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Diverse Economies—Same Problems: The Struggle for Corporate Governance Reform in Russia and the United States

Colleen R. Stumpf*

I. Introduction to the Need for Corporate Governance Reform

Since the fall of the Soviet Union and the subsequent transition to a capitalist economy, new businesses have appeared rapidly in Russia.¹ However, entrepreneurs, and even experienced business professionals, struggle in the new Russian corporate climate due to a lack of corporate governance.² Aleksei Panteliushin, for example, the owner of a sausage factory, arrived at his facility one morning only to find it guarded by its “new owners.”³ The “new owners” obtained control of the factory by exploiting the weak enforcement of corporate governance laws in Russia as well as through outright theft.⁴ Questions relating to corporate

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1. *Why Russian Companies Need to Improve Corporate Governance*, International Finance Corporation Russian Corporate Governance Project, at http://www2.ifc.org/rcgp/adv_en.htm (last visited Jan. 17, 2006).

2. *Id.* The International Finance Corporation and this Comment consider corporate governance as “a system of interaction and mutual accountability of shareholders, board of directors, managers and other stakeholders (employees, creditors, suppliers, local authorities, public associations, etc.), aimed at maximizing the company’s profits in accordance with current legislation and international standards.” *Id.*

3. *Survey: Watch your back*, *ECONOMIST*, May 22, 2004, at 13.

4. *Id.* Mr. Panteliushin began his fight to regain ownership of his sausage factory in February 2004. *Id.* The “new owners,” or “goons,” scheme to appropriate the factory began when they called a fictitious shareholder meeting and appointed a new factory director. *Id.* The director sold the factory to another firm, which immediately resold the factory. *Id.* Each subsequent owner re-registered his ownership of the company after the sale, creating a paper trail, but one that is almost impossible to follow. *Survey: Watch your back*, *supra* note 3. The “goons” then physically took over the factory, destroyed the shareholder register Mr. Panteliushin kept in the factory safe and

governance, such as monitoring, transparency, and the roles of officers and the board of directors arose as news of similar corporate scandals in Russia have come to light in recent years.⁵

Likewise, investigations of corporate scandals within highly valued American companies, such as Enron, Tyco, and WorldCom, saturate the international news.⁶ Seemingly countless stories emerged of employees who not only lost their jobs⁷ but all of their savings⁸ because of the fraudulent practices of numerous companies.⁹ The large number of scandals led to concerns regarding the state of corporate governance in the United States.¹⁰ Investor confidence slipped,¹¹ contributing to a weaker stock market¹² and increasing demands for corporate accountability.¹³ Questions of monitoring, transparency, and the roles of

bought any remaining shares from the employees at a discount. *Id.* The alternative to selling? Being fired. *Id.*

While the goons' scheme may have been relatively simple, it was extremely expensive; the cost of "necessary" bribes, hiring thugs, share buy-outs, and lawyers' fees brought the price of the "takeover" to over \$300,000 (USD). *Id.*

During the "takeover" process, the goons offered to sell the factory back to Mr. Panteliushin for \$6 million (USD), several times the factory's fair market value. *Id.* Unfortunately, Mr. Panteliushin did not have the resources to buy back his factory, and instead, he reported the incident to the local police, the internal security agency, tax officials, and the Economic Security Commission. *Survey: Watch your back, supra* note 3. None of these governmental entities would offer any support without substantial compensation; however, they did inform Mr. Panteliushin of similar takeovers that had occurred in his region of Russia. *Id.* Governmental agencies finally did become involved in the case after a local newspaper and *The Economist* ran the story in May 2004. *Id.* While this intervention may help Mr. Panteliushin, only the enforcement of laws addressing corporate governance can help his colleagues. *Id.*

At the time the article ran in *The Economist*, Mr. Panteliushin and the goons were in a stalemate over a solution. *Id.* Companies that originally made offers to buy the factory withdrew them after the authorities became involved. *See Survey: Watch your back, supra* note 3. The goons were becoming more desperate to sell because, while they know how to take over companies, they do not know how to make sausage. *Id.*

5. Yelena Shuvalova, *Business: Corporate Governance Begins to Change in Russia*, *RUSS. J.*, Jun. 20, 2003, at 64-66.

6. *Accounting Problems with WorldCom: Hearing of the H. Comm. on Fin. Services*, 107th Cong. (2002) [hereinafter *Accounting Problems with WorldCom*] (statement of Rep. Michael Oxley, Chairman, H. Comm. on Fin. Serv.).

7. *Id.*

8. *Id.*

9. *Id.*

10. *Conference Report on Corporate Responsibility Legislation*, H.R. 3763, 107th Cong. (2002) (statement of Rep. Michael Oxley, Chairman, H. Comm. on Fin. Serv.).

11. *Id.*

12. *Id.*

13. *Id.* Rep. Oxley stated that it is his belief that the market decline was not a result of the inability of American companies to "compete and excel." *Id.* He blames high-ranking corporate officials, who misled investors and, accountants, who ignored the actions of the corporate officials. *Conference Report on Corporate Responsibility Legislation, supra* note 10.

officers and the board of directors,¹⁴ the same inquiries that are at the forefront in Russia, suddenly arose in the United States—a country with an advanced economy and a sophisticated corporate governance system.¹⁵

In the midst of their individual corporate governance problems, both Russia and the United States recognized that investor confidence is essential to the success of companies.¹⁶ In order to bolster fragile investor confidence, the United States and Russia promulgated measures to reform corporate governance.¹⁷ These measures, which came from nations that are struggling with corporate governance, are strikingly similar in some respects, but, in the same way that the countries have divergent economic histories, the measures are completely divergent in other respects.

Russia's Federal Commission for the Securities Market ("FCSM") introduced the Code of Corporate Conduct ("Code") in 2002¹⁸ as a compilation of best practice recommendations to which the FCSM encourages companies to adhere. The Code addresses topics such as monitoring, transparency, and the board of directors.¹⁹ Also in 2002, the United States Congress passed the Sarbanes-Oxley Act ("SOX"),²⁰ a set of mandatory provisions that President George W. Bush described as "the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt."²¹ SOX, like its Russian counterpart, also addresses aspects of monitoring, transparency, and the board of directors.²²

In the years since the adoption of these provisions, proponents of increased corporate governance have welcomed the new provisions,²³

14. *Id.*

15. *Id.*

16. *Id.*; *Corporate Governance in Russia: Regime Change Required*, TRANSITION: NEWSL. ABOUT REFORMING ECONOMIES (The World Bank, Washington, D.C.), Jan. 2003, at 21. Investor confidence occurs when companies disclose their actions to shareholders and stakeholders, enabling shareholders and stakeholders to use that information to participate, freely and intelligently, in the ownership of the company. *Corporate Governance in Russia: Regime Change Required*, *supra* note 16, at 21.

17. Conference Report on Corporate Responsibility Legislation, *supra* note 10; Corporate Governance in Russia: Regime Change Required, *supra* note 16, at 21.

18. *Corporate Governance Members Briefing*, 11 RUSS. BUS. WATCH 1, 11 (2003). The FCSM is the principal governmental creator of corporate governance legislation in Russia. *Id.*

19. *Id.* at 11-12.

20. Remarks on Signing Sarbanes-Oxley Act of 2002, 38 WKLY. COMP. PRES. DOC. 1284, (July 30, 2002).

21. *Id.*

22. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002).

23. See Judith Burns, *Is Sarbanes-Oxley Working? We asked a variety of experts; Most of them said yes—with some caveats*, WALL ST. J., Jun. 21, 2004, at R.1; see also

highlighting the fact that they help to increase investor confidence and limit the number of corporate financial scandals.²⁴ Critics, however, have challenged such claims.²⁵ They question whether the provisions adequately address the demand for corporate accountability²⁶ and wonder if companies actually adhere to the internal and external supervision standards outlined by the regulations.²⁷

This Comment begins with a comparison of the provisions of the Russian Code of Corporate Conduct to the U.S. Sarbanes-Oxley Act, in light of their provisions addressing internal and external monitoring. More importantly, however, this Comment then analyzes these provisions in order to determine if they are indeed addressing the demand for corporate disclosure, transparency, and accountability in their respective countries. Section II explores the historical background of both the Code and SOX, with significant focus on the corporate development of each country. Section II also outlines how each country developed a hierarchy of review in order to provide for internal and external audits of business decisions. Section III focuses on the comparison of these supervision standards. This section endeavors to show how the standards (1) deal with the corporate governance deficiencies in each country and (2) attempt to achieve corporate accountability and transparency by using internal and external audits.

Section IV discusses the domestic and international reactions to these promulgated provisions, as well their perceived effectiveness. Section V suggests improvements to the Code and SOX, focusing on the necessity for enforcement of the Code and the need for a cost analysis of SOX.

Section VI concludes that although both countries have taken significant steps toward the development of corporate governance, more work needs to be done. This Comment resolves that, at the very least, each country must educate those involved in business as well as the public regarding the benefits of sound corporate governance. At most, the entire mindset of the business world needs to change and accept that corporate governance is essential to successful organizational development and is not merely good business practice.

II. Background of the Provisions

The rationale driving the creation of the Russian Code and the

Shuvalova, *supra* note 5, at 61-64.

24. *See* Burns, *supra* note 23, at R.1.

25. *See id.*

26. *Id.*

27. *See id.* Critics question if the cost of adhering to the new regulations is actually worth the trouble. *Id.*

United States' SOX was primarily the same: the regular occurrence of corporate scandals caused by a lack of adherence to corporate governance standards.²⁸ However, the reason for the lack of corporate governance differed significantly in each country.

A. The Development of Russia's Code of Corporate Conduct

Although the Soviet Union collapsed nearly fifteen years ago,²⁹ Russia is still in the process of developing a viable market-based economy.³⁰ Corporate governance, with its focus on corporate accountability, is one piece necessary for the creation of a successful capitalist economy.³¹ This fact should not diminish the importance of effective corporate governance because its absence contributes to many of the current market problems.³² The FCSM recognized the significance of sound corporate governance and the need to improve Russia's floundering corporate governance. In response to these needs, the FCSM developed the Code of Corporate Conduct.³³

1. Country Conditions Creating a Need for Corporate Governance Reform in Russia

Modern corporate governance has existed in Russia only since the fall of the Soviet Union.³⁴ This historical failing is one of the country's

28. The Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002 (Day 3): Hearing on H.R. 3763 Before the H. Comm. on Fin. Serv., 107th Cong. (Apr. 9, 2002) [hereinafter *The Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002*] (statement of Rep. Mike Ferguson, Chairman.); *see also* Svetlana Letova, *Business: Cleaning Up*, *RUSS. J.*, Mar. 31, 2003, at 84.

29. Nicholas V. Riasanovsky, *A History of Russia* 611 (6th ed. 2000).

30. HUGH RAGSDALE, *THE RUSSIAN TRAGEDY: THE BURDEN OF HISTORY* 269-72 (1996); *see* RIASANOVSKY, *supra* note 29, at 601-07. It is an especially difficult transition to a market-economy in Russia because the country has never had a free economy. *See* RAGSDALE, *supra* note 30, at 269-72. Prior to seventy years of Communist rule, the monarchy controlled Russia with the czars keeping strict controls on markets transactions, especially those transactions with foreign nations. *Id.* Even after the collapse of the Communist regime, very few people, even educated business professionals could conceive of working in a corrupt, non-governmental controlled market. *Id.*

31. *Corporate Governance Members Briefing*, *supra* note 18, at 11.

32. *Id.*

33. *Id.*

34. Shuvalova, *supra* note 5, at 64. In comparison, other industrial nations, specifically Western nations, can date their history of corporate governance back hundreds of years. *Id.* Many other countries that are transitioning from Communist economies to market-based economies also are struggling with a lack of corporate governance. *Id.*

Alternatively, Yulia Kochetygova, director of the corporate governance ratings

main obstacles in its transition to a market-based economy.³⁵ Corporate governance shortfalls, characterized by infringements on shareholder rights and poor company management, fed the lack of confidence foreign and domestic investors had in Russian companies.³⁶ Specifically, Russian companies faced the following issues:³⁷

- deficiencies in corporate management relative to transparency;³⁸
- deficiencies in corporate accountability between the management and shareholders;³⁹
- discriminatory treatment of minority shareholders;⁴⁰
- deficiencies in the coordination of shareholders and stakeholders, hindering their ability to successfully advocate;⁴¹
- poor promulgation of corporate governance as a matter of corporate culture;⁴² and
- inefficient enforcement of existing corporate governance legislation.⁴³

President Vladimir Putin recognized these shortcomings, which exist in other industrialized countries, and committed himself and his country to corporate governance reform when he said that

Russia has a strategic goal—to become a country that makes

department at Standard and Poor's in Moscow, claims that while Russia may lag behind the Western nations in most aspects of corporate governance, the West can learn some valuable corporate governance lessons from Russia. Vladimir Kozlov, *Corporate Governance: Investor Pressure Forcing Improvement*, RUSS. J., Feb. 22, 2002, at 1. For example, in Russia, one person cannot act as both the chief executive officer of a company and the chairman of that company's board of directors, a practice common in the United States, but which has led to situations where that individual wields too much power without appropriate checks and balances. *Id.* Additionally, only the shareholders of Russian companies have the ability to nominate candidates for the board of directors, a practice to which American companies do not adhere, sometimes resulting in directors who insiders have nominated working for the good of those insiders, rather than working to maximize shareholder value. *Id.*

35. *Corporate Governance in Russia: Regime Change Required*, *supra* note 16, at 21.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Corporate Governance in Russia: Regime Change Required*, *supra* note 16, at 21.

41. *Id.*

42. *Id.*

43. *Id.*

competitive goods and renders competitive services. All our efforts are committed to this goal. We understand that we have to solve questions pertaining to the protection of owners' rights and the improvement of corporate governance and financial transparency in business in order to be integrated into world capital markets.⁴⁴

It is essential that Russian companies improve their corporate governance so that they can attract investment, improve efficiency, and lower the cost of capital.⁴⁵ In an effort to achieve these goals, the FCSM published the Code in April 2002⁴⁶ as a compilation of best practice recommendations that companies are encouraged to adopt.⁴⁷ The standards of corporate behavior found in the Code provide guidance on how to structure relationships found in joint stock companies,⁴⁸ such as the interaction between shareholders, members of the board of directors, and members of the executive bodies.⁴⁹

Russian companies are not required to adopt the Code provisions.⁵⁰ Rather, the government only encourages their use.⁵¹ The Code does urge companies to develop their own corporate governance codes to reflect

44. Russian President Vladimir Putin, Remarks (Oct. 2001), *reprinted in* White Paper on Corporate Governance 3 (Organisation for Economic Cooperation and Development 2002).

45. *Why Russian Companies Need to Improve Corporate Governance*, *supra* note 1. Major investors display a preference for investing in companies, whether domestic or international, which adhere to high standards of corporate governance because these companies have improved their efficiency by streamlining all of their business processes, resulting in a higher rate of return for investors. *Id.* These investors are willing to pay a premium for shares of Russian companies that comply with the same high corporate governance standards as other successful, international companies. *Id.*

46. Governmental agencies, such as the United States Department of Commerce and the United States Agency for International Development, non-governmental agencies, such as the Organisation for Economic Cooperation and Development and the International Finance Corporation, and international organizations, such as The World Bank, all contributed monetary and intellectual resources to assist in the creation of the Code of Corporate Governance. U.S.—Russia Business Council, CODE OF CORPORATE CONDUCT EXECUTIVE SUMMARY (FED. COMM'N FOR THE SEC. MKT. 2002), at <http://www.usrbc.org> (last visited Dec. 18, 2004).

47. *Id.*

48. *Id.*

49. *Id.* Russian "executive bodies" are analogous to "corporate officers" found in American corporations. *Id.* Joint stock companies focus on soliciting capital investment from both domestic and foreign sources, and, consequently, have the greatest potential for corporate governance-related conflicts because there is a substantial separation between the company's shareholders and the company's officers. CODE OF CORPORATE CONDUCT EXECUTIVE SUMMARY, *supra* note 46.

50. U.S.—Russia Business Council, CODE OF CORPORATE CONDUCT INTRODUCTION (FED. COMM'N FOR THE SEC. MKT. 2002), at <http://www.usrbc.org> (last visited Dec. 18, 2004).

51. *Id.*

ethical, rather than legislative, corporate governance requirements.⁵²

2. Supervision Sections of the Code of Corporate Conduct

The Code contains ten chapters that deal with topics ranging from the holding of a general shareholder meeting to the distribution of corporate dividends.⁵³ Many of the provisions are similar to those found in a state corporate code in the United States.

Of particular interest to this Comment are those Code provisions that introduce the four supervisory bodies⁵⁴ responsible for the review of a company's daily financial and business operations.⁵⁵ The goal of supervision is to protect shareholders' capital investments and the assets of the company.⁵⁶ The four monitoring bodies interact to provide the requisite oversight to increase transparency.⁵⁷ The first body is the control and audit service,⁵⁸ comprised of company employees;⁵⁹ the second is the audit commission,⁶⁰ made up of the members of the

52. *Id.* Ethical standards typically are more stringent than statutorily created standards, because legislators often dilute statutory standards so that the legislation can be passed. *Id.* Ethics, however, present "a set system of behavioral norms and customs of the trade traditionally applied by the business community, which are not based on the law, and which form positive expectations with respect to the anticipated behavior of participants in corporate relations." *Id.*

53. U.S.–Russia Business Council, CODE OF CORPORATE CONDUCT (FED. COMM'N FOR THE SEC. MKT. 2002), at <http://www.usrbc.org> (last visited Dec. 18, 2004) [hereinafter CODE OF CORPORATE CONDUCT]. The ten chapters are entitled, Principles of Corporate Governance, General Shareholder Meeting, Board of Directors of the Company, Executive Bodies of the Company, Corporate Secretary of the Company, Major Corporate Actions, Disclosure of Information About a Company, Supervision of Financial and Business Operations of the Company, Dividends, and Resolution of Corporate Conflicts. *Id.*

54. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8.

55. *See id.*

56. *Id.* The protection of shareholders' capital investments and company assets will result when the following items have occurred:

- (1) approval and making arrangements for implementation of the financial and business plan;
- (2) establishment of and ensuring compliance with efficient internal control producers;
- (3) implementation in the company of an efficient and transparent management system, including preventing and curing errors and abuses on the part of executive bodies and officers of the company;
- (4) prevention, detection and minimization of financial and operation risk; and
- (5) ensuring accuracy of the financial information used or disclosed by the company.

Id.

57. *Id.* at ch. 8.

58. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8.

59. *Id.*

60. *Id.*

company's executive bodies;⁶¹ the third is the audit committee of the board of directors;⁶² and the fourth is the independent auditors, retained to review the company's financial statements.⁶³

a. The Role of the Control and Audit Service

The audit and control service, whose members are company employees,⁶⁴ performs the first level of supervision⁶⁵ by reviewing the company's daily operations to ensure adherence to the goals of the organization's business and financial plans.⁶⁶ In the hope of obtaining better technical analysis of business operations, the Code recommends that the head of the control and audit service and the majority of the other employees have an advanced financial or economic education, or in the alternative, a legal education.⁶⁷ Consequently, the members of the control and audit service are often better educated than their colleagues.⁶⁸

To avoid influence by company executives, which could have a detrimental effect on the employees' ability to control and review business functions,⁶⁹ the members of the control and audit service are independent of these officers.⁷⁰ One way this independence is achieved is through the unique negotiation of the labor contracts for the members of the control and audit service.⁷¹ The board of directors' chairman personally handles contract negotiations with the head of the control and audit service,⁷² while other service members deal with other company directors.⁷³

A second function of the control and audit service, which exists in conjunction with the audit committee, is to create, implement, and administer an efficient internal system of controls that monitor all business and financial operations.⁷⁴ Internal controls allow an

61. *Id.*

62. *Id.*

63. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.3.3. All members of these groups should have impeccable reputations in their personal and professional business dealings, in order to ensure that they will perform their duties with the best interests of the company in mind. *Id.*

64. *Id.* at ch. 8, § 1.3.5.

65. *Id.* at ch. 8, § 2.1.1.

66. *Id.* at ch. 8, § 1.3.5.

67. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.3.2.

68. *Id.*

69. *Id.* at ch. 8, § 1.3.5.

70. *Id.*

71. *Id.*

72. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.3.5.

73. *Id.* This also is true for those employees that serve on the human resources and remuneration committee or the audit committee. *Id.*

74. *Id.* at ch. 8, § 1.2. The Code defines "internal controls" as control of a

organization to quickly recognize and avoid financial and operating risks, while also preventing potential financial abuses by the company's officers.⁷⁵ The most effective internal controls reduce a company's expenses and facilitate efficient management of the company's resources.⁷⁶

After the completion of a financial or business operation, the control and audit service reviews the documents associated with that transaction. This ensures that the matter conforms to the corporation's business plan⁷⁷ and verifies that the documents adhere to the established internal control procedures.⁷⁸ In particular, the control and audit service determines whether departments obtained the necessary consent from senior members of those departments before executing the business operation.⁷⁹ Additionally, any funds invested in the operation must be a permissible expenditure under the business plan.⁸⁰ Finally, if there are any violations of the internal controls found, the control and audit service reports these infractions to the board of director's audit committee.⁸¹

There are instances when it is necessary for a company to perform business operations that fall outside of the scope of the business plan.⁸² In this situation, the control and audit service preliminarily approves the proposed non-traditional operation.⁸³ Before final consent, the control and audit service determines why the operation was not a part of the original business plan,⁸⁴ why the operation is necessary,⁸⁵ and if it is possible to delay the operation until the transaction can be restructured to fit within the business plan.⁸⁶ The control and audit service presents its findings to the board of directors' audit committee who makes the final decision regarding the actual performance of the proposed operation.⁸⁷

company's financial and business operations, including the execution of the financial and business plan by the company's business divisions. *Id.* The board of directors approves the proposed system of internal controls. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.2.

75. *Id.* at ch. 8, § 1.1.1.

76. *Id.*

77. *Id.* at ch. 8, § 2.1.1. The company's business plan, which all business operations should follow, is a document that defines the business and financial activity of the company. *Id.*

78. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 2.1.2.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at ch. 8, § 2.2.2.

83. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 2.2.2.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* The company's internal documents should vest in the board of directors the ability to veto justifiably any proposed non-traditional operation. CODE OF CORPORATE

By fulfilling these various monitoring functions, the control and audit service is the first line of defense against corporate abuse. However, the potentially more valuable result of the control and audit service is that it directly facilitates the Code's goals of supervision, transparency, and corporate accountability by reviewing the company's daily operations to ensure compliance with the business and financial plans.

b. The Role of the Audit Commission

Members of the company's executive bodies⁸⁸ make up the audit commission, the second level of supervision.⁸⁹ This body has the primary duty of performing the company's annual internal audit,⁹⁰ as well as periodic assessments of extraordinary operations.⁹¹ The members of the audit committee prepare an opinion based upon the conclusions of the audit⁹² that all audit committee members are required to sign.⁹³ If a member disagrees with the commission's report, that member may write a separate dissenting opinion and attach it to the committee report.⁹⁴

c. The Role of the Audit Committee of the Board of Directors

The audit committee, a committee of independent directors, directly controls the business and financial operations of the company.⁹⁵ The audit committee's primary function is to evaluate the performance of,

CONDUCT, *supra* note 53, at ch. 8, § 2.2.2. If it appears that there are many reasonable non-traditional operations that the company needs to perform, the board of directors may want to consider amending the company's business and financial plan to reflect these necessities. *Id.*

88. *Id.* at ch. 8, § 3.1.

89. *Id.*

90. *Id.* at ch.8, § 3.1. The audit committee has ninety days from the date of commencement to complete the annual audits. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 3.1.

91. *Id.* at ch. 8, § 3.1.1. The audit commission conducts extraordinary audits for a specific business operation or all operations over a specified period, as requested by the board of directors or the shareholders. *Id.* Unlike annual audits, the audit commission must complete these audits within thirty days of such a request. *Id.* Within three days of the completion of the extraordinary audit, the audit commission presents their opinion to the party who requested the audit. *Id.*

92. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 3.1.

93. *Id.*

94. *Id.* at ch. 8, § 3.1.4. Decisions made by the audit committee require a majority vote and the Code does not permit audit committee members to transfer their voting rights to third party. *Id.* While the Code does not require a quorum to be present prior to bringing an issue to a vote, it does require that a majority of the audit committee be present to hold a meeting. *Id.* at ch. 8, § 3.1.2.

95. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.3.1.

and adherence to, the company's financial and business plans.⁹⁶ In order for the audit committee to carry out these critical assignments successfully, its members need unlimited access to all of the company's documents.⁹⁷

At each meeting, the audit committee discusses any deviations from the business and finance plans found in the company's documents⁹⁸ and prepares conclusions based upon its analysis.⁹⁹ These conclusions may include: (1) the reasons for violations of the business and financial plans; (2) who might be liable; and (3) recommendations as to how to avoid future infractions.¹⁰⁰ The audit committee presents its conclusions to the entire board of directors.¹⁰¹

d. The Role of the Independent Auditors

The fourth body of supervision outlined by the Code is the independent auditor. An independent auditor certifies that all of the company's financial reports were prepared pursuant to either Russian or international accounting standards.¹⁰² It also reviews the annual reports to ascertain if there are any errors or violations of the law.¹⁰³ The company must amend any infraction the auditor finds before shareholders receive the reports.¹⁰⁴ The auditors should also take part in the annual shareholder meeting so that they may address any issues shareholders raise regarding the annual reports.¹⁰⁵

B. *United States' Sarbanes-Oxley Act*

The world recognizes the United States as a nation with an advanced free-market economy, successful companies, and successful stock markets.¹⁰⁶ However, events in recent years cast doubt on this rosy

96. *Id.* If it is impossible for the entire audit committee to be composed of independent directors, then at a minimum, an independent director serves as the head of the committee, and the members should not be company executives. *Id.*

97. *Id.* at ch. 8, § 2.3.1. The control and audit service, executive bodies, employees, and the independent auditor may provide the documentation to the audit committee. *Id.*

98. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 2.3.1.

99. *Id.*

100. *Id.*

101. *Id.* at ch. 8, § 2.3.2.

102. *Id.* at ch. 8, § 4.1.6.

103. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 4.1.3. The auditors may not repair violations; they may only locate them. *Id.* The audit committee supervises the work of the independent auditors. *Id.*

104. *Id.* at ch. 8, § 4.1.4.

105. *Id.* at ch. 8, § 4.1.3.

106. *See* Accounting Problems with WorldCom, *supra* note 6.

view of America's financial system.¹⁰⁷ The downfall of powerful companies such as Enron, WorldCom, and others,¹⁰⁸ led to concerns about the accountability of American corporations to their shareholders.¹⁰⁹

1. Country Conditions Creating a Need for Corporate Governance Reform in the United States

Corporate governance in the United States, although it has existed for years, was never a hot issue until several years ago.¹¹⁰ The trend of reforming corporate governance began in 2002¹¹¹ when Enron,¹¹² one of the world's largest energy companies,¹¹³ suddenly filed for Chapter 11 bankruptcy,¹¹⁴ causing a loss in share value and the loss of employees' pensions.¹¹⁵

The name "Enron," once symbolizing a strong and powerful company,¹¹⁶ is now synonymous with corporate scandal.¹¹⁷ In the fallout that occurred in the months following the bankruptcy filing, investors, analysts, and the international community discovered that Enron was not the corporate giant most of the world believed.¹¹⁸ The company hid massive amounts of debt by transferring it to off-balance sheet partnerships that technically are permissible,¹¹⁹ but which can lead to questions regarding a lack of transparency.¹²⁰ Additionally, the use of the partnerships to shield debt made Enron's debt ratios appear more favorable to investors,¹²¹ although the company was unable to cover their obligations.¹²² The federal government launched an investigation of Enron after some company executives found shredded materials in the

107. *See id.*

108. *See id.*

109. *See id.*

110. *See generally id.*

111. *See generally* Accounting Problems with WorldCom, *supra* note 6.

112. For a thorough discussion of Enron and the company's accounting scandal from the perspective of the Enron employee and whistleblower, Sherron Watkins, *see* MIMI SWARTZ & SHERRON WATKINS, *POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON* (2004).

113. *See* Kurt Eichenwald, *Enron's Collapse; Audacious Climb to Success Ended in a Dizzying Plunge*, N.Y. TIMES, Jan. 13, 2001, at A1.

114. *Id.*

115. *Id.*

116. *See generally* SWARTZ & WATKINS, *supra* note 112.

117. *Id.*

118. Eichenwald, *supra* note 113, at 1.

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

corporate headquarters.¹²³

Arthur Andersen & Company, Enron's independent auditor, became embroiled in the scandal when it admitted to errors in its audit of Enron.¹²⁴ Arthur Andersen's involvements led to questions about the role of independent auditors when reviewing their clients' business dealings.¹²⁵ Allegations arose that Arthur Andersen was more concerned about Enron paying the accounting firm for its services,¹²⁶ rather than being concerned about actually performing these accounting and auditing services.¹²⁷

In the wake of the Enron and Arthur Andersen scandals, President George W. Bush, voicing concern over the lack of transparency and integrity in American companies,¹²⁸ outlined a ten-step plan to restore confidence in the American corporate system.¹²⁹ The plan required chief executives to personally vouch for the validity of their company's financial statements,¹³⁰ suggested that corporations should ban officers who abused their power from participation in corporate leadership,¹³¹ and proposed the creation of a private board to oversee the accounting industry.¹³² Additionally, President Bush recommended banning some accounting practices,¹³³ such as a single accounting firm serving both as a company's internal and external auditor.¹³⁴ This ten-step plan eventually crystallized itself into the Sarbanes-Oxley Act,¹³⁵ which President Bush signed into law on July 2002.¹³⁶

2. "Supervision" Provisions of Sarbanes-Oxley Act

SOX presents a set of requirements for the oversight of an

123. David Streitfeld & James Gerstenzang, *Federal Agents Probe Shredding Inside Enron*, L.A. TIMES, Jan. 23, 2002, at A1.

124. Andrew Hill, Sheila McNulty, & Gwen Robinson, *The Enron Failure—Counting the Cost*, FIN. TIMES, Dec. 31, 2001, at 18.

125. David Nicholas, *Checks Failed, Leaving Investors Vulnerable*, ST. LOUIS POST-DIS., Feb. 10, 2002, at B1.

126. *Id.*

127. *Id.*

128. Andrew Hill & Peter Spiegel, *Feeling the heat: George W. Bush wants chief executives to become more accountable for financial problems at their companies following the collapse of Enron*, FIN. TIMES, Mar. 8, 2002, at 18.

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. Bob Kemper, *Bush Tells CEOs to Strengthen Ethics; President Offers 10 steps to Better Accountability*, CHI. TRIB., Mar. 8, 2002, at 8.

134. *Id.*

135. Remarks on Signing Sarbanes-Oxley Act of 2002, *supra* note 20.

136. *Id.*

American corporation's financial dealings.¹³⁷ The act is primarily concerned with three types of supervisors:¹³⁸ (1) the senior financial executives;¹³⁹ (2) the board of director's audit committee;¹⁴⁰ and (3) the independent auditors.¹⁴¹ Unlike the Russian Code, SOX does not outline the functions of each supervisory body. Instead, SOX amended existing statutes that provide the groundwork for the monitoring bodies and leveled penalties against those companies that do not adhere to the new provisions. Additionally, SOX briefly laid out new requirements for the internal monitoring process.¹⁴²

a. Senior Executives

Under SOX, senior executives, who sign the reports that the company submits to the Securities and Exchange Commission ("SEC"), are responsible for more than merely reviewing them.¹⁴³ Signing executives affirm that the reports do not contain any "untrue statement of material fact,"¹⁴⁴ that the information included in the reports fairly

137. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 15 U.S.C.).

138. *See id.*

139. Sarbanes-Oxley Act of 2002 §§ 301-308.

140. *Id.*

141. *Id.*

142. The U.S. Securities and Exchange Commission issued a final rule defining "internal control over financial reporting" as:

[A] process designed by, or under the supervision of, the registrant's principal executive and principal officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principals and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
- (3) Provide reasonable assurance regarding prevention or timely detection of the registrant's assets that could have a material effect on the financial statements.

Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, 68 Fed. Reg. 36636, 36640 (June 18, 2003) (to be codified at 17 C.F.R. pt. 240.13a-15(f)).

143. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 302, 116 Stat. 745, 777 (2002) (codified in scattered sections of 15 U.S.C.).

144. *Id.*

represents the actual financial condition of the company,¹⁴⁵ and that any potential fraud is disclosed to the audit committee and the auditors.¹⁴⁶ The signing officers also are responsible for creating internal controls that enable material information regarding the company and its subsidiaries to pass efficiently to other officers,¹⁴⁷ as well as ensuring that the auditors are put on notice of changes to the control mechanisms.¹⁴⁸

b. The Audit Committee

SOX requires that members of the board of director's audit committee are independent directors.¹⁴⁹ This committee of independent directors is responsible for the selection and compensation of any public accounting firm retained by the company,¹⁵⁰ and the supervision of the audit work performed by that firm.¹⁵¹ The other main responsibility of the audit committee is to establish a system to manage and address complaints made by employees regarding questionable accounting practices or audit matters.¹⁵²

c. The Independent External Auditors

The drafters of SOX viewed the independence of external auditors as paramount.¹⁵³ Consequently, under the new law, auditors must not have any other interaction with the company, or its executives, contemporaneously with the audit.¹⁵⁴ To prevent the corporate officers

145. *Id.*

146. *Id.*

147. *Id.* Other members of the management also assist in the creation and implementation of the internal control system. Sarbanes-Oxley Act of 2002 § 404. Section 404 of the Sarbanes-Oxley Act charges the Securities and Exchange Commission with the promulgation of rules requiring the annual report to contain an internal control report. *Id.* This report must (1) state the responsibility of management to establish and maintain the internal control system and the procedures used for financial reporting and (2) an assessment of the effectiveness of the internal control system and the financial reporting procedures. *Id.* The independent auditors must attest to the assessment made by the management. *Id.*

148. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 302, 116 Stat. 745, 777 (2002) (codified in scattered sections of 15 U.S.C.).

149. Sarbanes-Oxley Act of 2002 § 301. In order to be considered independent, an officer must not accept any compensatory fee from the company or be affiliated with any of the company's subsidiaries. *Id.* If the Securities and Exchange Commission approves the exemption, a director may be exempt from these independence requirements. *Id.*

150. *Id.*

151. *Id.*

152. Sarbanes-Oxley Act of 2002 § 301.

153. Conference Report on Corporate Responsibility Legislation, *supra* note 10.

154. Sarbanes-Oxley Act § 201. Non-audit services include:

(1) bookkeeping or other services related to the accounting records or financial

and directors from influencing the auditors,¹⁵⁵ SOX requires the rotation of the accounting firm's lead audit partner every five years.¹⁵⁶

The independent auditor must inform the audit committee as to which accounting practices it used to conduct the audit,¹⁵⁷ alternative treatments of financial information that the auditor discussed with the company's management,¹⁵⁸ and any material written communication that has occurred between the auditor and the management.¹⁵⁹

III. Comparing the Supervision Standards Found in Russia's Code of Corporate Conduct and the United States' Sarbanes-Oxley Act

Both the Code and SOX are responses to proven and perceived failures in the corporate governance systems of their respective countries.¹⁶⁰ Their approval by the Russian and United States governments were indicators that each nation's leaders understood the inherent weaknesses in previous corporate governance structures and their desire to address these problems.¹⁶¹ At their core, each country's corporate governance deficiencies were alike, and both governments chose to address these deficiencies in a similar and standard fashion. Yet, there are some differences created by the circumstances found in each country.

Russia's Code provides the groundwork necessary for corporate governance, while the United States' SOX establishes more of the nuances needed to provide efficient supervision of a company's

statements of the audit client;

(2) financial information systems design and implementation;

(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(4) actuarial services;

(5) internal audit outsourcing services;

(6) management functions or human resources;

(7) broker or dealer, investment adviser, or investment banking services;

(8) legal services and expert services unrelated to the audit;

(9) any other service that the Board determines, by regulation is impermissible.

Id. The auditor may perform some of these services, including tax services, if the audit committee approves of the activity. *Id.*

155. Sarbanes-Oxley Act § 303.

156. Sarbanes-Oxley Act § 203. The lead audit partner has primary responsibility for the audit. *Id.*

157. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 204, 116 Stat. 745, 773 (2002) (codified in scattered sections of 15 U.S.C.).

158. *Id.*

159. *Id.*

160. *Conference Report on Corporate Responsibility Legislation*, *supra* note 10; *Corporate Governance in Russia: Regime Change Required*, *supra* note 16, at 21.

161. *See* The Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, *supra* note 28; *see also* Letova, *supra* note 28, at 84.

operations. SOX also outlines the potentially harsh penalties for failing to adhere to the mandatory regulations,¹⁶² while the Code merely is a compilation of suggested best practice standards promulgated by the Russian government and does not include any penalties for failing to adhere to the recommendations.¹⁶³

Upon examination, one discovers that both sets of provisions, despite their differences, are attempting to achieve the same goals of corporate accountability and transparency through internal and external monitoring bodies.¹⁶⁴ The signing requirements to which members of Russian audit commissions, who are also company executives, must adhere¹⁶⁵ are similar to the signature requirements to which SOX holds American executives.¹⁶⁶ Both sets of provisions adopted similar independence requirements for the members of the board of directors who sit on the audit committee and for the independent auditors.¹⁶⁷

The glaring difference between the monitoring provisions of the corporate governance documents occurs in the creation of a control and audit service in Russia.¹⁶⁸ Russia adds an initial level of monitoring with the creation of the control and audit service,¹⁶⁹ a group exclusively made up of company employees.¹⁷⁰ Although American employees do assist in the creation and implementation of their internal monitoring systems, American managers ultimately are responsible for performing monitoring duties.¹⁷¹

This initial level of internal monitoring may be successful in Russia because it has never had any form of “corporate governance.”¹⁷² Companies in Russia may need this additional level as a safeguard against corporate fraud. When one considers that Russian companies must build their corporate governance systems from the ground up, the inclusion of a control and audit service is no more drastic than other reforms that companies implement. Additionally, it may be no more expensive in Russia to create a control and audit service while creating other levels of monitoring.

162. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 15 U.S.C.).

163. CODE OF CORPORATE CONDUCT, *supra* note 53.

164. *Id.* at ch. 8, § 3.1; Sarbanes-Oxley Act of 2002 §§ 301-308.

165. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 3.1.

166. Sarbanes-Oxley Act of 2002 § 302.

167. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.3.1; Sarbanes-Oxley Act of 2002 § 301.

168. CODE OF CORPORATE CONDUCT, *supra* note 53, at ch. 8, § 1.3.

169. *Id.* at § 1.3.5.

170. *Id.* at ch. 8, § 1.2.

171. Practising Law Institute, *Fraud and the Role of the Audit Committee*, 1449 PLI/Corp. 1177, 1182 (Oct. 2004).

172. Shuvalova, *supra* note 5, at 64.

There are two reasons why the creation of another formal level of monitoring may not be beneficial to the corporate governance system already in place in United States companies. First, the United States, unlike Russia, has a base upon which to build corporate governance reform. Most American companies now have some sort of internal monitoring system, whether in the form of whistleblower protections or committees that review corporate transactions.¹⁷³ Consequently, requiring American companies to create a control and audit committee may duplicate an existing internal monitoring system. Alternatively, a new system potentially could replace an effective internal monitoring system that has been adapted to the specific needs of the company with a mechanism that may not be appropriate for the particular company in question.

Furthermore, because there are complaints that the implementations of the additional standards found in SOX are too expensive,¹⁷⁴ the creation of a control and audit service could be even more burdensome for some companies. American corporations need the flexibility to form an internal monitoring system that best suits the goals and objectives of each company, but which is still within the budget of the organization. Consequently, a control and audit system, although helpful in establishing Russian corporate governance, may not be as essential to corporate governance reform in the United States.

Although there are differences between the American and the Russian corporate governance systems, the basic goals of each are the same—to increase the transparency and corporate accountability of companies. Now that Russia and the United States have instituted their respective provisions, two new questions and potential differences arise. The first asks how companies in each country are accepting the new regulations, while the second addresses the actual success of the regulations in achieving better corporate governance.

IV. Reactions to New Corporate Governance Regulations in Russia and the United States

Companies, consumers, and critics constantly are consumed with analyzing the possible impact of new governmental regulations on a nation's businesses and economy, usually even before the regulations take effect. These initial perceptions may linger forever, but the best indicator of a new provision's effectiveness cannot be rendered until that provision has been in place for some significant amount of time. Both the Russian Code and the American SOX have been in place for several

173. Practising Law Institute, *supra* note 171, at 1182.

174. Burns, *supra* note 23, at R.8.

years, making this an ideal time to review the provisions.

A. Considering the Russian Code of Corporate Conduct

In Russia, studies show that large companies view the voluntary implementation of the Code as a positive initiative for their companies and the country's economy.¹⁷⁵ Even a significant number of the businesses that have not introduced the Code recognize that improved corporate governance, especially more sophisticated internal controls, make them more attractive to domestic and foreign investors.¹⁷⁶ Consequently, some of these organizations make the Code's implementation one of their goals for the future.¹⁷⁷

Those companies that have implemented the Code and have developed internal controls, even in part, show some improvement in investor confidence.¹⁷⁸ This is especially true of those companies that now have independent directors seated on their board of directors.¹⁷⁹

175. Christopher Kenneth, *Corporate Governance Ethics Finally Taking Root in Russia*, RUSS. J., Mar. 31, 2003, at 81. The International Financial Corporation, the investment section of the World Bank, with the help of the Netherlands and Switzerland governments, polled 304 CEOs regarding the Russia Code of Corporate Conduct. *Id.* Of the CEOs polled, about forty-nine percent believed that implementing the Code was important to their companies. *Id.*

Conversely, the overwhelming majority of small and mid-sized companies do not view problems associated with corporate governance to be as essential to the success of their companies as do large corporations, possibly because these smaller companies are not trying to attract the same large-scale and foreign investors to which larger companies are appealing. I.V. Belikov, *Adoption of the Russian Code of Corporate Conduct: Accomplishments and Problems*, 25 (Oct. 23, 2003), at http://www.riu.ru/uploads/db2file_en/RussianCGCode_OECD_rep21003eng.pdf. Therefore, smaller Russian companies do not view the implementation of the Code of Corporate Conduct as a company objective. *Id.*

176. Belikov, *supra* note 175, at 23.

177. Kenneth, *supra* note 175, at 81. One barrier to the Code's universal implementation in Russia is the lack of understanding of the Code's value and importance. *Id.* Russia simply does not have the specialized manpower to campaign for the Code, particularly in the outer regions of the country. *Id.* at 82.

178. Alex Nicholson, *Independent Directors Find Seat on the Board*, MOS. TIMES, Oct. 10, 2003, at 14. To some extent, frighteningly enough, investor confidence in Russia may be tied merely to the high price of oil!

179. *Id.* Alexander Filatov of the National Association of Independent Directors, a body established to promote the appointment of independent directors, said, "Today it's not just minority shareholders that are interested in putting forward independent representatives, but the companies themselves, their controlling and strategic shareholders. The companies feel real returns from the inclusion of independent members on the board, which make them more attractive to investors and raise their capitalization." *Id.*

Filatov also stated that a survey conducted by Ernst & Young showed that the presence of independent directors serving on the board of directors was the primary factor affecting investment attractiveness. *Id.* Companies that have become even more successful after the inclusion of independent directors include YUKOS, LUKoil, Wimm-

Unfortunately, drastic improvement seems to be limited to those top Russian companies that are attempting to make themselves more attractive to foreign investors,¹⁸⁰ and, therefore, are working harder to improve their corporate governance structure.¹⁸¹

Many Russian managers still fear the inclusion of independent directors because these directors should demand answers to those questions that directors in the current business structure do not want to ask and current management does not want to answer.¹⁸² Such unease may occur because inquisitive directors could restrict the freedom of powerful managers.¹⁸³ In the alternative, fear of probing directors may stem from the managers' belief that new independent directors, who supposedly adhere to the Code, will perform their oversight duties better than the current independent directors discharge theirs.¹⁸⁴

There is, however, a contradiction when examining the implementation of the recommendations for improving internal monitoring in Russian companies.¹⁸⁵ Although there is a widespread desire to improve internal control systems, companies, at the same time, are hesitant to form a control and audit service and an audit committee of the board of directors.¹⁸⁶ This occurs because companies simply are reluctant to disclose information relating to their financial transactions,¹⁸⁷ a possible result of managers' fears that the internal auditors will question the transactions and reduce their power.¹⁸⁸ Additionally, even those companies that have created these internal control bodies subsequently are reluctant to provide the bodies with the information needed to perform adequately their monitoring duties.¹⁸⁹

Beyond problems relating to corporate governance, Russian companies also face issues that American businesses would not even consider. It is common in Russia for government officials to demand bribes in order to have filings approved or applications accepted. Additionally, there are many conflicting and overlapping laws in the

Bill-Dann, Norilsk Nickel, Sibnef, United Heavy Machineries, and Vimpelcom. *Id.*

180. Belikov, *supra* note 175, at 23.

181. Nicholson, *supra* note 178, at 14.

182. *Id.*

183. Belikov, *supra* note 175, at 6.

184. *Id.* at 7.

185. *Id.*

186. *Id.* While there is a lack of control and audit committees, many companies do have an audit commission as required by the Code of Corporate Conduct and the Federal Law "On Joint Stock Companies." *Id.* at 10. However, a substantial number of those companies that do have an audit commission do not conduct internal audits, making the audit commission superfluous. Belikov, *supra* note 175, at 10.

187. *Id.* at 8.

188. *Id.*

189. *Id.*

country, so that in following one law, another may be broken. The result of these additional concerns is that corporate transparency is nearly impossible because it would reveal “illegal” conduct by the company. In order for the Code to be truly successful in Russia, companies and their managers must not only come to understand the importance of disclosure and transparency, but incorporate these principles into their standard business practices, while the government addresses these other complications.

B. Studying the Sarbanes-Oxley Act

In the United States, it is not a question of whether or not to implement SOX, but rather a question of whether it is accomplishing the goal of improving corporate governance. One challenge to overcome is the amount of money that companies must expend to implement the provisions.¹⁹⁰ For example, companies and critics question the cost effectiveness of regulations that attempt to improve internal monitoring.¹⁹¹ While these regulations may prove to be successful in reforming internal controls, companies have had to go to tremendous expense in order to implement the provisions.¹⁹² Without the immense costs, the regulations might have been more widely embraced by companies but, currently, the expense may outweigh any perceived value of SOX.¹⁹³

One example of the costs eclipsing the benefits occurs during the implementation of SOX’s monitoring provisions. Managers’ certification of financial statements, the creation of additional internal monitoring systems, and making managers answerable to independent directors have all led to higher corporate responsibility and accountability—some of SOX’s major goals.¹⁹⁴ However, implementing these provisions come at a high cost to most corporations, especially

190. Carol Hymowitz, *Corporate Governance (A Special Report)—Experiments in Corporate Governance: Finding the Right Way to Improve Board Oversight Isn’t Easy; But Plenty of Companies Are Trying*, WALL ST. J., June 21, 2004, at R.1.

191. *Id.*

192. Burns, *supra* note 23, at R.8. In response to complaints regarding the expense of implementing internal monitoring provisions, Representative Oxley, one of the authors of SOX, quoted a Financial Executives Institutes study that showed costs relating to the first year of implementation of internal monitoring are likely to be only one percent of a company’s revenue. *Id.* While this may be true, one percent of revenue for a company such as General Electric is vastly different from one percent of revenue for a small start up company in Pittsburgh, which could result in potentially severe financial repercussions for smaller companies. *Id.*

193. *Id.*

194. *Id.*

smaller ones.¹⁹⁵ Some smaller capitalized companies spent nearly one million dollars to meet the Section 404 internal monitoring requirements of SOX.¹⁹⁶ These smaller firms also are concerned that they may see their external auditing costs more than double as they seek to comply with the independent auditor provisions of SOX.¹⁹⁷

While the majority of experts and critics want SOX to be refined, most agree that its provisions are beneficial to corporate governance in the United States, especially those dealing with reporting and internal monitoring.¹⁹⁸ At the same time, SOX is still a work in progress and requires further development, primarily through SEC regulations, rather than by Congressional amendments.¹⁹⁹

V. Potential Improvements to the Code of Corporate Conduct and the Sarbanes-Oxley Act

Corporate governance experts cheered the arrival of Russia's Code and the United States' SOX, but some companies have expressed more trepidation. Most agree, however, that while both sets of provisions may be a success in the public's opinion, they still need to be further developed.²⁰⁰

The most significant improvement that Russia should implement is to make the Code mandatory law, instead of a mere list of recommended practices, in an effort to combat more effectively that country's poor corporate governance structure.²⁰¹ Until the Russian legislature passes significant corporate governance reform legislation, as the United States Congress did with SOX, Russia can make little progress in the way of consistent, widespread improvements.²⁰² For example, current Russian law does not define the qualifications necessary for independent director status.²⁰³ Consequently, "independent" directors do not have the same independent attributes as their Western counterparts.²⁰⁴ Russian

195. Burns, *supra* note 23, at R.8.

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. See Burns, *supra* note 23, at R.8; see also Hymowitz, *supra* note 190, at R.1. A Harris poll taken in early 2004 found that fifty-nine percent of investors questioned believe that the provisions found in SOX will help in protecting their investments. Hymowitz, *supra* note 190, at R.1. Additionally, fifty-seven percent said that they would probably not invest in a company that did not comply with the new standards. *Id.*

201. Nicholson, *supra* note 178, at 14.

202. Nicholson, *supra* note 178, at 14; Igor Belikov, Dir., Russian Inst. of Dirs., Breakfast Roundtable at the Ctr. for Int'l Private Enterprise: Corporate Governance in Russia: Past, Present, and Future (Apr. 13, 2006).

203. *Id.*

204. *Id.*

independent directors often have significant connections to the companies on whose board they sit and can sometimes appear to be outside managers, rather than independent directors.²⁰⁵ Their “independence” comes from the fact that their connections do not rise to the level of actual employment by the company.²⁰⁶

Russian companies should supplement the legal definition of an independent director with a contract made between each individual director and the company.²⁰⁷ This contract should clearly outline the director’s role on the board and his duties to the company.²⁰⁸ Russian companies need more than two or three independent directors serving on their boards, but these directors need to understand their role in relationship to the company.²⁰⁹ The consequence for breaching this contractual obligation should be removal from the board.²¹⁰

Another problem that exists regarding Russian independent directors is that these directors know which block of shareholders voted for them.²¹¹ However, the same shareholders that voted for a director can call a special meeting of the shareholders and remove that director from office.²¹² Consequently, in an effort to retain their position of power, the newly elected directors often are more loyal to their electors than they are to the company, negating their independent status.²¹³ Russia companies need to adopt measures that ensure the anonymity of shareholder voting so that directors do not know which shareholders have backed them in their race for a seat on the board.

As Russian corporate governance codes need to prevent “managers” from being independent directors, SOX may need some adjustments to prevent directors, both inside and independent, from becoming managers.²¹⁴ SOX requires directors to become more involved in company oversight in the hope that there will be more supervision of

205. *Id.* The main criteria used to select members of the board of directors include, length of service to the company (sixty-three percent of companies use this criteria), maturity (forty-seven percent), experience in company’s business sector (thirty-six percent), useful connections (twenty-four percent), and loyalty to the company (nine percent). Belikov, *supra* note 175, at 9. Independence from company management or major stockholders is an important criterion that one should find on this list. *Id.*

206. Nicholson, *supra* note 178, at 14. One exception to the typical Russian “independent” director is Mark Mobius, an independent director of LUKoil, and others like him, whose reputations guarantee their independence. *Id.*

207. Belikov, *supra* note 202.

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.*

212. Belikov, *supra* note 202.

213. *Id.*

214. Hymowitz, *supra* note 190, at R.1.

managerial decision-making and financial transactions.²¹⁵ However, a director becoming “more involved” means different things to different boards.²¹⁶ At one extreme, boards view increased involvement as only reviewing a checklist to ensure company compliance with the new regulations.²¹⁷ Other boards carefully have considered their role since the implementation of SOX and have fundamentally changed the way in which they oversee their companies.²¹⁸ At the other extreme, some boards are so concerned about complying with the provisions of SOX that they micromanage the chief executive officer and other members of management, creating an imbalance in the corporate governance structure.²¹⁹ Such a disparity breaks down the monitoring system that the company has in place and is almost as dangerous as the lack of oversight, the problem that created the need for SOX in the first place.²²⁰ Legislators and agencies, such as the SEC, should review the provisions of SOX that deal with the role of the board of directors in the supervision of the company, to better define the role to avoid oversight imbalance.

Another improvement to the Russian Code would be to take a page from SOX and include penalties for those companies that do not adhere to the provisions. The Russian government should at least attach such penalties to those provisions that relate to the disclosure of information, in order to achieve universal compliance with the Code.²²¹ Without the addition of penalties or sanctions, the Code, even if made into law, will not have any “teeth” to encourage companies to comply with the regulations.²²² Penalties should include fines imposed by the FCSM, as well as criminal sanctions for companies that neglect to disclose information to shareholders.²²³

Finally, an enhancement to SOX would not be so much a specific improvement, as it would be a recommended cost analysis of the various provisions. Overall, SOX implements appropriate reforms to corporate governance.²²⁴ However, these reforms have the potential to be even

215. *Id.*

216. *Id.*

217. *Id.*

218. *Id.*

219. Hymowitz, *supra* note 190, at R.1.

220. *Id.*

221. Nicholson, *supra* note 178, at 14; Belikov, *supra* note 175, at 29. If penalties were to be included in the Code of Corporate Conduct, and enforced, Russia would have to reform its extremely corrupt judicial system, completely and immediately. Nicholson, *supra* note 178, at 14. Without such reform, any proposed penalties would be useless as there is no actual incentive to follow the corporate governance laws; currently, there is only an incentive to continue to bribe judicial officers. *Id.*

222. *Id.*

223. Belikov, *supra* note 175, at 29.

224. Burns, *supra* note 23, at R.8.

more effective if companies did not have to bear the prohibitive cost of its implementation.²²⁵ A thorough cost-benefit analysis might assist governmental agencies in the promulgation of more cost-effective SOX-related regulations that still efficiently and effectively address corporate governance issues in the United States.²²⁶

One method that could make SOX more cost-effective is adapting the provisions to make their implementation dependent on a company's level of capitalization.²²⁷ This might allow smaller, less capitalized companies to implement amended provisions that are less expensive and more suited to their structure.²²⁸ This would make SOX more feasible for smaller companies to implement, while still accomplishing the goal of overall improved corporate governance in all American companies.²²⁹

VI. Conclusion

Although there are differences in the provisions, Russia's Code and the United States' SOX are attempting to reform corporate governance in their respective countries. Both nations have continued to develop their corporate governance structures in the years since each passed the original provisions. However, companies in both countries still have a long way to go before either achieves the ideal level of corporate governance. To reach this goal, the Russian and American governments should focus on educating the business world and the public regarding the virtues and benefits of well-constructed corporate governance. Without such instruction, businesses in each country remain in jeopardy of being stagnant and ritualistic in their use of corporate governance provisions. Sound corporate governance is as much a state of mind as it is a compilation of regulation-created hoops through which companies must jump.²³⁰ To truly develop the corporate governance environment in Russia and the United States, businesses, both small and large, must change their mindset toward corporate governance, instead of just their company practices. When this is accomplished, sound corporate governance will result in substantially increased investor confidence, regardless of what laws governments introduce or how long corporate governance has existed. Until then, the Code and SOX need to exist, and companies must use them to their full potential in order protect against corrupt business practices and corporate scandals.

225. *Id.*

226. *Id.*

227. *Id.*

228. *Id.*

229. Burns, *supra* note 23, at R.8.

230. *Id.*