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Legal and Economic Aspects of Corporate Governance – Market Transparency and Disclosure in Private and Public Companies

The Book of Abstracts

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Hana Horak[*]
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Transparency and disclosure as key elements for companies and markets

Transparency and disclosure are one of the key elements for good corporate governance in public and private companies. Regarding different definitions of corporate governance authors refer to different aspects of achieving high standards of transparency and disclosure. Corporate governance relies on a set of rules that are different by its legal nature so the application of these rules is not always easy to implement in business practice and it is subject of numerous debates. To enable all the relations that concern corporate governance issues it is necessary to have a framework of laws, rules and institutions which differs from country to country and are affected by country institutional set up. The problem that is also discussed is how transparency and disclosure rules can guarantee the same market position for the companies either public or private. The new achievements in European Union concerning this area are presented and accentuated in the Action Plan of the European Commission. According to the Action plan there is a need for modern set of binding rules bearing in mind that soft-law rules in the form of recommendations haven´t efficiently achieved certain goals. But on the other hand it must be born in mind that mandatory rules can reduce the focus on the substance of good governance and they can remove the key responsibility of boards and shareholders for the quality of corporate governance and reduce the governance to the compliance debate with the regulators. The transparency and disclosure have an important role for the market, but also for the company itself. High standards of transparency influence the cost of the capital at the market. Rules that apply on transparency and disclosure can prevent fraud and corruption and have important role in achieving market prosperity.

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Roger Barker[*]

The latest EU Action Plan on Corporate Governance and Company Law: A Positive Development for European Corporate Governance?

Roger Barker will evaluate the EU's new Action Plan on corporate governance and company law, and consider if it will contribute to improved board effectiveness across the EU member states.

[*] Head of Corporate Governance at the Institute of Directors (UK)

Bistra Boeva[*]

Corporate Governance and companies's and country competitiveness (the case of new market economies in SE Europe)

The transition from a planned to a market economy is mainly about dismantling long-term structures and mechanisms and building (and rebuilding) new institutions from scratch. Corporate Governance is an integral part of these new institutions. The focus of the paper is to present the role of corporate governance from a different perspective: the objective is not about what is corporate governance in a new market economy country, but rather to trace the contribution of the corporate governance to the company's and country's competitiveness. The basis of this paper are the results of a research project and the author's personal involvement in the establishing of good corporate governance in Bulgaria and in the countries of SEE. The relationship between the corporate governance is explored via traditional theoretical survey and empirical studies.

[*] Professor at University for National and World Economic Studies, Sofia, Bulgaria

Ivana Gažić[*]

Zagreb Stock Exchange: Establishing rules of transparency for Croatian companies in light of soon entrance to EU

Harmonization of legislation due to entrance to EU in area of financial sector was one of the major challenges for Croatian financial industry in the negotiation process for admission to EU. All of the segments of financial industry were affected, with strong emphasis on different areas of capital market: investor protection, best execution rules, risk management of financial institutions and investment companies etc. Focus of this paper is transparency in relation to obligatory information on issuers whose securities are admitted to trading on a regulated market. Following this request for transparency, internal processes and corporate governance of the companies were improved over time, with different pace and success. Changes in this area are also likely in near future.

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Melissa Rencanto[*]

To Privatize or Not: The Delicate Role of the Governance Commission for GOCCs (GCG) in Determining the Relevance of a State-Owned Enterprise

It all started almost three (3) years ago when it has been realized that "there [was a] need to improve the efficiency of government-owned and controlled corporations and their subsidiaries in order to promote economy, efficiency and effectiveness in the delivery of public services;" and that there was "an excessive proliferation of government-owned and controlled corporations (GOCCs), or what is otherwise known as State-Owned Enterprises (SOEs) without clear delineation of the grounds for government activities in corporate form and without adequate supervision and control." Consequently, laws were enacted particularly Administrative Order No. 59, entitled "Rationalization of the Government Corporate Sector" and Executive Order No. 55 and Memorandum Circular No. 64, which laid down the principles relating to the attainment of prudential level of government expenditures in the GOCC Sector but provided as well for the rationalization of the sector and the move towards privatization.

In June 2011, cognizant of the need to undertake reforms to enhance the ability of GOCCs to act as significant tools for economic development, and to promote growth by ensuring that its operations are consistent with the national development policies and programs of the country, Republic Act (R.A.) No. 10149 was promulgated into law. Through R.A. No. 10149, the policy framework and the guiding principles in the previously enacted laws found themselves expressed in statutory language thereby effectively promoting "financial viability and fiscal discipline in GOCCs and to strengthen the role of the state in its governance and management to make the GOCCs more responsive to the needs of public interest" and the Governance Commission for GOCCs (GCG) was created as the "central advisory, monitoring and oversight body with authority to formulate, implement and coordinate policies" governing GOCCs.

The GCG has been described to have been constituted by the Act with "awesome powers". Indeed, the GCG has been given the powers and mandates to:

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a) Classify, Re-classify, as well as Sub-classify GOCCs;
b) Conduct periodic studies, examination, evaluation and require reports on their operations and management; and
c) Evaluate their performance and determine the relevance of GOCCs, to determine whether a GOCC should be:
    - Reorganized or Rationalized;
    - Merged or Streamlined;
    - Abolished; or
    - Privatized; or
    - Upon determination that there is a conflict between the regulatory and commercial functions of a GOCC, recommend to the President, in consultation with the Supervising Agency, such plan of action to ensure that commercial functions of the GOCC do not conflict with such regulatory functions.

The author, in this paper, aims to discuss the delicate role of the GCG in determining the relevance of the GOCC or an SOE as to whether it should be privatized or not, in order to ensure rationalization of the GOCC sector and the move towards privatization.

Christian Strenger[*]

Board efficiency with special emphasis on employee participation: the German experience

The presentation outlines first the relevant points for sufficient board efficiency in the German two-tier board system. It then features the important characteristics of the Co-Determination Act of 1976 followed by a SWOT analysis of the German system that has found practical no international following.

The international context is presented by giving examples of employee participation of boards in other countries. Finally, a proposal for sensible employee participation is presented: a combination of the structure of the Societas Europaea (SE) with its optimal size and the Austrian approach of employee participation.

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Nada Bodiroga Vukobrat[*]

Ana Poščić[**]

Adrijana Martinović[***]

Employees Representation and the Sustainable Company (Croatian Experience in the European Context)

From Freedman and Reed to Hutton it has been recognized that a company is a social organization dependent upon the contribution of different groups to the production of goods and services. The so called stakeholder theory rests on the premise that all stakeholder groups are needed for a firm to work and function properly (employees, society…..). On the other hand, there is a "shareholder value model" that claims that the stock market is the best criterion for company value. In recent years the "shareholder value model" is in crisis. There have been therotical flaws in the concept, but also practical reasons for the idea not functioning properly.

We are in front of a "triple crisis" including financial crisis, climate change and social inequality. A new approach is needed to corporate governance. An alternative approach can be found in a sustainable company model with the following principal elements: a multi – dimensional concept of sustainability and stakeholder value, precise sustainable goals and detailed strategy, employees' involvement in decision making and transparent financial and nonfinancial reporting system.

One element that deserves special attention concerns the stakeholder involvement. The worker involvement is the central element for the sustainable company. One of the elements in measurement of employees' involvement in a company sustainability policy is the degree to which their livelihoods are connected to the fortunes of the company.

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There are several routes for grater worker involvement in sustainability issues. One of them concerns collective bargaining and stakeholder boards. The idea is to show that the worker representation is needed to ensure company sustainability. It can take various forms and concepts: worker participation, employee involvement, industrial democracy. Different conceptual and concrete way in defining employees' participation will be examined. We argue that stronger worker involvement could bring major improvements in the way companies operate and it will generate the win - win situation.

It is necessary to start discussion on a framework instrument on workers' involvement. The idea is to rethink the national models of information, consultation and participation. Also the process has to be followed with the more convergence between the various EU company and labour law directives.

Joelle Simon[*]

"The new French Boards?"

● The time when boards were men's clubs supportive of the management in place is over.

● Over the last two decades things have dramatically improved concerning boards' efficiency due to the implementation of the AFEP/ MEDEF Code on corporate governance of listed companies.
And now, the boards' composition faces significant changes on two items:

- diversity and especially gender diversity,
- employees participation.

● On both issues, MEDEF and its partner business organisation AFEP, privileged a soft law approach, but the French Parliament and government decided after all to intervene.

I. Board diversity and especially gender diversity first

● **Diversity** that means more directors from abroad, more directors with different backgrounds, more women directors.

→ French listed companies already have one of the highest rates of foreign directors: 23.4 p. cent for CAC 40 index listed companies and 15.2 p. cent for all listed companies.

● **Gender diversity:**

2010: a clear MEDEF's commitment in favour of quotas →the April recommendation: at least 20 p. cent of women within a three years period and at least 40 p. cent of women within a six years period.

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Why did we change our mind? “*Quotas, a necessary evil*”

2011: adoption of a law on gender diversity on boards of companies

- scope: all listed companies and some private companies meeting some criteria (new government initiative to lower the threshold)
- calendar: 20 p. cent by 2014, 40 p. cent by 2017
- sanctions: cancellation of any legal appointment; suspension of any payment of fees.

2013: where are we now?

- 25.2 p. cent of women for CAC40 index listed companies (one with already 50 p. cent of women)
- 21.1 p. cent for SBF 120 index listed companies
- not only an increase in numbers but a change of culture

And what are the perspectives after the 2013 general meetings?

By 2017:

- between 800 and 900 positions need to be filled by women
- the current pace should be maintained to reach the goal of 40 p. cent.

● **What about the European proposal for a directive on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures?**

- MEDEF supportive of the objectives and already compliant within main provisions,
- but critical of some provisions:
  - too intrusive on the internal recruitment process,
  - impracticable for executive directors.

II. Employees on boards of companies:

● **The state of law**: before the reform, already possible and in some cases compulsory to elect or to designate employees on boards of companies:

- **Work council representatives** compulsory above 50 employees, with consultative voice;
- **Employee directors**: an obligation for state-owned companies and denationalized ones, a faculty for others;
- **Employee shareholder directors**: an obligation, if 3 p. cent or more of the capital of the company is held by employee shareholders.

● **<u>Generalization of employees on boards of some companies</u>**:

- A commitment of Mr Hollande as a candidate for the Presidency of the French Republic in 2012,
- A provision of the Growth, Competitiveness and Employment Pact (decision 33), Nov 2012,
- A provision (article 13) of the agreement *"Improving company competitiveness and security of employment"* of 11th January 2013 concluded between trade unions and employer organisations:
  - participation of employees as directors with voting rights in mother companies of groups with 10,000 employees or more worldwide or 5,000 employees or more in France (exclusion of subsidiaries),
  - one employee on boards of directors of 12 directors or less
  - two employees on boards of more than 12 directors
  - elected or designated through proceedings defined by the articles of association
  - employees as directors should have the same rights and duties as other directors
  - representation to be introduced within a period of 26 months as from the passing of the bill that includes this provision

- **<u>The implementation bill</u>** which should be definitive in two weeks.

The government and the Parliament wanted to copy the German codetermination system, but ignored the major difference between a one-tier and a two-tier system.

- <u>Scope of application and number of employee directors</u>: in line with the social agreement + exclusion of mother companies which have less than 50 employees,
- <u>Ways of election or designation</u>: choice between 4 ways:
  - direct election by employees of French companies (candidates proposed by trade unions)
  - designation by the group work council, the central work council or the work council,
  - designation by the most representative trade union,
  - designation by the European work council for one of the two directors, or the council of the European company.

→ We are not fully satisfied with those provisions for the following reasons:

- the lack of the expected flexibility on the ways of election or designation of employees: the trade unions are given too much power through this proposal,
- the refusal to take into consideration the existence of employee shareholder directors when there are some and the international dimension of groups of companies.

Status of employee directors: → They will have a protected status as employees → they will not be directors as other directors as we wanted → more trade union representatives.

That is why the formation of those new directors will be essential, determinant.

Cristoph Van Der Elst[*]

Transparency of directors attributes

In modern days corporate environments, multi-tasking must be the credo of the board. The board of directors must provide in expertise in challenging the executive officers. Next, the board members should offer invaluable networking to the company. Finally, in its advising role, the board member ought to serve management in the strategic decision process.

Bringing together all these characteristics and attributes in one board pushes the general meetings of shareholders electing the board members to the limits. However, are shareholders sufficiently well prepared? Are the shareholders appropriately informed on the board competences and expertise as well as of the individual attributes of board candidates that stand up for (re)election? Conversely, are shareholders keen to take this responsibility in the quest for better corporate boards? This paper studies these questions in a comparative perspective. It concludes that shareholders have hard times preparing their "say on selection" but it is far from clear if shareholders can add value in this quest for directors.

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Irena Prijović[*]
Gorazd Podbevšek[**]

Supervisory board evaluations-experience in Slovenia

The purpose of the presentation is to show how Slovenian Directors Association in few years time changed absent practice of supervisory board evaluations with publishing the manual with matrix for self-evaluation of SB. The manual standardized the approach to assessment of performance of supervisory boards and boards of directors in Slovenia. Together with outside pressures from shareholders and codes this has allowed a better understanding of the assessment process and its contents to supervisory board members, as well as shareholders, investors, and other stakeholders. Members of supervisory boards and boards of directors are offered a tool to improve their performance and quality of both their activities and corporate governance at the company. The Manual offers understanding of the assessment process and provides answers to the frequently asked questions.

Presentation will focus on different aspects of board evaluations and experience from the side of being assessed in the evaluation process and the side of the independent facilitator.

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Mario Vinković[*]

Diversity in board of directors – the cure for gender discrimination?

Norwegian formula apparently has found its place in the European Union when comes to women in the boardrooms. However, quality of normative solutions is just a first step in the fight against discrimination and its forms in the workplace. A far more complex problem is implementation of the existing normative solutions and development of practical tools that would enable a gradual transition from the culture of prejudices and stereotypes, the culture of intolerance and repudiation of the right of diversity to the culture of appreciation for diversity, the culture of equality and tolerance, as major building blocks of professional and business ethics. Moreover, workplace environment without mobbing, harassment and discrimination of employees has far-reaching and palpable effects on employee productivity, job satisfaction, and thereby also business success and employer's market position. Diversity management should therefore be observed as a significant practical "tool" which should be used in favorem creating a motivating work environment and gradual mitigation of effects of discriminatory behaviour in the workplace.

In the light of the new legislative momentum in the EU author seeks to identify diversity management as a tool in the function of the implementation and harmonisation, as well as the limits of its interpretation and application.

KEYWORDS: *diversity management, legal tools, gender equality, discrimination, implementation*

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Unblocking women´s paths to the boardroom a critical note on the EC´s plans to regulate board diversity one-dimensionally

The recent financial crisis has led to a loss of trust in the quality of corporate governance worldwide. The European Commission (EC) currently intends to regulate board diversity (at first gender diversity) by quota, as companies have not voluntarily met the EC's expectations on this issue. Considering the political debate, it often becomes obvious that the debate on board diversity is primarily discussed from a moral perspective and on the basis of standard economic arguments or stereotypes, ignoring the majority of empirical findings in this field. Focusing on this gap, we identify very mixed results on the links between different attributes for board diversity and economic outcomes. Furthermore, these empirical findings mainly do not consider important aspects of work psychology and organizational behavior in the black box/closed circle of corporate boardrooms and often only focus on single attributes for board diversity and their direct impact on economic outcomes. Thus, without having a deeper understanding of the processes and dynamics within corporate boardrooms, we do not think this is the right time to regulate board diversity. Additionally, we think such a measure disproportionately intervenes in companies' authority to staff their boards and neglects companies' specific (economic) situations.

KEYWORDS: *Board Diversity, Economic Perspective, Moral Perspective, Regulation*

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Gian Piero Cigna[*]

Corporate Governance of Banks in Southeast Europe

The Policy Brief on Corporate Governance of Banks in Southeast Europe, recently published by the EBRD and the IFC emanates from the assessment on corporate governance of banks undertaken by the EBRD and the reflections of a High level Policy Group composed of representatives of banks and regulators from Southeast Europe and international experts who met in Belgrade and in London to draw lessons from the financial crisis, discuss international best practices in bank governance, and develop recommendations and action plans for the different countries in the region.

* * *

Corporate governance can be defined as the "system by which businesses are directed and controls are implemented". This definition is simple and to the point. It focuses on "internal governance", which is the core when debating corporate governance of banks. The concept of internal governance is also endorsed by the EC Commission, the European Banking Authority (EBA) and the Basel Committee on Banking Supervision.

Corporate governance of banks differs from the "ordinary" corporate governance of companies. This is due – among others - to the nature of the banking business (i.e., dealing with money), the need for protection of the weakest party in the chain (which is mainly "the depositor", and not "the minority shareholder", as in ordinary corporate governance) and the systemic risk that bank failure might cause.

Banks in Southeast Europe are characterised to a very large degree by foreign ownership, while state participation is extremely limited (with the notable exception of Serbia and – to some extent – Romania). This massive foreign penetration has been often welcomed by IFIs, local government and supervisors as an excellent source of FDIs. It is in fact also generally acknowledged that the presence of well know and reputable banking groups has accelerated the transfer of good practices between parents and subsidiaries. However, this process is bearing a price. Sometimes, regulators find themselves limited in their reach by their position as "host supervisors" to their most important banks. Local regulators' limited ability to influence the adequacy of group governance and control

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functions that are at the core of the governance soundness of their most systemic institutions is becoming a key challenge for many banking systems. In this context, the legal framework and supervisory authority not always include sufficient checks and balances to ensure that subsidiaries do not blindly follow policies and practices of the group. It is not so common to see supervisors requiring the parent/group to disclose the policies detailing their role in the decision making process of the subsidiary or being active in establishing direct contacts with key representatives in the group. Often, there is a sense of over-reliance on the parents' and group's policies and strategy and there is a risk that the subsidiary board is viewed as mere formality. This should be seriously addressed.

From a group's perspective a subsidiary board is a very useful "hub "of local accountability, bringing together the oversight of all functions and business lines at local level. When it comes to controls, local boards are a very useful additional buffer, another "line of defence", to prevent lapses and failures at local level. From a forward looking strategic perspective, they are also a useful way to provide an out- of the- box perspective on local threats and opportunities which might often elude both local and group executives. Finally, from a regulatory perspective, subsidiary boards ensure that institutions, especially the systemically important ones, are focused in preserving the stability and effectiveness of the local banking system even in the few cases where these priorities might not be aligned with the broader interests of a multinational corporate group.
The limited local regulator's ability to influence the adequacy of group governance and control functions that are at the core of the governance soundness of their most systemic institutions is a key challenge for the banking system in the region.

Further, in a number of countries the composition, functions and responsibilities of the supervisory board and board committees in banks is not comprehensively regulated, causing potential conflicts of interests' situations and unclear accountability lines. Fit and proper requirements concentrates mainly on the qualifications (or better, the lack of negative factors) required from executives, but rarely guide banks in setting the necessary mix of skills at the board level for sound direction and oversight of the bank. In addition, there are weak requirements for independent and qualified directors in boards and board committees.

In the large majority of jurisdictions, independent directors do not exist. In order to obtain some objectivity at the board, in few jurisdictions the banking framework requires banks to appoint "outsiders" in committees. This practice needs to be carefully assessed. The key question here is what could a person that it is not a board member add to the debate? The arguments in favour of this approach are that non-board members would allow committees to draw from a larger pool of industry and expertise and that it might give the committee greater independence. This is not fully convincing and the discussion is open. First, one could argue that the committees should include only board members if the functions delegated to them are typical board functions. Secondly, it is essential that those sitting on the committee and recommending specific actions to the board, then follow up such recommendations by voting at the board, therefore reinforcing their position and "objective judgement" as board members. Finally, committees made of outsiders rarely have the clout to compel access to information that would allow them to effectively challenge management. This structure might also create confidentiality and accountability issues. While it is legitimate that the committee might need external advice or expertise on specific issues, it should be able to request such advice, but without leaving the advisor(s) to take the place of the committee in its decisions and recommendations.

In addition, in some jurisdictions, executives are allowed to sit in the audit committee, which is concerning and highly potential for conflicts of interest.

As the audit committee is at the top of the bank's lines of defence, its structure, composition and qualification and its members is a key determinant of the bank's soundness.

If the banks' business is the business of taking risks, then it is clear that risk governance is at the core of banks' good corporate governance. Most countries in the region have enacted comprehensive regulations on risk management offering guidance to banks in setting up their risk management function. However, only few jurisdictions require banks to go the extra mile and make the effort to develop an autonomous and detailed forwarding looking assessment establishing the level of risk that the bank is prepared to accept, before action is deemed necessary to reduce it. In most of the cases, this "acceptable level of risk" is generally embedded in the bank's strategy or derived from the group. As mentioned above, the large majority of banking assets in the majority of countries in the region is controlled by international banking groups. Often, in a group setting, subsidiary boards are viewed as mere formality, instances that exist only to justify the "fiction" of the separate legal entity. Moreover, rarely the framework is clear in delegating the strategic decisions regarding risk management to the subsidiaries' board, even in case of systemically important subsidiaries. In order to avoid the mistakes of the recent past, boards need to have a more thorough discussion of forward looking risk issues and set clear boundaries that management should respect.

Only in few cases, the law require banks to appoint an independent chief risk officer (CRO) with direct access to the board. In most cases, this function is cumulated with other senior positions, such as the CFO. Often CROs do not have sufficient "gravitas" within their organisations. Sometimes, CROs or heads of risk departments do not report to the CEO or to the management board and there seems to be a perception that the risk function is not an integral part of the business but rather an additional "control".

Non-financial disclosure is often poor and banks' compensation practices are rarely aligned with prudent risk management. When turning the analysis to bank’s practices, banks very often do not have a nomination policy for the board and do not perform board evaluations. As a result, it is not clear if the composition and mix of skills at the board is optimal for providing direction and oversight of the bank. In some cases, external auditors are allowed to provide non-auditing services, which might seriously weaken their independence.

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Iris H Chiu[*]

Corporate transparency for banks and financial institutions – enhanced accountability for the future

This paper deals with the key question of why corporate transparency in banks and financial institutions failed to flag up the excessive risk-taking positions in the run-up to the financial crisis, whether and how regulation should address this issue and the way forward.

There are commonly two reasons for explaining why corporate transparency did not illuminate the financial position of banks and financial institutions sufficiently to point to signals of crisis in the run-up to the global financial crisis of 2008/9. One is that the financial reporting of banks did not reflect the impaired value of toxic securitised mortgage assets and therefore gave the impression that bank balance sheets were stronger than they were, failing to warn investors of the impending crisis when the toxic assets imploded. This is due to the accounting approach known as the amortised cost accounting approach undertaken in the valuation of financial instruments under IAS39. The second reason is that corporate financial reporting and audit focus on traditional hard numbers such as earnings and do not reflect risk-taking, such the risks of high leverage, and hence may paint a rosier picture of the financial health of the bank than is actually the case. Post-crisis, the International Accounting Standards Board is moving towards addressing the first issue by switching to a more forward-looking form of accounting for valuing financial instruments so that financial reporting may be able to provide investors with earlier warnings. As to the second issue, in the UK, investors have criticised directors and auditors for signing off 'going concern' certifications by directors made for banks which failed in the crisis, and this triggered an inquiry led by the Financial Reporting Council in the UK. The Council appointed Lord Sharman to lead an independent inquiry into the state of corporate transparency in the UK, and some recommendations made by Lord Sharman would address the second issue on the adequacy of financial reporting.

This paper will first deal with the reforms to accounting standards in valuing financial instruments in a bid to improve corporate transparency. The reforms will bring about a form of fair value accounting, a forward-looking approach that incorporates expected losses in market value of assets

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held for trading on the books of banks and financial institutions. The paper will deal briefly with the debate on whether fair value accounting indeed improves market transparency and accountability to investors, and will point out that there are commentators who are concerned about whether fair value accounting affects corporate transparency to the extent that regulatory objectives in financial stability may be jeopardised. The paper will discuss the future of accounting standards reforms in the broader context of the dilemma between possibly conflicting objectives between market transparency and regulatory objectives in financial stability. The paper will critically explore whether corporate financial reporting should serve a number of purposes including market transparency and regulatory scrutiny and how the future of corporate financial reporting may be situated in the wake of the range of regulatory reforms in financial regulation.

The paper will then discuss how legal reforms intend to address the issue of inadequacy of financial reporting as regards bank and financial institution risk profiles, which has caused the investor outcry against the 'going concern' certifications signed off by directors and auditors in the run up to the failure of several banks. The UK approach to this is to encourage less investor reliance on short-termist and narrowly-focussed financial information such as earnings but to move towards engaging with more narrative reports issued by banks and financial institutions. Such narrative reports would focus on risk profiles and would be legally required to be enhanced and expanded in order to provide investors with information to assist in their risk-adjustment of perspectives from financial statements. The paper will discuss the reforms proposed in the UK to move towards an emphasis on enhanced narrative reporting, and the encouragement of investor engagement and stewardship. The paper will therefore raise questions as to whether reforms in corporate reporting in banks and financial institutions may be supported by corporate governance reforms. The advantages and drawbacks of the UK's approach will be discussed.

Dionis Jurić[*]

Implementation of the Capital Requirements Directive III rules on remuneration policies in financial institutions

Financial crisis in financial services sector from 2007 to 2009 showed that poor remuneration policy was one of the factors which contributed to emerging of problems in financial institutions. The remuneration policy that reward short-term profit and give incentives to take risks that exceed the general level of risk undermines sound and effective risk management and promotes excessive risk-taking behaviour.

Commission of the EC enacted the Recommendation on remuneration policies in the financial services sector in 2009 responding to the ongoing financial crisis. The need for connection of the remuneration policy with long term performance of financial institutions has emerged. Strengthening of the risk management and internal revision of the remuneration policy enables sound remuneration practices in financial institutions. The payment of bonus must be corrected with additional mechanisms (claw-backs, deferment of payment). In this course the Recommendation proposed principles on creation of the remuneration policy (structure of the remuneration policy, performance measurement, governance), disclosure of information on the remuneration policy and supervision of application of Recommendation´s principles. This enables information on the remuneration policy to relevant stakeholders and strengthens control function of national competent authorities on remuneration practices. Because of the non-binding character of the Recommendation, implementation of the Recommendation varied significantly in Member States of the EU.

European Parliament and European Council enacted in November 2010 Capital Requirements Directive III (CRD III) and introduced new binding provisions regarding remuneration policy in credit institutions and investment firms. CRD III Directive provisions accepted solutions of previous European Commission recommendations on remuneration policies in listed companies and financial institutions. The Member States were obliged to harmonise their national provisions on

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remuneration policies in credit institutions and investment firms until 31st November 2011. The Member States implemented the new remuneration rules in two different approaches: first, revision of corporate law, second, amendment of legislation on financial markets.

Croatian Parliament has not yet implemented the new remuneration rules in credit institutions and investment firms in national provisions, so there is a need for further harmonisation of these provisions.

KEYWORDS: *remuneration policy, financial institutions, Capital Requirements Directive III*

John Gašparac[*]

The role of the audit committee in Corporate Governance

This presentation focuses on Audit Committee effectiveness, and what works best. The first discussion point sets the stage, looking into the current regulatory environment and the impact it has had on the expectations of the public. Some of the impacts considered are the global economic crisis, focus on anti-corruption, increased level emerging legislation and developments in the role of auditors. The next discussion point is what we are hearing from audit committee members, and covers concerns over the extent of their role in risk management oversight, information technology and intensity of the enforcement agenda. Finally, the discussion turns to selected leading audit practices. This covers financial reporting, risk management and internal control, company culture and compliance, internal audit, external auditors, investigations, committee meetings and other processes. The presentation draws on international as well as local experiences in the context of the discussion points.

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Auditing as external surveillance mechanism of corporate governance

This paper examines the main functions and responsibilities of external auditing as external surveillance mechanism of corporate governance and its connection with audit committees in order to increase the quality of corporate governance according to law and professional standards. Considering the main features of organizing and function of external auditing as external surveillance mechanisms is key assumption for understanding the complexity of the entire process of corporate governance. In that sense, the responsibilities of audit committees are surveillance of risk management process and systems of internal controls, financial reporting process, compliance with laws and regulations, communication and cooperation with external auditors. Among other responsibilities, audit committee must cooperate with external auditors. This paper summaries the relevant facts of auditing as external surveillance mechanisms and explains the influence of organizational and functional factors of external auditing and audit committee on the quality of financial statements reporting. Based on the findings and results of research it can be concluded that there are necessary further significant improvement in organizing and functioning external surveillance mechanisms, especially coordination between audit committees and external auditing, in order to improve the process of corporate governance.

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External auditor´s normative characteristics set out in the Directive 2006/43/EC as an element ensuring correctness of business entities´ disclosure

The purpose of an article is the analysis of selected issues of European Union accounting law, understood as a set of EU regulations about accounting and statutory audit. Accounting law seems to be underrated by judicial doctrine, although it plays an important role in the functioning of enterprise (especially companies), capital market or finally the tax system. Therefore, the analysis of reasons, for which EU put an effort on harmonisation process, and sometimes also the unification of accounting law seems to be interesting. The integration of an accounting law on the European level should be evaluated in the context of potential influence on the EU internal market. The purpose of the study is an attempt to formulate the assessment if some important institutions of EU accounting law meet the requirements of internal market. Currently, the most significant function in this matter regulates the directive adopted in 2006. The directive regards to statutory audit of annual financial statements and consolidated financial statements. It is worth adding, that it is the newest normative act concerning accounting law - important because it deals with the challenges faced by regulators of an economic activity.

The considerations in this essay are based on the assumption that, from the perspective of proper functioning of the internal market, comparability of financial statements of business entities from different EU Member States and comparability of the external audit, are necessity. One of the elements constituting optimal state of affairs is a high level of harmonization of legal regulations on accountancy in a strict sense, but also the high level of harmonization of legal regulations on external audit (financial revision). Concern for the high professional level of the external audit process requires establishment of legal rules for defining external auditors’ normative characteristics. This issue will have an important influence on the quality of information presented and disclosed in the financial statements. It is one of the arguments for maintaining the comparability of financial statements of business entities from different EU Member States. It also plays an essential role in the internal market functioning.

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An American experiences indicate the essential role of auditors' autonomy and objectivity. Unfortunately, provisions of the EU directive are in this regard unsatisfactory. The regulation has editorial flaws, it is also ramble and some solutions are substantively inconclusive. From the viewpoint of proper internal market functioning, current regulation of external audit does not seem to be sufficient enough. It is rather scattered and can be justified only partially. Adopted solutions should be considered as distant from the optimal ones. Important role should also be assigned to the method of integration of law - it seems inappropriate to use minimum standard of harmonization to describe normative characteristics of external audit and external auditors. This is one of the reasons why the current regulation cannot serve internal market well enough.

This essay presents ideas for improvement of the current situation. Some of them are far-reaching, as for example ownership unbundling of audit services. The aim of these ideas is to considerably improve functioning of the internal market and the quality of financial statements' audit.

Despite the fact that the European legislator attempts to take basically right legislative action, the details of these regulations leave much to be desired. In terms of efficient functioning of the internal market, EU accounting law requires more unification and determination, so that it can effectively conduce the freedoms of internal market.