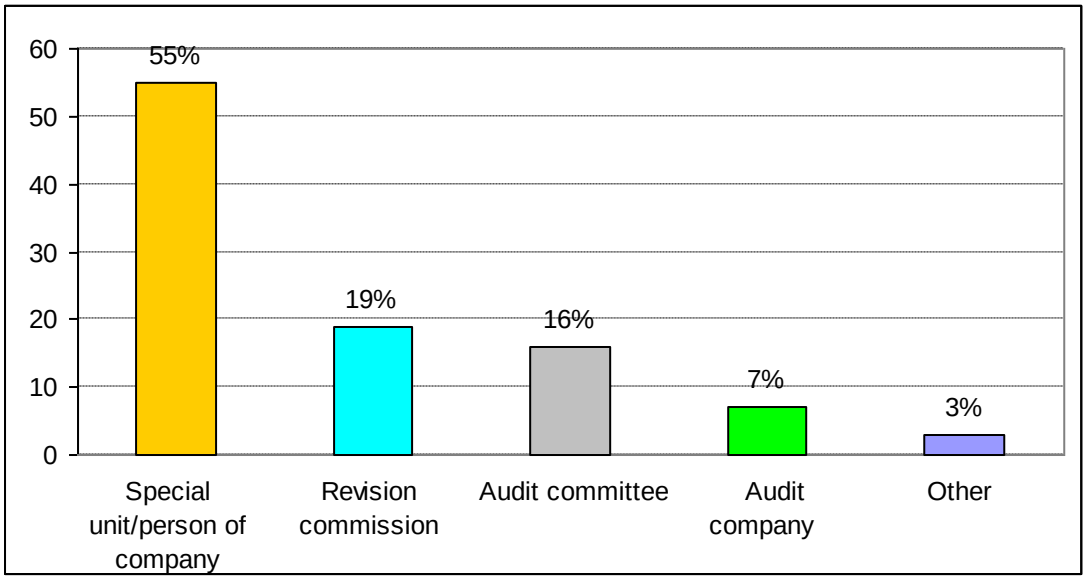


Figure 17. How interested are you in attracting additional funds?

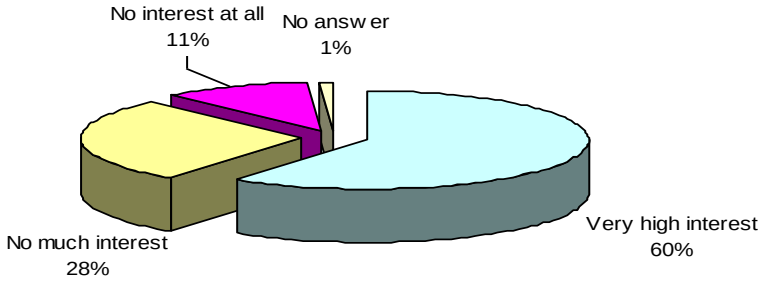


Figure 18. How accessible are the following ways of attracting funds for your company?

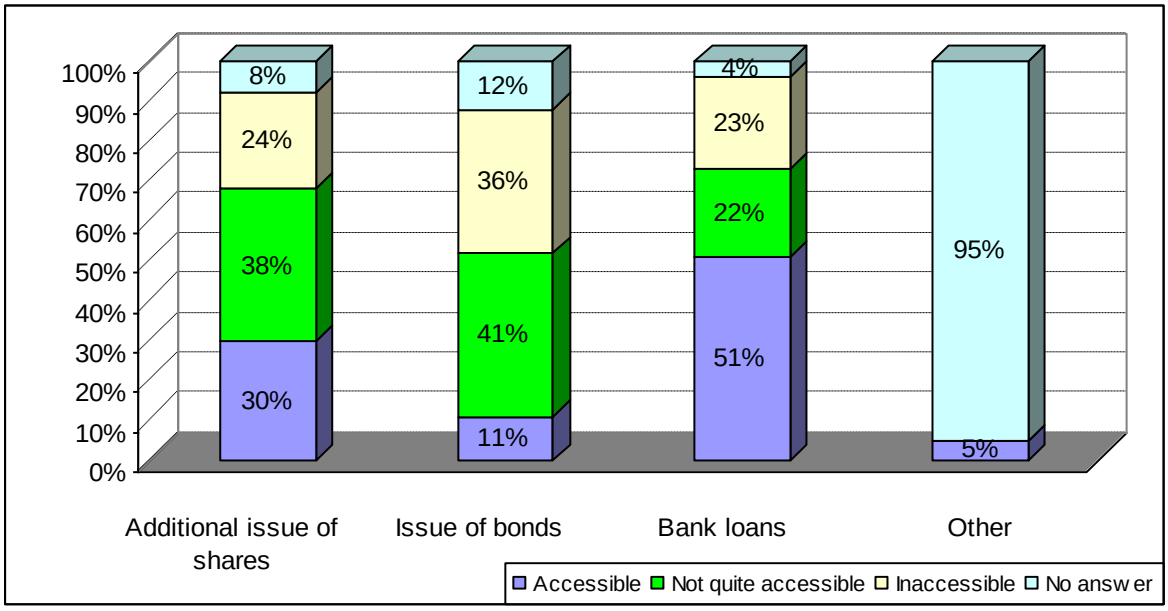


Figure 19. Which are the main barriers that interfere with the development of the securities market in Moldova?

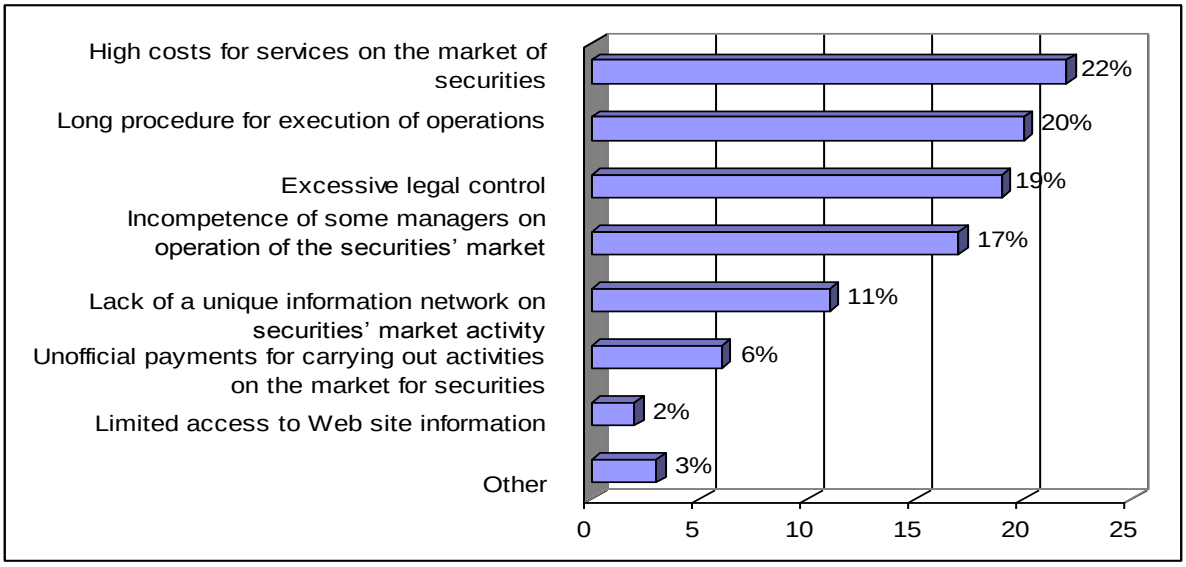


Figure 20. Which are the most efficient actions for improvement of corporate governance?

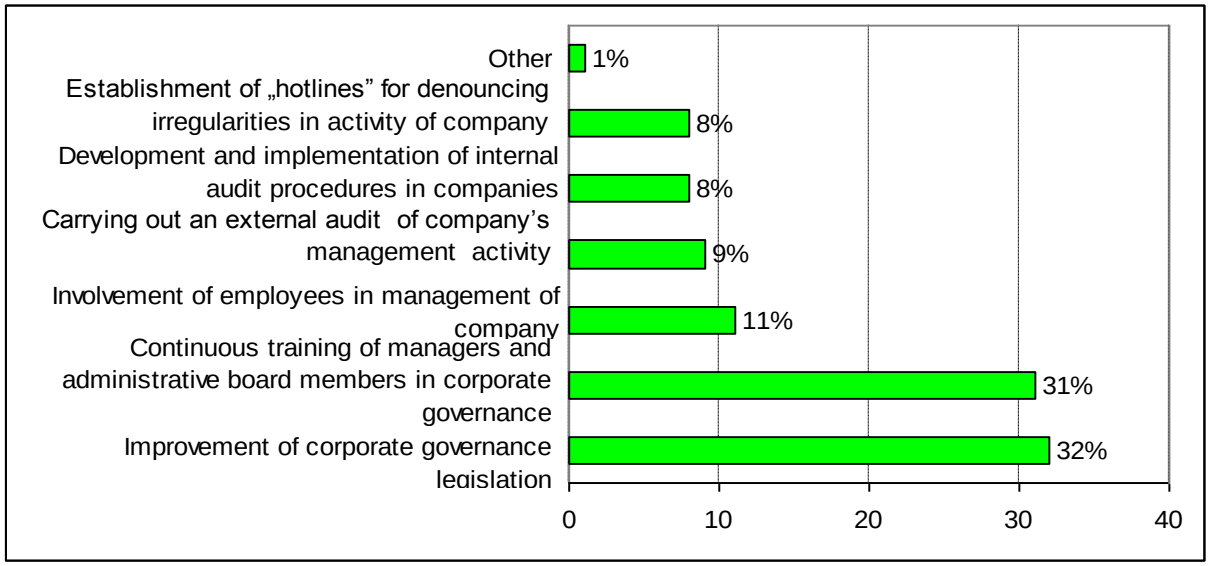


Figure 21. Which is your position in the company?

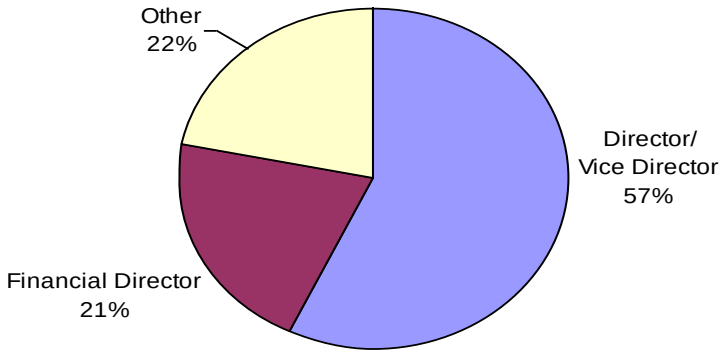


Figure 22. How long have you been in the respective position?

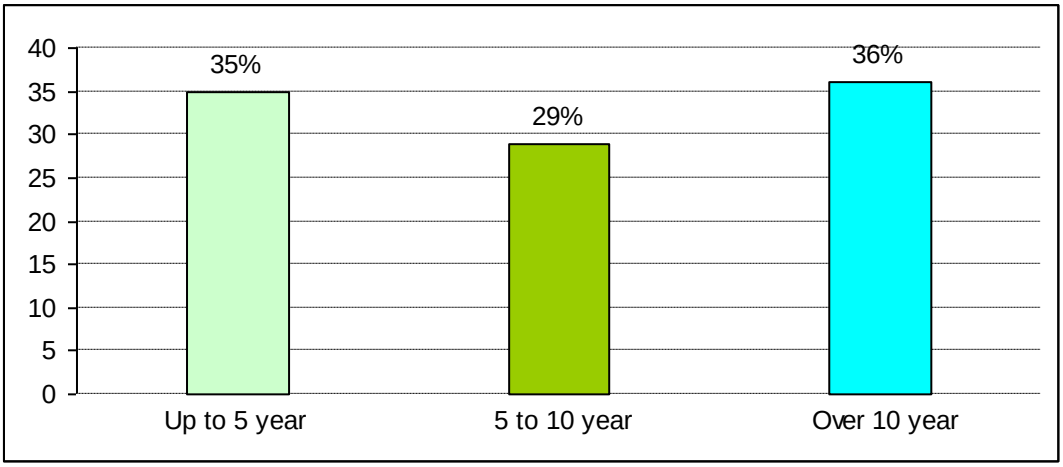


Figure 23. How many employees are there in your company?

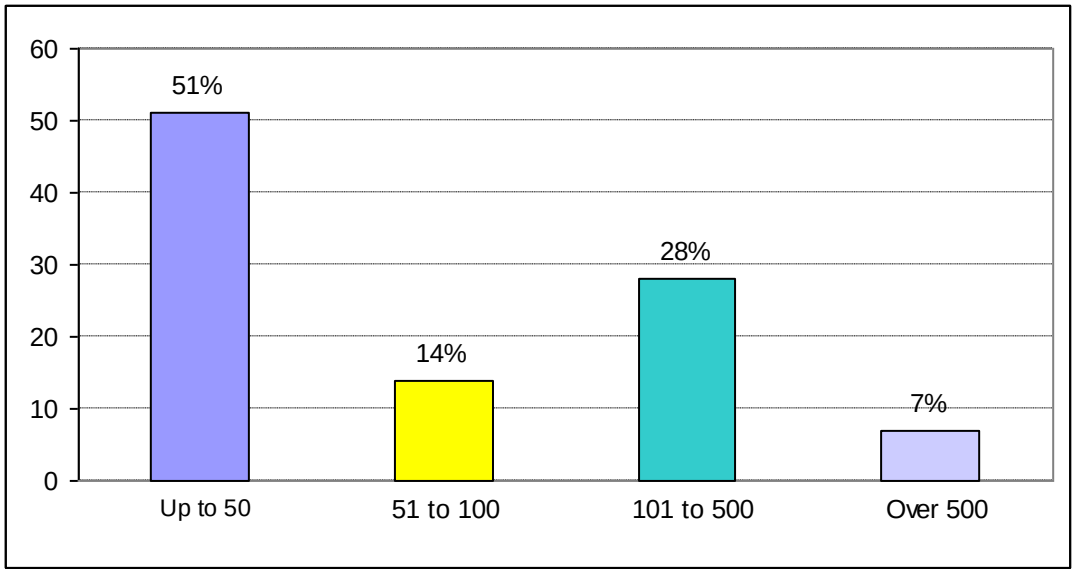


Figure 24. How many shareholders are there in your company?

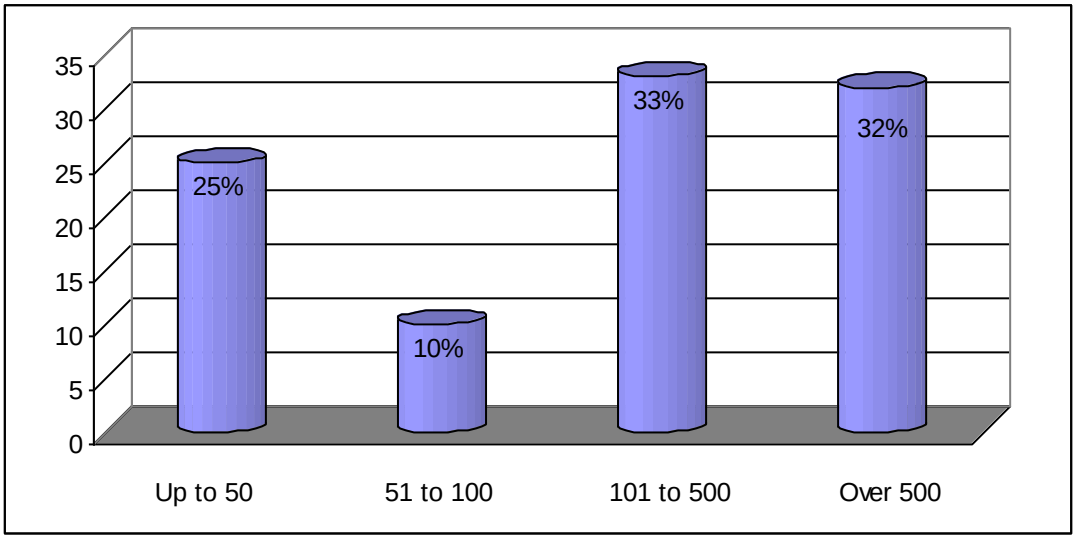


Figure 25. In which way was your company established?

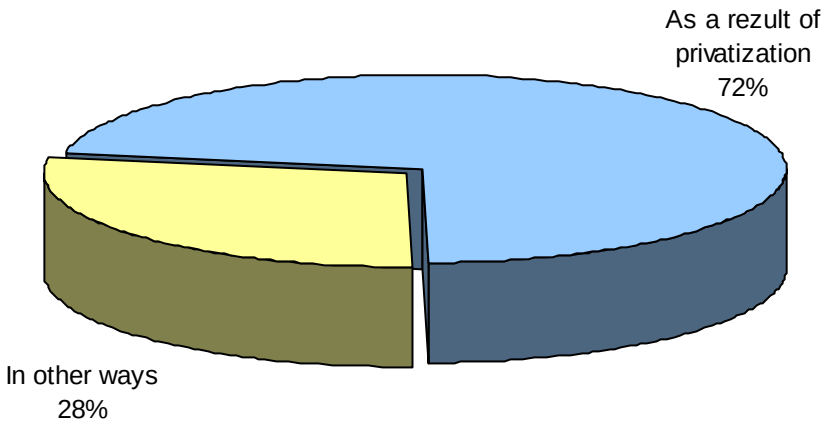


Figure 26. In which year was your company established?

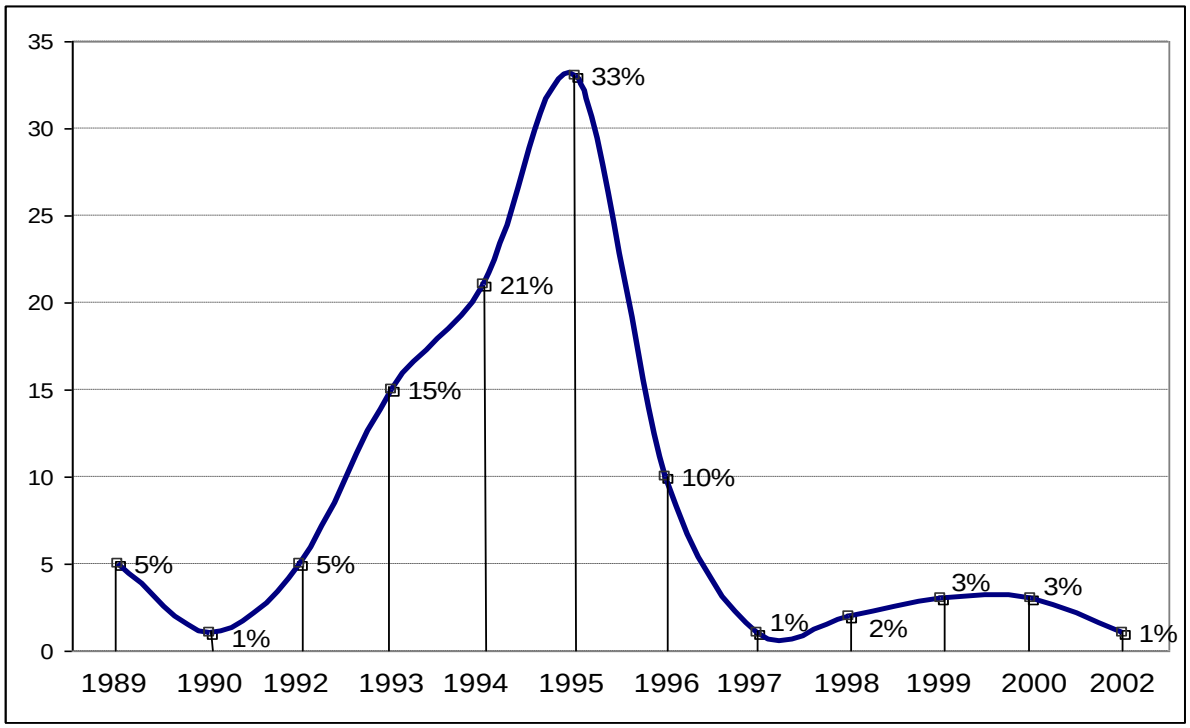


Figure 27.Observance of shareholders rights in the opinion of managers and shareholders (%)

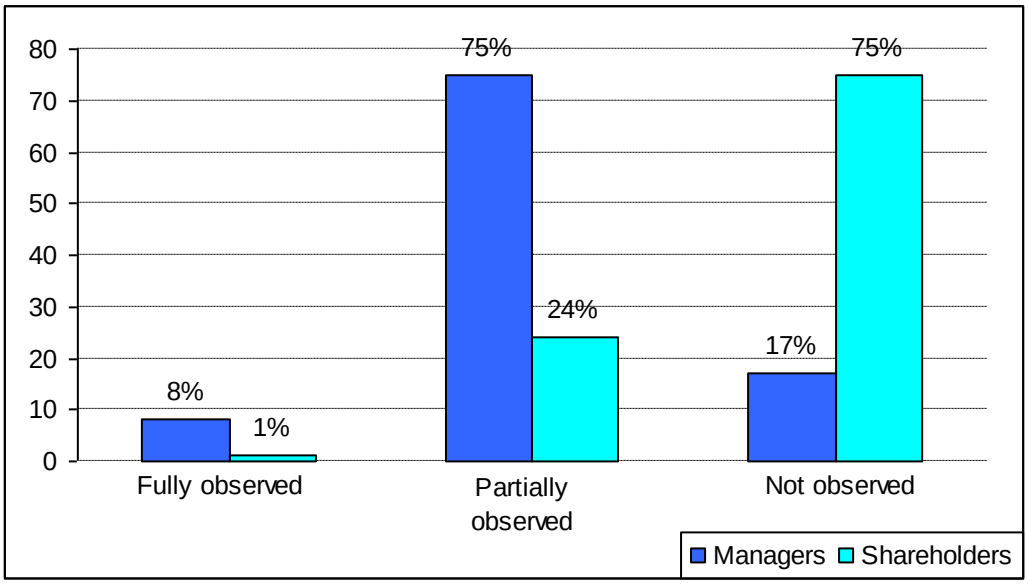
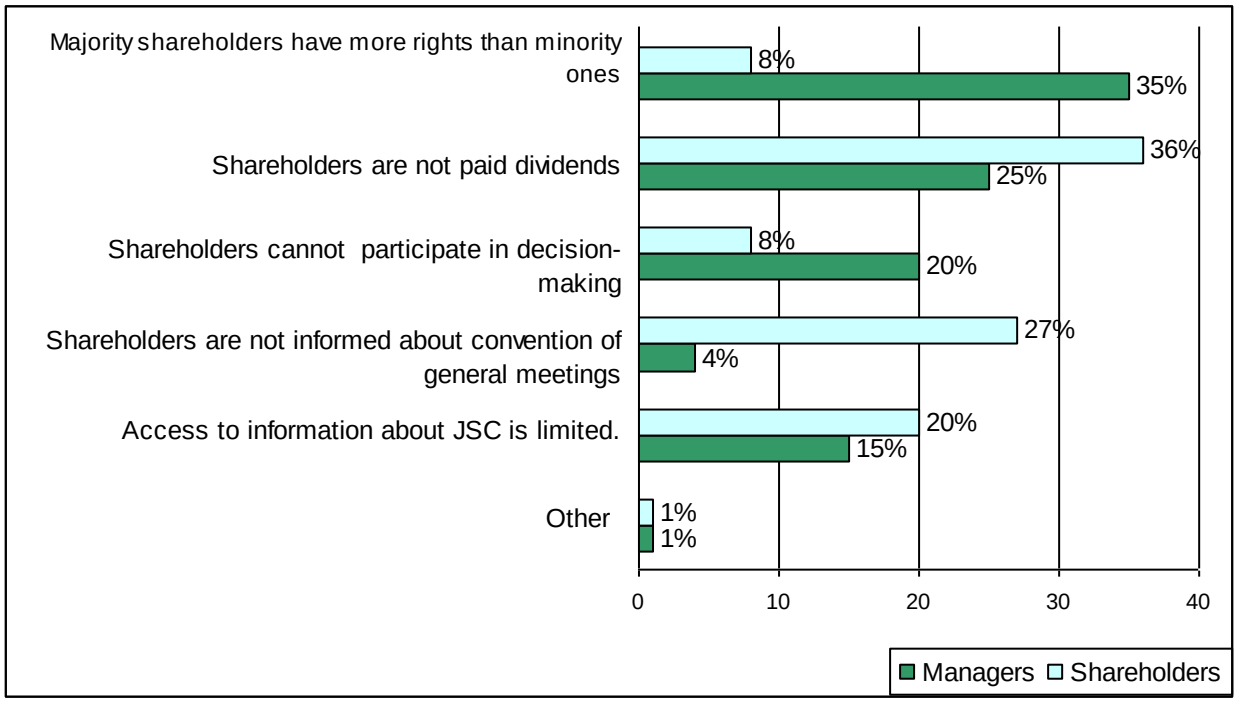


Figure 28. The most frequently violated rights of the shareholders (%)



Annex 3
Legal provisions in the area of corporate information disclosure

Legal provisions	Description of information that has to be disclosed	Mode of accessing, costs
1. Assuring the access of shareholders to the information of the joint stock company - Art. 170 of the Civil Code No.1107-XV of June 6, 2002	Publication in the press of the annual balance sheet, income and loss statement, nominal value of shares and bonds, other data , in compliance with the legislation. Provision to the shareholders, according to the law and to the incorporation document, of information on governance, management and representation of the company, on its financial condition and others, including the incorporation document, registration certificate of both the company and the shares, the regulations of the company, the minutes of general meetings, board meetings, the list of board members, managers, contracts with the registrar, with the auditor, accounting and tax reports, internal control reports.	Shall be published at least 10 days prior to the date of the annual general meeting. Copies and extracts of documents shall be provided to shareholders upon their application at their expense.
2. Access of creditors and shareholders to the documents of the joint stock company - Art. 92 of the Law on Joint Stock Companies No.1134-XIII of February 02, 1997)	• Company incorporation contract, the charter of the company with all their modifications and completions ; • State registration certificate of the company; • Regulations of the company with all their modifications and completions; • Contracts with the registrar, managing and audit organizations of the company; • Minutes of the general meetings and vote bulletins; • Minutes of the company's board meetings; • List of the board members of the company, members of the executive body and of other persons with responsible positions within the company; • List of stakeholders with details as required by the law; • Prospectuses of securities issue with any modifications and completions, reports on results of securities issue; • Data on monthly amounts and average prices of operations registered in the book of holders of company's securities; • Financial, statistical and specialized reports; • Reports of internal audit committee, control documentation, as well as reports of the audit organisation , documents on control and resolutions of the state authorities having carried out control of company's activity; • Annual reports of the board of the company and of its internal audit committee; • Correspondence with shareholders; • Other documents provided for in the charter or in the regulations of the company.	The extracts and copies of documents (except the ones which are state or commercial secret) shall be submitted permanently upon ***application*** of any creditor or shareholder against pay at the office of the company or in another place indicated in the charter or shall be posted. The costs shall be established by the company and shall not exceed the expenses needed for submission of extracts, their copying and posting.
3. Submission of materials for the agenda of the shareholders' general meeting - Art.56 of the Law on Joint Stock Companies No.1134-XIII of February 02, 1997)	• List of shareholders that have the right to participate in the annual general meeting of the shareholders; • Annual financial report of the company, annual report of the Board and annual report of the internal audit committee • Reports of internal audit committee of the company and/or the control documentation and the reports of the audit organisation , as well as documents on control and resolutions of the state authorities having carried out control of company's activity during the reporting year; • Data on candidates for positions of company's board member and members of the internal audit committee; • Proposals for modification and completion of company's charter or the draft charter in the new version, as well as draft documents to be approved by the general meeting; • Data on amounts and average prices of operations registered in the book of company's holders of securities for each month of the year , etc.	Shall be submitted throughout the process of preparation for the annual general meeting of shareholders (at least 10 days prior to the date of the meeting) at the office of the company or in another place indicated in the charter or shall be posted.
4. Disclosure of information by issuers of open type securities - Art.54 of the Law on Securities'	• Annual report on securities; • Information on events and actions affecting the financial-economic activity of the company; • Prospectus of the public offer; • Report on the results of the public issue of securities.	The annual report shall be published in the press no later than March 15 of the year following after the reporting year,

Market No. 199-XIV of November 18, 1998		while the notifications on events that affect company's financial-economic condition – within 5 days of their production.
5. Publication of information on the activity of the open type joint stock company* - Art. 91 of the Law on Joint Stock Companies No.1134-XIII of February 02, 1997)	• Annual balance sheet; • Income and loss statement; • Other reports provided for in the legislation; • Full name of the audit organisation and the main findings of the audit report in case the general meeting of the shareholders has taken the decision to carry out the audit, for open type companies with a number of over 50 shareholders or nominal holders.	Shall be published in the newspaper (magazine) shown in the charter, which has circulation throughout the country. The deadline for publication is no later than March 15 of the year following after the reporting year.
6**. Submission and publication of specialized reports of the open type joint stock company** - Resolution of the NCS on approval of normative acts referring to submission of specialized reports of issuers of securities No. 17/6 of June 28, .2001	*Forms of the specialized annual report* : • Information on insiders and affiliated persons of the issuer; • List of shareholders that hold at least 5 percent of the total number of voting shares placed by the issuer; • Information on securities placed by issuer; • Information on dividends and interest calculated and paid on securities; • Information on issuer's operations with placed securities; • Information on issuer's major operations; • List of issuer's affiliates and representations; • Information on reorganization of the issuer; • Title page, copies of shareholders general meetings minutes, board meeting minutes of the issuer. *Press releases on events and actions affecting the financial-economic activity of the issuer:* • Modifications and completions in the list of issuer's affiliated persons and insiders; • Modifications in the list of shareholders owning over 5 percent of the issuer's voting shares; • Information on issuer's reorganization and of affiliated persons' reorganization; • Calculation and payment of income on issuer's securities; • Purchase and repurchase by issuer of placed securities; • Major operations carried out by the issuer; • Date of book's closure; • Resolutions of the shareholders' general meetings; • Resolutions of the company's board meetings; • Substitution of the registrar, auditor of the issuer; • Information on registration of public offer of securities with NCS, approval of report on results of public issue of securities and their registration with the NCS, NCS assessment of the securities issue as haven taken place or not.	Shall be submitted to NCS no later than March 15 of the year following after the reporting year; its copy shall be provided to holders of securities upon their request against pay which shall not exceed the expenses of documents' execution. Shall be published in newspapers (magazines) authorized by NCS and stated in the charter. The copy of the press releases shall be submitted to the holders of securities and to other stakeholders upon their request against pay which shall not exceed the expenses of documents' execution. The deadline for publication – within 5 days of the date of the event.

"Corporate Governance – a Component of Transparency and Corruption Prevention"

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