

CORPORATE GOVERNANCE IN THE EXTRACTIVE INDUSTRY – COMPARING RUSSIAN OIL AND GAS COMPANIES AND SOUTH AFRICAN GOLD PRODUCERS

*Thomas Gstraunthaler**, *Maria Ulyanova***

Abstract

The influence of local culture on the way business is conducted has been recognized by a whole array of literature (e.g. Hofstede, 2001). Due to the focus on the financial industry throughout the last years, other vital sectors like the extractive industry have been neglected by academic research. This is even more surprising given the fact that the extractive industry is a particularly exciting study object. Its main capital is mining rights to explore and exploit the natural resources in a specific geographic area. Once a corporation decides to start exploitation, the venture is most likely to employ lots of workers out of the communities around the plant. This entangles the companies unavoidably closely with local and national politics. This paper inquires into the reporting of corporate governance in the extractive industry. For the purpose of this study, four Russian companies in the Oil and Gas sector and four South African gold producers were chosen. Besides obvious differences in the mining process, both sectors are vital to the economies of both nations and both are under strong influence of regulations and politics. Both groups report about their corporate governance on a very high level. The paper concludes that the notion of closed and opaque Russian companies does not hold any longer.

Keywords: corporate governance, oil companies, Russia, South Africa

**Corresponding Author, Associate Professor, University of Cape Town*

***Faculty of Economics, Moscow State University*

Introduction

Corporate Governance describes the system through which companies are directed and controlled. Through the separation of the ownership and the use of the capital, director's responsibilities cover the functions of direction, executive action, supervision and accountability (Reinecke, 1996). By its nature, corporate governance covers a set of rules and principals written and enforced by law and professional bodies and goes down to good practices and suggestions. Yet, Corporate Governance is also necessarily political (Roe, 2003; Gourevitch and Shinn, 2005). It is dominated by the power-relation at a given point in time and strongly driven by political ideology and interest.

Insights into the corporate governance mechanisms of companies can be of vital interest to investors, particularly if the company is situated in a country that is not on the same stage of accepted accountability practices as the investor would expect it. Now, one could argue that with the spread of internationally accepted standards of accountability and corporate governance, these systems would be widely comparable. The answer to such a position must be yes and no. Yes, the listing requirements on the major European and US-American stock exchanges force companies to comply with the relevant and applicable regulation. Take SOX as an

example, or the UK Corporate Governance code for companies listed at the London Stock exchange. On the other hand, these set of standards are largely addressing formalisms and run the risk of becoming a box-ticking or copy-and-paste exercise instead of a true reflection of business conduct.

The influence of local culture on the way business is conducted has been recognized by a whole array of literature (e.g. Hofstede, 2001). Yet, there are sector-specific differences on the influence of local culture – depending on the degree of internationalization. The banking sector or the airline sector with lots of shared business interests with other partners respectively the offering of shared services are probably a good example for quite internationalized sectors. Contrary to this openness and international approach of e.g. the airline industry is the extractive industry. Its main capital are mining rights to explore and exploit the natural resources in a specific geographic area. Once a corporation decides to start exploitation, the venture is most likely to employ lots of workers out of the communities around the plant. This entangles the companies unavoidably closely with local and national politics.

This paper inquires into the reporting of corporate governance in the extractive industry. For the purpose of this study, Russian companies in the Oil and Gas sector and South African gold producers were chosen. Besides obvious differences in the

mining process, both sectors are vital to the economies of both nations and both are under strong influence of regulations and politics.

South Africa

South Africa is the largest economy in Africa. Its historically Anglo-Saxon shaped administration and business values led to a very westernized approach to corporate governance like the market-based model of corporate governance and its dominant shareholder's view. E.g. a single-tiered board structure is standard, without any representation of stakeholders like employees. The steps South Africa decides to make in pursue of their economic policy are often echoed throughout of Africa. The South African Corporate Governance Codex, King II, has been reworked and the new codex, King III, will be released in March 2010. King III takes an interesting route and tries to balance between international developments and African particularities. South Africa, together with the 56 countries of the Commonwealth and the 27 EU members, chose a code of principles and practices on a 'comply or explain' basis. Thereby, so the explanation, it is intended to guarantee enough freedom to the companies to balance the cost of compliance with their immanent business needs.

In addition to the Corporate Governance Code, there is a lot of demand from politics to disclose how a company is actively engaging in the transformation of the South African society, like Black Economic Empowerment. The Code of Conduct for Broad Based Black Economic Empowerment (the Code), which is administered by the DTI and based on the Black Economic Empowerment Act, 2003, was published in the Government Gazette in February 2007. There is growing pressure, across the economy, for companies to achieve adequate BEE ratings. To get this rating, companies wishing to do business with any organ of state, including municipalities, or state-owned enterprises, must have a qualifying score (leaving aside the special considerations applying to exempt micro-enterprises and qualifying small enterprises). A large part of the scorecard is devoted to preferential procurement. An enterprise scores points for acquiring goods and services from other entities which are black-owned, or have a high recognition level. This creates a type of cascade whereby companies, in order to increase their own BEE ratings, are applying pressure on their suppliers to be compliant.

Despite the strong focus on the attraction of foreign direct investments into South Africa and a strongly market-orientated economic system, some players focused on a more 'social' redistribution of wealth (e.g. the Congress of South African Trade Unions) or the pursuit of socialist ideologies (socialist party). They rejected free-markets as the driver of economic growth and instead suggested strong government interventions to overcome the debilitating legacy of uneven development and extreme

socioeconomic inequalities (Andreasson, 2007). Some authors have subsequently taken extreme positions, rejecting the shareholder wealth maximization model as "incongruent with South Africa's commitment to situating the corporation within civil society" (Sarra, 2004: 21).

The ideologically unpredictable times after the first free elections were countered by a move of corporations and professional bodies and the drive for guidance and 'best practices' to enhanced legitimacy. As a consequence, the Institute of Directors in Southern Africa established the King Committee on Corporate Governance, chaired by Mervyn King, a retired judge. The two corporate governance codices that were issued in 1994 respectively in 2002 both carried his name and are commonly referred to as the King Report on Corporate Governance (King I) and the King Report on Corporate Governance for South Africa (King II) from March 2002. King II received positive feedback, in particular for its integrated Sustainability Reporting section (e.g. Barrier, 2003).

The report focuses on three pillars: leadership, sustainability and corporate citizenship. Effective leadership is seen as the key to good governance and is facilitated through ethical values, in particular responsibility, accountability, fairness and transparency. The King III's interpretation of these values shows its denial of a one-size-fits-all approach and its focus on two South African issues: the changes in the economic situation and the principle of uBuntu.

uBuntu is largely translated as "I am, because we are; and since we are, therefore I am" (Mbiti, 1989, p. 110). Every individual is an extension of others, and therefore reaching the fullness of his/her potential without the concrete act of relating to other individual persons is impossible. *uBuntu* pinpoints the importance of community to individual identity and hence to human dignity (MEC for education, 2006). In African cultures, effective leadership is based on moral duties. Despite these interesting insights, little is known about how to crystallize these African values into private corporations. One possibility is the decision-making by consensus (Nash, 2002; Wiredu, 1977), discussing matters with everybody concerned. For businesses in a global economy, this approach would be hard to achieve.

Russia

After the fall of the Soviet system, the Russian economy went through turbulent times. It collapsed in 1991-92, didn't take off until 1998, just to collapse again. In 2000 until 2008 nevertheless the GDP other indicators improved.

Its currency has devaluated frequently throughout the last years and the government has defaulted on its debt (dollar- and ruble denominated). In 2010, due to the higher price for oil, the ruble strengthened. The corruption still is rampaging the country, tax collection is abysmal, and new investment – for reasons just mentioned – rare.

Besides the extractive industries, the fundamental expectations for growth are quite ambiguous.

One of the most decisive events in its recent economic history was the phase of privatization Russia went through. Driven by the idea that profit incentives unleashed by privatization would soon revive faltering companies held by the state to close the gap to their western peers. Yet, it never happened.

A corporate code of conduct developed by the Russian Union of Industrialists and Entrepreneurs and signed by many Russian companies, including in the energy sector. Many Russian companies also joined the UN Global Compact and similar international initiatives (IFC Equator Principles, etc.)

... offered three reasons for why the expected success didn't. Firstly, mass privatizations in a country with a bad infrastructure for controlling self-dealing will offer the opportunities for massive self-dealing by managers and controlling shareholders. Particularly those with access to money can use their advantage to accumulate assets. Secondly, the authors conclude that new business creation was prevented through a punitive tax-system, official corruption, organized crime and an unfriendly bureaucracy. For a detailed account of the events around the privatization see MAXIM BOYCKO, ANDREI SHLEIFER & ROBERT VISHNY, *PRIVATIZING RUSSIA* (1995), Stephen S. Cohen & Andrew Schwartz, *Privatization in the Former Soviet Empire: The Tunnel at the End of the Light*, AMER. PROSPECT, Spr. 1993, at 99; Peter Murrell, *What is Shock Therapy? What Did it Do in Poland and Russia?*, 9 POST-SOVIET AFF. 111 (1993)

Corporate control should be enforced through the market as a good owner would buy a bad owner's assets and be more efficient, which would in turn be more valued by the market. So why did the market not provide the expected solution?

"Good owners don't exist in Russia in significant numbers or with the capital to buy large enterprises. If they existed, they wouldn't pay a bad owner anything close to fair value, because they couldn't verify what shape the business was in.

Moreover, the business might be worth more to the bad owner, who has a comparative advantage in the important tasks of self-dealing, evading taxes, obtaining favors from the government, not paying workers, and using effective albeit unofficial means (read: the Mafia) to enforce contracts and scare off competitors. In contrast, an honest owner risks having the government expropriate his investment" (Black, Kraakman & Tarasova, 2000, p 6).

Methodology

This paper investigates into the reporting on Corporate Governance of two sectors of the extractive industry, namely oil and gas as one sector and gold producers as a second group. Throughout the last years, the extractive industry was largely neglected by academic research as the focus was more directed towards the financial industry. The financial crisis has started to redirect the spotlight of academic research on other sectors, and due to the latest rise in commodity prices it feels due to pay attention to this vital part of economy.

Inquiring into this sector also seems warranted from an investor's perspective. Companies in the extractive industry are bounded to mining rights which are granted by different levels of government. Therefore, these companies are strongly interlinked with governments and their officials, which often led to a very opaque situation for outside investors.

This paper looks at companies in specific regions. For the oil and gas sector, Russian companies were chosen. The gold producers were chosen from the listing at the Johannesburg Stock Exchange (JSE) in South Africa. The analysis comprised the annual reports of the year 2008.

The paper compares two leading companies out of the sectors, LUKOIL for the Russian oil and gas sector and Anglo AshantiGold for the South African Gold sector. In addition, accumulated data from the other companies in the same sector are presented to provide insights into similarities in the sector.

Table 1. Companies included in the study

LUKOIL	Russian Federation
Rosneft	Russian Federation
Surgutneftegas	Russian Federation
Tatneft	Russian Federation
Ashanti Gold	South Africa
BMD	South Africa
Harmony Gold Mining Company Limited	South Africa
Village Main Reef Gold Mining Company (1934) Ltd	South Africa

The structure of analysis used in the paper is as follows. Firstly, the information about the board structure and the committees is screened. Subsequently, the focus moves on to reporting on risk management and internal control. Thereafter, social issues like corporate social investments, environmental issues etc. are analyzed.

Direct quotations out of the annual reports are printed in italics and not individually cited anymore. Due to the particular nature of the business and their situation in emerging countries, this paper focuses in particular on auditing and control.

Use of derivatives, risk reporting, payment to board members and executives, including interests in contracts, board charter, code of ethics.

AngloGold Ashanti

About the company

AngloGold Ashanti became included into the JSE Sustainability Index 2008 and was nominated as one of the sixteen "Best Performers" in the 2008 index. The company won the Southern African Institute of Chartered Secretaries and Administrators and the JSE Limited's Annual Report Award.

The company has undergone a severe reorganization of its business and has aimed to refocus on the core of its business. An introductory statement about management reports about these happenings

"Operational restructuring has been undertaken across AngloGold Ashanti over the past two years to align the company's structure with the revised corporate strategy and the new executive team, so as to bring the company's leadership closer to the operations".

The board

The board faced in 2008 the handling of the global financial crisis, particularly driven by a strong decline of the gold price. In addition, the board was engaged in the successful refinancing of the company's convertible bond, due in February 2009.

The board structure of Anglo-Ashanti is strongly in line with the recommendations of the King III. The board is directed by an independent non-executive director, and so is its deputy. The two executive directors share their attendance in the board with 10 independent non-executive directors.

The number of directors in other companies varied widely. One company had a board consisting of 12 directors (10 non-executive, 8 of which are independent), 6 directors (5 non-executive, 0 independent) and the other of only two (one non-executive). Thereby, all companies had half or way more than half of their board consisting out of non-executive members.

Directors are required to retire every three years at the annual general meeting which is a suggestion from the King III report. New directors can be appointed by the board after suggestion by the

Nomination Committee. These directors have to stand election by shareholders in the next annual general meeting.

The board has the following committees:

- audit and corporate governance committee,
- Transformation and Human Resources Development Committee (formerly the Employment Equity and Development Committee),
- Investment committee,
- Nominations committee,
- political donation committee
- remuneration committee
- Safety, Health and Sustainable Development Committee.

• In addition the board has a sub-committee for Treasury.

This rich selection of committees is unique. The other companies in the gold sector had either the minimal committees required by the King III code (Auditing and Remuneration committee). One company had a transaction committee in place, to approve any transaction proposed by the company advisors.

The company offers detailed descriptions about the set-up and meetings of the committees. Still, little is known what they were actually doing throughout the year.

The appointment of directors is a matter for the board as a whole but the Nominations Committee, whose membership comprises solely of independent non-executive directors, is responsible for identifying and recommending suitable candidates for appointment to the board. The fit and proper standards policy for directors guides this process. The committee is also responsible for establishing and reviewing succession plans for members of the board, particularly those of the chief executive officer and board chairman. Mrs E Le R Bradley resigned from the committee on 6 May 2008. No meetings of the committee took place during 2008.

Interestingly, the company issues a list of policies issued by the board of directors, including any changes made to them throughout the last year. There is a whistle-blowing policy in place which can be downloaded.

There are several mediums by which reports can be made such as through the intranet, internet, telephone, fax and post. An initiative is being undertaken to implement short messaging system (sms) as a medium for reporting as well.

These statements on policies were unique and no other company in the sector reported on these issues.

Director's share trading

Directors as well as employees of AngloGold Ashanti who have access to price sensitive information are prevented to trade in the company's shares during certain closed periods. Closed periods last from the end of the reporting period to the date of publication of the quarterly, half-yearly and year-end results. If

directors and key employees want to deal with the company's shares, they are obliged to follow a formal process. Dealing in warrants and derivatives of the company is forbidden to them at any time.

All other companies in the gold sector reported on their major share holdings, the shares and options that their directors and members of the management committee hold and on their procedure on director's share dealing.

Audit and Corporate Governance Committee

The Audit and Corporate Governance Committee consists of only independent non-executive directors (as demanded by the Sarbanes-Oxley Act). Prof Wiseman Nkuhlu acts as the board's financial expert.

The internal audit manager enjoys unrestricted access to the chief executive officer and the chief financial officer, the board chairman and the chairman of this committee, and is invited to attend all committee meetings and to report on his department's activities. This privileged access enables him to perform his duties to the company. The function, duties and powers of the internal audit department, for which the group internal audit manager is responsible, are governed by a formal internal audit charter approved by the committee. At the meeting of the group internal audit managers with committee members, the management is not present. The same applies for meetings with the external auditors. The committee examines the risk policies of the company (risk identification and the risk management process), ensuring compliance with the guidelines of the King Code and the requirements of the US Sarbanes-Oxley Act and advises the board on the effectiveness of the risk management system.

The Remuneration Committee, responsible for evaluating the performance of executive directors and executive management and for the appropriate payment of the company officers. A detailed list about the remuneration payments for all directors and information on the Share Incentive Scheme can be downloaded. The performances of the executive directors take prevailing business climate and market conditions into account, as well as annual evaluations of the achievement of key predetermined objectives. Bonuses for executive directors depend on both, their individual performance and the company as a whole.

Risk Management and Internal Control

The statements about risk management and internal control are strongly directed towards compliance with the applicable laws and regulations.

The risk management system's focus is to ensure that the requirements of the South African King Code and the US Sarbanes-Oxley Act are met. In conducting its annual review of the effectiveness of risk management, the board considers the key findings from the ongoing monitoring and reporting process, management assertions and independent assurance reports.

All other companies mentioned their concern of internal controls and an internal auditing function.

The report include a comprehensive list of all relevant risks related to the gold mining industry in general like

- Global economic conditions could adversely affect the profitability of AngloGold Ashanti's operations.

- Commodity market price fluctuations could adversely affect the profitability of AngloGold Ashanti's operations.

- Uncertainty and costs of mining exploration and acquisition

- Development risk

- Ore reserve estimation risk

- Production or mining industry risk

and to the operations of AngloGold Ashanti in particular like

- AngloGold Ashanti's level of indebtedness could adversely affect its business.

- AngloGold Ashanti uses gold hedging instruments and has entered into long-term sales contracts, which may prevent the company from realizing potential gains resulting from subsequent commodity price increases in the future. AngloGold Ashanti's reported financial condition could be adversely affected as a result of the need to fair value all of its hedge contracts.

- Power stoppages, fluctuations and energy cost increases could adversely affect AngloGold Ashanti's results of operations and its financial condition.

- Foreign exchange fluctuations could have a material adverse effect on AngloGold Ashanti's operational results and financial condition.

- AngloGold Ashanti's new order mining rights in South Africa could be suspended or cancelled should the company breach, and fail to remedy such breach of, its obligations in respect of the acquisition of these rights.

- The introduction of South African State royalties where a significant portion of AngloGold Ashanti's Mineral Reserves and operations are located will have an adverse effect on its results of operations and its financial condition.

- AngloGold Ashanti's Mineral Reserves, deposits and mining operations are located in countries that face political, economic and/or security risks.

- AngloGold Ashanti competes with mining and other companies for key human resources.

- AngloGold Ashanti faces certain risks in dealing with HIV/AIDS that may adversely affect the results of its operations and the company's financial condition.

- AngloGold Ashanti faces certain risks in dealing with malaria and other tropical disease outbreaks, particularly at its operations located in Africa, which may have an adverse effect on operational results.

- The treatment of occupational health diseases and the potential liabilities related to occupational health diseases may have an adverse effect upon the results of AngloGold Ashanti's operations and its financial condition.

- The costs associated with the pumping of water inflows from closed mines adjacent to AngloGold Ashanti's operations could have an adverse effect upon operational results.

Risks related to AngloGold Ashanti's ordinary shares and American Depositary Shares

- Sales of large quantities of AngloGold Ashanti's ordinary shares and ADSs, or the perception that these sales may occur, could adversely affect the prevailing market price of such securities.

- Fluctuations in the exchange rate of currencies may reduce the market value of AngloGold Ashanti's securities, as well as the market value of any dividends or distributions paid by AngloGold Ashanti.

- The recently announced proposal by the South African Government to replace the Secondary Tax on Companies with a withholding tax on dividends and other distributions may impact the amount of dividends or other distributions received by the company's shareholders.

One other company reported on operational risks. All companies in the sector gave a detailed analysis of their financial risks, mainly credit risk and liquidity risk. Only one company specifically named commodity price risks. Interesting are the sensitivity analysis that AngloGold Ashanti discloses. As the mining operations consume a lot of oil, the company discloses its price dependency on the rise of oil.

...for each \$1 per barrel rise in the oil price, the average cash costs of all its operations increases by about \$0.50 per ounce with the cash costs of certain of its mines, which are more dependent on fuel, being more sensitive to changes in the price of oil.

This increase in production capacity expansion has taken place, in certain instances, without a concomitant increase in the capacity for production of certain strategic spares, critical consumables and mining and processing equipment used to operate and construct mining operations, resulting in shortages of, and an increase in the lead times to deliver, these items.

All companies reported on their internal control system and their regular reviews. Only two companies had an internal audit activity established. One company reports that it is regularly reviewing the need for it:

Due to the dormant status of the business, the company has not established an internal audit function. As the business and operations grow going forward, the need for such a function will be revisited on a regular basis.

Only AngloGold Ashanti reported the use of derivatives to hedge the risk of movements in the price of gold:

A number of products, including derivatives, are used to manage the gold and silver price and foreign

exchange risks that arise out of the group's core business activities. Forward sales contracts and call and put options are used by the group to manage these risks. At year end, the volume of outstanding forward sales contracts was 39,990kg (2007: 108,403kg). The volume of outstanding net call options sold was 146,542kg (2007: 242,373kg) and the volume of outstanding net put options sold was 16,963kg (2007: 46,585kg).

As the group does not enter into financial instruments for trading purposes, the risks inherent to financial instruments are always offset by the underlying risk being hedged. The group further manages such risks by ensuring that the level of hedge cover does not exceed expected sales in future periods, that the tenor of instruments does not exceed the life of mine and that no basis risk exists.

Shortage of skills

As in so many sectors of the South-African economy, there is a prevailing shortage of skills in the mining industry. Being aware of the threat that this situation can impose on a company of this size, Anglo Gold Ashanti introduces the System for the Management of People. Unfortunately there is no more information about this approach.

Given AngloGold Ashanti's renewed vision and values and revised corporate strategy, a complete review of the group's human resource management systems and structure, called the System for the Management of People (SMP) is being undertaken. Given the changing world of work, the current socio-economic climate and continued key skills shortages in the mining industry, this is considered a strategic imperative.

Working in the mines has always been associated with a work environment that is potentially detrimental to one's health. Occupational risks therefore take a prominent position in the consideration of the company. The most significant occupational health risks at AngloGold Ashanti are: occupational lung disease (silicosis and occupational tuberculosis in underground operations that are host to quartz-bearing rock), noise-induced hearing loss, heat stress and radiation. Occupational health regulations in South Africa require an ongoing biological monitoring for lead, mercury and arsenic, among others.

From a regional health perspective, malaria is identified as an area of concern for the company's operations in Ghana, Guinea, Mali and Tanzania. Therefore, the company runs a malaria control programme with the following steps:

- information, education and communication, particularly among the communities;
- vector control, which is essentially the control of mosquitoes through indoor residual spraying and larviciding of breeding areas;
- early, effective diagnosis and treatment; and
- surveillance, monitoring and research.

All other companies report the shortage of skills as a major issue.

Environmental concerns

Major issues for AngloGold Ashanti are old areas of operations which were established at times before environmental standards were introduced. This resulted in several operations being unable to meet current requirements. AngloGold Ashanti also addresses climate change and reports on the introduction of a project which was still in the beginning

In 2008, AngloGold Ashanti embarked on a process to develop a business case for responding to climate change, with 2007 used as the benchmark year. A three-part study, begun in detail in September 2008, includes:

- *a group-wide assessment to determine in more precisely the greenhouse gas footprint of all AngloGold Ashanti; and*
- *a comprehensive assessment to determine risks to which the company is exposed as a result of climate change.*

Interestingly, all other companies did not report on environmental issues.

Human rights

Discrimination, particularly on the basis of race, is a huge issue in African Societies. Most countries in which the company operates have a very strict legal system against such developments. In addition and probably beyond the regulations, the company has introduced a couple of policies to deal with this issue.

Policies are in place at all operations to protect employees from prejudice and, in some countries, to promote the advancement of certain groups of employees. Specifically in countries in Africa and in Australia, the rights and promotion of indigenous peoples, the historically disadvantaged and women are provided for in law and adopted and followed by the company.

The company offers the download of their social and labour plan which is demanded by the Mineral and Petroleum Resources Development Act (MPRDA) of South Africa. Submission and adherence to such a plan is a condition for the granting of new order mining rights. Also, the companies are obliged to give back to the communities close to the mining operations which home their workers.

To actively tackle the technical skills that are linked with disciplines such as mining, metallurgy, and engineering which are key to continued operations, the company offered bursaries within these fields of study. Once these skills are required, the company is focusing on the retention of these key personnel. The company gives 70% of these bursaries to so called historically disadvantaged South Africans, but notes that it takes a long time until these students reach the level of top management. On average, the company spends 4-5% of their payroll towards skills

development. Throughout the commodity boom, the company lost a great deal of their employees.

In particular, employees in the Officials ranks (Geosciences, Shift bosses, Engineering and Metallurgical Foremen and selected others such as Training Officers in the technical fields and Rock Engineering Officers) were in high demand. For Miners and Artisans the company offered a salary increase together with a retention bonus.

LUKOIL

In the Russian Federation, the two companies LUKOIL and Rosneft are quite equal in importance, with Rosneft having a higher market share in Oil and LUKOIL a higher market share in the gas production.

In the year of the report, the company took on two unsecured credits (\$ 530 mio for 3 years at LIBOR+3,25%) to acquire 100% of the Turkish company Akpet and a 49% of the ISAB refining complex in Italy. Now, LUKOIL's level of information disclosure and the quality of the disclosed information comply fully with internationally accepted standards and with standards. Interestingly, the company reports on its successful use of a companywide treasury department and reports cost savings achieved by that. The company has introduced an information openness policy since its listing at the LSE in 2002.

Throughout the last years LUKOIL engaged in a major restructuring program.

LUKOIL has been implementing a restructuring program since 2002. The main aim of the program is to increase shareholder value through increased transparency and efficiency of management processes, consolidation of core subsidiaries and withdrawal from the group of non-core and inefficient assets.

Also, the company added a new business sector, namely Power Generation to its portfolio.

Other companies in the Russian oil and gas sector conducted similar restructuring programs, like Tatneft:

Active restructuring of the Company was performed under improvement of production and management organization. Non-core activities were withdrawn from TATNEFT. As a result of restructuring, 72 enterprises working in the main areas of oil service and 10 companies working in the non-productive area were created as of Jan. 1, 2009 instead of 127 enterprises, structural divisions, workshops and sites.

As a part of the corporate management improvement and corporate restructuring, the Company formed an institute of Management Companies with breakdown by segments of activities. The Company also implemented uniform corporate standards and determined priorities of investment policy on a strategic basis.

LUKOIL states right at the beginning of the corporate governance section, that the system of corporate governance, which has been put in place by

LUKOIL, is an effective tool for protecting the rights and observing the interests of Company shareholders.

Board of directors and management

LUKOIL has 23 directors, 11 of which are non-executives (five are independent). The company operates a strategy and investment committee, human resources and compensation committee and an audit committee. The description of the committees is short, but comprises the necessary information, namely its scope of responsibilities and its members.

In other oil and gas producing companies, the number of directors and members of the management committee is smaller. For example, Tatneft's board consists of 17 members, Rosneft's board 10.

LUKOIL presents its board of director and members of the management committee with a short CV. When reading through these impressive CVs it becomes clear how important LUKOIL is for Russia. As an example, one finds the president of the Moscow State Law Academy or the director of the Russian Institute of Directors or the president of the Russian Union of Industrialists and Entrepreneurs and president of the State University – Higher School of Economics.

Also other companies in the same sector have quite prominent members in their board of directors. In Tatneft for example the reader finds the Minister of land and property relations of the republic of Tatarstan or the director of the almetyevsk branch office of the national non-state retirement fund.

The remuneration for each of the members of the board of directors and the management committee is clearly indicated. Each member received 4.3 mio roubles, and some got additional payments like the remuneration for the Board chairman etc.

The disclosure of his information depends on the company. Whereas Rosneft gives a detailed list of remuneration for its management, Surgutneftegas for example, only discloses the total amount of payment to the board and management committee:

Remuneration is paid to the members of the Board of Directors in compliance with the Company's Charter. Remuneration paid to the members of the Board of Directors in 2008 totaled RUR 17,719,217. Tatneft adds this piece of information to its footnotes:

The total sum of remuneration paid to all members the Board of Directors for the year 2008 amounted to 256 million rubles. Remuneration for persons in the Board of Directors and Collegial Executive Body (Management Board) is accounted in the amount of remuneration for all members of the Board of Directors. The total sum of remuneration paid to all members of the Collegial Executive Body for the year 2008 amounted to 134.7 million rubles.

Risk management and internal control

Interestingly, there is an own section reporting about internal control and audit.

The system of control and internal audit is an integral part of the Company's corporate governance

structure, enabling the company to function efficiently and the interest of its shareholders and investors to be protected. The Group has created a Unified Control and Internal Audit Service, which ensures that management receives objective and accurate information on the business of organizations in LUKOIL Group and of its structural subdivisions.

21 control and internal audit checks at the LUKOIL Group in 2008. The audits followed a risk-based approach. The tasks of the checks included the analysis of business efficiency, investment efficiency, the identification of risks or the assessment of measures by management of subsidiaries and structural subdivisions to allow the different components in different subsidies to correspond.

In addition, LUKOIL set up audit commissions which were elected in 69 subsidiaries and affiliates of the company. Key areas of control were procedures and authorizations in conduct of transactions affecting the interests of Company shareholders and investors. The company is working on its system for conduct of tendering procedures as an internal control procedure. This system allowed the company to save \$26 mio due to tighter control and improved quality of assessment.

Rosneft also operates audit commissions and states their scope

The Commission carries out an obligatory audit of annual financial and operating results for the year (no later than 60 days after the end of the financial year) as well as additional audits, as proposed by the Commission, or subject to a decision of the General Meeting of Shareholders, the Board of Directors or upon demand of shareholders who own no less than 10% of voting shares of the Company.

Only one company does not mention their system of internal control or an internal audit in the annual report. Of the four companies analyzed, only two made use of derivative instruments. In both cases these were used as a hedge against interest rate risks.

Environmental issues

LUKOIL has a very extended chapter in its annual report devoted to environmental issues in which it states that \$700 mio was spend by LUKOIL Group in 2008 on measures to ensure environmental safety. In addition, LUKOIL focuses on the recycling of accumulated and newly generated waste, raising the level of utilization of associated gas to 95% by 2012, implementing the mechanisms of Kyoto Protocol.

The company completed implementation of the Environmental Safety Program at LUKOIL Group organizations for 2004-2008. More than \$1.2 billion was spent on the Program implementation in the course of five years. Results achieved by the Program make LUKOIL a leader in terms of main environmental indicators among companies in the fuel and energy sector.

LUKOIL also describes situations in which they have improved their environmental standing

The company's new filling stations are equipped with systems for returning gasoline fumes from the reservoir to tankers during discharge of petroleum products, as well as systems for preventing spillages of petroleum products from reservoirs and facilities for waste-water purification.

All the other companies in the Russian oil and gas sectors have implemented programs to deal with pending environmental issues.

Following its industrial and consumption waste management program, the Company intends to complete construction of 4 temporary storage and disposal plants for oil sludge and other oily wastes, including 3 plants, which will be outfitted with thermal waste liquids separation and treatment facilities with one of the plants already located in Eastern Siberia (Surgutneftegas).

Tatneft, on the other hand, has an integrated uniform policy regarding industrial safety, labor safety and environmental protection which was approved January 21, 2008.

New versions of the following corporate system-wide documents came into effect in 2008:

- Manual for integrated management system of industrial safety, labor safety and environmental protection of OAO TATNEFT;
- Procedure for management of industrial risks of OAO TATNEFT;
- Manual for internal audit of integrated management system of industrial safety, labor safety and environmental protection in OAO TATNEFT.
- Ecological safety and environmental activity of the Company are regulated by a special corporate Ecological program for the period of 2000-2015. The program is aimed at maintenance of environmental condition of TATNEFT activity regions at the admissible level corresponding to potentiality of self-recovery of natural ecological systems.

To keep track of the effectiveness of their environmental programs, Tatneft runs a system of key-figures which are listed in their annual report.

Main indices of Company activities for ecological safety and reduction of impact on environment

No.	DESCRIPTION	MEASURE UNIT	REPORT	
			2007	2008
1	Gross emission of harmful substances into the air	K tons	79.8	76.9
2	Specific emissions of polluting substances into the air per 1 ton of produced oil	kg/t	3.099	2.985
3	Trapped and neutralized polluting matters	K tons	0.179	0.185
4	Resources of associated oil gas	Million m ³	785.3	805.3
5	Oil gas utilization level	%	94.0	94.6
6	Fresh water consumed	Million m ³	36.324	30.232
7	Specific discharge of polluted waste water into surface water bodies per 1 ton of produced oil	m ³ /t	0.022	0.016
8	Produced wastes per annum	t	126,945.3	105,098.2
9	Wastes at the company by the end of the year	t	383.5	29.2
10	The area of disturbed lands by the beginning of the year	hectare	484	372
11	Ecological damage from failures	Thousand rubles	–	–
12	Ecological payments	Thousand rubles	105,319.9	52,574.1
13	Investments into the main capital, used for environmental protection purposes	Thousand rubles	243,683.3	301,316.4
14	Current environmental protection expenses	Thousand rubles	3,706,399.0	3,566,249.9

LUKOIL faces a shortage of skills in their sector and tries to tackle to situation with individual incentives. The annual report provides insights into some of them. In addition to material incentives the Company uses moral encouragement as a way of developing personnel potential: 33 company employees received national awards for professional excellence, and for conscientious and successful work, while 814 were awarded sectoral marks of distinction for their work... Also, the company held a competition for the title of "Best Employees and

Organizations in LUKOIL group". The group spent a total of 348 mil \$ on the program total. There is also a strong social package for employees in place.

In their Industrial Safety and Labour Protection section, LUKOIL includes a detailed list of the number of accidents and the lost time injuries.

There were 10 comprehensive and 15 targeted inspections at Group organizations in the accounting year to determine the state of industrial safety and labour protection management systems and enforcement of the Management Committee decision

on increase of employees' responsibility for industrial safety and labour protection requirements. These actions were in response to a rise in the number of fatalities within the Company from 7 in 2007 to 13 in 2008.

LUKOIL uses the whole spectrum of modern training aids: workshops, seminars away from the working place, special training programs, work placements abroad, training sessions, courses to gain higher qualifications, professional training days, distance learning, MBA programs, etc.

Lots of cooperations, including the Gubkin Russian State Oil & Gas University, the Russian Government Financial Academy, the Oil & Gas Business Institute and the Higher School of Economics.

Corporate Social Investment

Social policy and charity: "social and charity programs are an integral part of the company's corporate strategy and help to ensure constructive partnership with the state, business and society".

As well as traditional forms of charity, LUKOIL carries out strategic charity programs and social investment programs, which find synergies between approaches to social problems and the Company's strategic aims. Total spending by the Company in 2008 for charity and social partnerships was in excess of \$ 180 million.

LUKOIL has established a social code which all subsidiaries of LUKOIL have to follow. They won the price for Russian Corporate Donor 2008.

The company continues to deliver on commitments, which it undertook voluntarily and on its own initiative under the LUKOIL Social Code. This Code is obligatory for all LUKOIL organizations and represents a set of principles and norms of socially responsible behavior towards all parties whose interests are affected by Company business.

LUKOIL supports more than 50 children's homes and boarding schools and finances summer vacation for children on the Black Sea and the Caspian Sea. They also run an ambitious social project competition, which allows different projects to apply for funding. The company states that the competition budget in 2008 was 25 times bigger than in 2002.

- Support for medical institutions
- Preserving cultural and spiritual heritage
- Help to war veterans and the disabled
- Support for northern people
- Sport

Oil workers and other veterans of the Great Patriotic War (World War II), as well as veterans of the labour front, have a special place in LUKOIL's social program. Every year veterans who live in regions where the Company has operations receive special payments and gifts from the Company to coincide with Victory Day.

Conclusion

The eight companies that were compared in the light of their corporate governance reporting provided an interesting case to see differences in company reporting throughout industries and countries. The board of directors (including the management team) is much larger in Russian oil and gas producers than in South African gold companies. The ratio of executives to non-executives was in both cases in favor to the latter. Also, the members of the board of the Russian companies might be more prominent and probably more associated with the public life. Three of the four gold producers revealed the direct compensation to their directors, whereas only two of the oil and gas producers did.

Both the reporting about the internal control system/internal audit and the reporting about the environmental concerns were more sophisticated on the side of the Russian oil- and gas producers. Three Russian companies reported on internal control and had an own internal audit activity. One company, Surgutneftegas, didn't report anything about their internal control and internal audit. Their South African counterparts in return only had internal audit activities in two of the four companies. It seems that the Russian companies provide more quantitative materials in addition to the financial statement. This paper questions the notion of Russian companies as closed and inaccessible for foreign investors.

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