



THE WORLD BANK

Report on the Observance of Standards and Codes (ROSC)

Corporate Governance

Corporate Governance Country Assessment

Former Yugoslav Republic of Macedonia

June 2005

Overview of the Corporate Governance ROSC Program

WHAT IS CORPORATE GOVERNANCE?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The *OECD Principles of Corporate Governance* provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the Board of Directors.

WHY IS CORPORATE GOVERNANCE IMPORTANT?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research.

Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

THE CORPORATE GOVERNANCE ROSC ASSESSMENTS

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment reviews the legal and regulatory framework, as well as practices and compliance of listed firms, and assesses the framework relative to an internationally accepted benchmark.

- Corporate governance frameworks are benchmarked against the OECD Principles of Corporate Governance.
- Country participation in the assessment process, and the publication of the final report, are voluntary.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the ROSCs can also include special policy focuses on specific sectors (for example, banks, other financial institutions, or state-owned enterprises).
- The assessments are standardized and systematic, and include policy recommendations. In response, many countries have initiated legal, regulatory and institutional corporate governance reforms.
- Assessments can be updated to measure progress over time.

By the end of June 2005, 48 assessments had been completed in 40 countries around the world.

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate governance country assessment

Former Yugoslav Republic of Macedonia

June 2005

Executive Summary

This report assesses FYR Macedonia's corporate governance policy framework, and enforcement and compliance practices. It highlights recent improvements in corporate governance regulation, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in FYR Macedonia.

FYR Macedonia is currently in the final stages of an intense period of corporate governance reform. A new Company Law that incorporates a variety of international good practices was enacted in 2004. Planned for the second half of 2005 are (1) the introduction of a corporate governance code; (2) a business ethics code; (3) a revised Securities Law; and (4) a revised Audit Law. Awareness of the importance of good corporate governance has increased. Recent reforms have resulted in a corporate governance framework that has improved compliance with many of the OECD Principles.

The report identifies a number of key recommendations:

1. First, the disclosure framework should be overhauled, as part of the on-going revision of the Securities Law. Shareholders should be required to disclose all direct and indirect ownership. The Central Securities Depository should publish up-to-date lists of the significant owners of listed companies on a special web site.
2. The law should increase authority of the Macedonian Securities and Exchange Commission (MSEC), and especially its powers to impose sanctions, and MSEC should develop a strategy to use its new authority to improve corporate governance and shareholder rights. The authorities should greatly increase the amount of resources (staff and budget) available to the MSEC to implement its strategy.
3. The Macedonian Stock Exchange (MSE) should complete the process of drafting a corporate governance code, should revise its listing rules in line with the Code and the new Securities Law, and consider the development of a "corporate governance tier". The exchange should fully implement a system of electronic information dissemination.

Acknowledgements

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The assessment reflects technical discussions with the Macedonian Securities and Exchange Commission, the Macedonia Stock Exchange, the Central Securities Depository, the USAID Corporate Governance and Company Law Project, the USAID Financial Sector Strengthening Project, commercial banks, issuers, and numerous market participants. The World Bank *Legal and Judicial Enforcement Assessment* was also useful.

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Country assessment: FYR MACEDONIA

This ROSC assessment of corporate governance in FYR Macedonia benchmarks law and practice against the OECD Principles of Corporate Governance, and focuses on listed companies. Related recommendations are presented in the Accounting and Auditing ROSC (2003) and the Technical Note on the Review of Governance in the Banking Sector (2005).

Rapid reform, with the adoption of a new company law in 2004, and improving compliance with OECD Principles

FYR Macedonia is currently in the final stages of an intense period of corporate governance reform. A new Company Law that incorporates a variety of international good practices was enacted in 2004; the introduction of a corporate governance code and a business ethics code along with a revised Securities Law and Audit Law, is planned for the second half of 2005. Recent reforms have resulted in a corporate governance framework that has improved compliance with many of the OECD Principles, and most basic minority rights framework are in place.

Strong legacy of management control (with relatively dispersed formal ownership)

Several key features distinguish FYR Macedonia's corporate governance framework.

- Privatization in the 1990s left the legacy of companies largely controlled by managers, with the formal and informal support of employees.
- There is limited foreign investment, and no domestic institutional investors.
- The 2004 Company Law improved shareholder rights in a number of areas.
- Awareness of the importance of good corporate governance has greatly increased in recent years, with the activities of the USAID-funded Corporate Governance and Company Law project.¹ The Macedonian Securities Commission (MSEC) and the Macedonia Stock Exchange (MSE) have played important roles in promoting minority protection and corporate governance reform. The MSE sponsored the translation of the OECD White Paper on Corporate Governance in South East Europe in 2004 while the recently established Macedonian Corporate Governance Council hosted the OECD regional corporate governance roundtable in June 2004.
- The shareholder rights group Akcioner also plays an important role, drawing attention and media scrutiny to corporate governance abuses, and supporting the claims of minority shareholders.
- Two important institutions (the MSEC and the court (company) registrars) have historically had weak authority and limited resources; A new registration law is being drafted that will abolish the court registration of commercial legal entities in September of this year and that will introduce a one-stop-shop registration facility by the end of this year.
- FYR Macedonia has established the goal of joining the European Union, and is gradually moving to adopt the *acquis communautaire* with the transposition of EU company law directives and OECD standards.

Few foreign investors

Increasing awareness of corporate governance

Enforcement bodies have relatively few resources and limited authority

¹ <http://www.maccorpgov.com.mk>. The Corporate Governance and Company Law project website contains a variety of useful information on corporate governance in Macedonia.

Market profile

Small equity market with 62 listed (and an additional 118 public but unlisted companies)

Market capitalization at the end of 2004 was MD 18.6 billion (US\$ 413.1 million or 7.9 percent of GDP), a 4.9 percent increase since the end of 2003. The market is smaller than those in most emerging and transition markets. In 2004, the top 10 companies in the market represented 66.4 percent of total market capitalization, and the top 10 most traded companies accounted for 36.6 percent of total trading volume. The turnover ratio was 44 percent in 2004.

At the end of May 2005 there were 62 companies listed on the MSE, down from 68 at the beginning of the year, and 98 at the beginning of 2004. This decline reflects the removal of mandatory listing requirements since the beginning of 2005. Mandatory listing had been imposed in 2003 and resulted in approximately 100 companies listed on the exchange. Both listed and unlisted shares trade on the MSE; an additional 118 companies have reporting obligations to the MSEC (and are referred to in this report as “public” companies).

Current ownership framework is based on past privatization policy (management – employee buyouts)

FYR Macedonia’s privatization program was dominated by management-employee buyouts. As a result, most large companies today are controlled by managers, and in many companies control has not changed since privatization. Formal ownership remains relatively dispersed, with shares owned by current and former employees and management (approximately 260,000 shareholders). For example, the average free float of the listed companies on the Macedonian Stock Exchange (whose definition excludes management and registered 10 percent shareholders) was 68.6% at the end of March 2005. Control is frequently maintained by formal and informal agreements between employee owners and managers.

Managers control companies through a variety of formal and informal agreements with employees

Foreign investment remains relatively limited, although over the last year investors from Slovenia and elsewhere in the region have begun taking positions in a number of companies.

The key corporate governance institutions are in place

Public companies are under the supervision of the Macedonian Securities and Exchange Commission. The Macedonian Stock Exchange (MSE) is the country’s leading stock exchange, and the CSD (Central Securities Depository) is the national depository of securities. Companies are currently registered in three registration courts. With the introduction of a new registration law later this year, companies will be registered with the Central Register and court registration will be abolished.

Key issues

The following sections highlight the principle-by-principle assessment of FYR Macedonia’s compliance with the OECD Principles of Corporate Governance.

Investor protection

Basic minority rights recently put in place

Basic minority shareholder rights are in place. All shareholders have the right to participate in general meetings, and the right to obtain a wide variety of important information (including minutes of shareholder and board meetings). Significant decisions (including amendments to the company charter) require 66 percent supermajority approval. Authorized capital increases (in which the board has discretion to issue shares up to the level of authorized capital) are possible. Existing shareholders have pre-emptive rights in the event of a capital increase

The 2004 Company Law reformed the rules covering the conduct of general meetings of shareholders, but problems reportedly remain with the implementation of the new law

and redemption rights under particular circumstances.

The Company Law provides a strong and comprehensive framework for the basic regulation of the annual general meeting, and introduced innovative advances to allow for electronic and postal voting at general meetings. The charter may allow shareholders to vote by telephone and/or by “other appropriate electronic means”. So far, few companies use this option because of the required investment in electronic infrastructure.

The opinions of market participants on the conduct of shareholder meetings in practice were mixed. Some felt that dissenting minority shareholders in many companies continue to have problems obtaining access to GMs; the company may reject their identity as shareholders, or use bodyguards or “friendly police” to exclude them and “protect” the meeting. Although problems occur with the organization of meetings, observers note that the shareholder meeting situation has greatly improved over the past few years, and abuses will be further reduced by the protections and clarifications in the new Company Law.

Cash flow rights are relatively closely aligned with voting rights

FYR Macedonia has a relatively strong “one-share/one-vote” framework. Companies can issue ordinary shares and multiple classes of preferred shares. Voting caps are not allowed. Preferred shares can also have voting rights. Pyramid structures, share parking in subsidiaries, and cross-shareholding have traditionally been relatively rare.

Shareholder agreements between management and employees now regulated, but still a concern

A major corporate governance issue has been the regulation of agreements between the company / managers / controlling shareholders, and employee-shareholders. These agreements allowed controller-managers to remain in control with a relatively small amount of capital.

Based on the (old) 1996 company law, management could sign shareholder agreements with employees of the company, who were by default also shareholders of the company. These agreements were used to transfer voting rights, the right to dividends, and the right to transfer shares. One quarter of Macedonian joint stock companies (mostly non-listed) had signed agreements with their shareholders in 2003. The agreements caused confusion at AGMs, when disputes arose over who had voting rights of particular shares.

These agreements were regulated by the 2004 Company Law. Agreements between shareholders and a member of the management body or supervisory board (including family members and certain related parties) are no longer legal. In addition, proxies are by default issued for one general meeting.

Takeover rules are unclear, and voluntary delisting is not regulated

The Takeover Law, although unclear, is interpreted by many as requiring a mandatory bid for all shares once the 25 percent threshold has been crossed. Privatization transactions are not covered by these provisions. Voluntary delisting is not regulated.

Comprehensive approval procedures recently introduced for major transactions, related party transactions and managing board conflicts of interests

All related party transactions are subject to the prior approval by disinterested members of the board of directors / supervisory board; major transactions involving assets with a value between 20 and 50 percent of the assets require approval by the board of directors / supervisory board. Transactions with more than 50 percent of the value of assets require the approval of the GM. Any members of management or a board with a conflict of interest must disclose it to the board / supervisory board, and board members cannot compete with the company without the approval of the board of directors / the supervisory board. However, these rules do not apply to family members, supervisory board

members, or to significant shareholders who are not board members. Companies may not grant loans to management, the supervisory board, or to their close family members.

In general, market participants report that in practice many companies do not properly disclose related party transactions possibly since the concept was just recently introduced by the 2004 Company Law.

Disclosure

FYR Macedonia is in the early stages of putting in place a modern disclosure regime that is complied with by the listed sector

The 2004 Company Law introduced a requirement for joint stock companies to prepare an annual report with a variety of information, including executive remuneration. However, these reports appear to be generally available only to shareholders; MSEC/MSE disclosure requirements (which include annual, semi-annual, and quarterly reports) have not been harmonized with the annual report requirement of the new Company Law, focus only on financial statements (without attached notes), and suffer from low compliance rates. The MSEC cannot impose fines on non-filers.

IFRS is now required for listed companies, but evidence suggests that many companies are only beginning their transition

The 2004 Company Law requires listed companies, banks, insurance companies, and other large and medium-sized companies to prepare their financial statements according to IFRS. IFRS was recently re-translated and introduced into the law (including IAS 24 for related party transactions). Market participants (and experience from other countries) suggest that the conversion to high-quality IFRS is in its early stages in most companies, and will take considerable additional time and effort.

Ownership disclosure is relatively limited, and there is a large discrepancy between formal statements of ownership, and informal understandings of ownership and control

In general, there is limited disclosure of ownership and control information. According to the Listing Rules, companies must disclose significant (10%) owners annually to the stock exchange. However, compliance with this rule is unclear, and the filings are not made public. Each shareholder can inspect the shareholder registry of the company in which he/it is a shareholder at the CSD; however, the law does not allow any copy to be made of the list. There are no requirements for shareholders to disclose ownership and control positions. The draft Securities Law does contain requirements that would reportedly bring Macedonia in compliance with the EU Transparency Directive.

No institutional framework for audit oversight

There is currently no audit oversight process, although the forthcoming Audit Law is expected to put a basic framework in place.

Company oversight and the board

Optional one-or two-tier board

Joint stock companies can select either a one-tier board (with a board of directors) or a two-tier board (with a supervisory board and management board). A recent census suggests that about half choose each form. The one-tier board consists of both executives and non-executives, with the non-executives in the majority. In a two-tier structure, the supervisory board appoints the management board. Banks currently have a third structure, in which a “managing board” appoints two directors. Under the draft banking law, bank board structure would be harmonized with the requirements of the Company Law.

Optional cumulative voting for the election of the board /

The board of directors / supervisory board is normally elected by majority vote at the GM. If the company chooses a two-tier system, the management board is appointed by the supervisory board. The company charter can opt to elect

supervisory board introduced, but rarely used

directors through cumulative voting, but in practice no companies appear to have done so since the recent introduction of this option in the new Company Law.

Clear new definitions of fiduciary duties for board members

The 2004 Company Law contains relatively strong board duties of loyalty and care. Members of the board(s) are obliged to fulfill their duties ... in the interest of the company and in the interest of shareholders, with due care and diligence. In the event that the members of the management body violate their obligations, they are liable to the company for damages, if they have failed to operate and act with due care and diligence. Shareholders can directly sue members of the board (without waiting for the company to act). Lawsuits against directors are rare to non-existent.

No required audit committee

The company law allows the formation of board committees, but they are not required, and are rare in practice. The draft banking law introduces an audit committee of the supervisory board for banks.

New board independence requirements came into force in 2005

The 2004 Company Law introduced the concept of director independence. At least one member must be independent from the company, the management boards, and the controlling shareholder. Because the independence provisions came into effect at the beginning of 2005, companies are only now in the process of electing new boards (and changing company statutes) to comply with the new law. Market participants report that most companies are moving to comply with the law by the end of the June 2005 deadline. In practice, real independence remains rare, and controlling shareholders nominate and elect boards.

Enforcement

Shareholders have private redress opportunities

Shareholders have a number of private redress possibilities. A shareholder or a group of shareholders holding at least ten percent of voting shares can call an extraordinary meeting of shareholders and a meeting of the board of directors / supervisory board. Shareholders can file suits against directors, although such suits are almost unknown. Shareholders can also sue to overturn meeting decisions. Shareholders in joint stock companies do not have the right to appoint an inspector to audit the company, and withdrawal rights are limited to mergers.

MSEC has very limited ability to oversee listed companies or to intervene to protect shareholder rights, but can investigate complaints

Every shareholder has the right to file a complaint with the MSEC, but MSEC has no special powers that enable it to serve as a specialized shareholder dispute-resolution body. Limited resources and lack of authority over listed companies and their officers have prevented MSEC from playing a major role in protecting shareholder rights. MSEC has played a role in certain high-profile cases (for example, working to invalidate shareholder agreements between management and employees at Makpetrol).

Recommendations

The following policy recommendations are broken down into recommended changes to legislation, institution building, and private sector initiatives, and are further categorized into high priority (immediate action), medium priority (1-2 years) and lower priority (long term / 3-5 years).

Legislative changes

High priority

Revise the Securities Law. The Securities Law should be revised to upgrade the corporate governance framework in a number of areas.

First, the entire disclosure framework should be overhauled, and harmonized with the Company Law and Listing Rules. In general, as an EU accession country, the Law should meet the standards of the EU Transparency Directive. Specific formats for annual, semi-annual, and quarterly reports should be defined that include the non-financial disclosure required by the Company Law (and the OECD Principles), including a full annual report with a management discussion and analysis. Listed companies should be required to report on the extent to which they comply with a national corporate governance code.

Second, ownership disclosure rules should be revised to place the onus of disclosure of ownership on shareholders, including shareholders acting in concert. Insiders should be required to disclose all transactions by company insiders. Shareholders should be required to disclose all significant direct and indirect ownership. The law should fully implement the detailed EU requirements on direct and indirect ownership disclosure for publicly-traded companies.

Second, the authority of the MSEC, and especially its powers to impose sanctions, should be increased. The MSEC should be able to fine issuers that do not meet their statutory disclosure obligations.

Third, the securities law should explicitly state that any restrictions on the transferability of shares should be null and void.

Enact the draft Audit Law. Specific recommendations are contained in the Accounting and Auditing ROSC (2003).

Medium Priority

Revise the Company Law to capture lessons learned and evolving international best practice. Specific recommendations (based on the principle-by-principle assessment) include:

- Expand management competition restrictions to supervisory board members and family;
- Allow shareholders to make a copy of the shareholder list at the CSD;
- To protect shareholders from dilution, consider requiring a rights offering to all shareholders in the event of a capital increase (to allow shareholders who do not participate in a capital increase to benefit), or raise the supermajority required to waive pre-emptive rights from 66 percent to 75 percent;
- Imposing a board meeting requirement on one-tier boards (supervisory boards are required to meet once per quarter);
- Review proxy regulation; policymakers should consider the experience of Slovenia, which carefully regulates proxies (and has had corporate governance concerns similar to FYR Macedonia);
- Remove the possibility for legal entities to sit on boards (which weakens accountability and liability of board members);
- Provide some basic “whistleblower” protection to employees who report fraud or shareholder abuse;
- Streamline related party transaction quorum requirements with those of major transactions.

Lower Priority

Revise the Takeover Law to meet the EU Takeover Directive. As noted, the current Takeover Law is unclear and subject to varying legal interpretations.

Regulate the corporate governance role of the new pension funds. Although the two pension funds are only now in formation, in 3-5 years they will start to play a major role in the corporate governance of the listed sector. Over time, their

role (including disclosure of voting policies, board representation, and the appointment of independent directors) should be examined and regulated, based on international good practice. The experience of Chile (where funds hold major stakes in many listed companies) is a useful starting point.

Institutional Strengthening

Macedonian Securities and Exchange Commission

Develop a strategy to improve corporate governance and shareholder rights. Given the weaknesses in the court system, an active securities market regulator is likely to remain a crucial part of the corporate governance enforcement framework for many years. It is thus important for the MSEC to develop an aspirational strategy for the future. Policymakers should consider what role it should play, and what tasks can or should be delegated to other institutions.

Based on the strategy, build a case for increased budget and resources. The level of resources and staff is currently much too low for the MSEC to carry out an enhanced mission of corporate governance enforcement.

Prioritize enforcement efforts on disclosure and “moral suasion”. MSEC should make the enforcement of disclosure rules a top priority. Given the importance of transparent ownership to overall levels of transparency (and to the enforcement of related party transaction disclosure), the MSEC should work to carefully enforce new ownership disclosure rules, and bring as many sanctions as possible.

Consider delegating the implementation of the new disclosure requirements to the Stock Exchange and its new electronic system. Experience in many countries suggests that Stock Exchanges are better-placed to implement sophisticated electronic information dissemination platforms. If possible, the MSEC should work with the MSE to delegate all disclosure processing tasks to the MSE for publication on its website.

Macedonian Stock Exchange

Revise listing rules in line with Code and new Securities Law. The listing rules (and particularly its disclosure requirements and reporting formats) should be revised and harmonized.

Implement the new SEO-NET system. The MSE should work to rapidly implement the new SEO-NET system, to improve disclosure dissemination. As part of a collaborative partnership with the MSEC, the exchange’s board should consider assuming the role of processing the disclosure of the companies which are registered with the SEC but not listed.

Central Securities Depository

CSD should play a role in information disclosure. The CSD is a key player in the corporate governance framework. However, it is currently an underutilized resource. The CSD could play an important role in the disclosure of information. Laws should be put in place to allow the CSD to: (1) Publish up to date lists of the significant owners of listed companies (either the top 20 owners, or all owners of at least one or two percent of capital), and (2) Maintain lists of company “insiders” (including all types of board members, major shareholders, and their families) and publish records of all trading carried out by the insiders.

Private sector initiatives

High priority

Draft a corporate governance code of best practice. The Stock Exchange, with support from government authorities, should complete its current efforts to draft and implement a corporate governance code of best practice. The code drafting process should combine the best international experience (including the

forthcoming toolkit from the Global Corporate Governance Forum) with a high level of consultation and debate among all of the various stakeholders. The code should focus on board issues, but should address recurring problems of shareholder access at shareholder meetings, and shareholder agreements. Board training should be strongly recommended. Drafters should also consider the inclusion of a true audit committee of the board / supervisory board, to assume responsibility for company internal control policies. A process for evaluating a company's "comply or explain" statements should be designed into the draft code from the beginning and be introduced as a legal requirement (as was recently introduced in the Netherlands). The National Bank should be consulted from an early stage in the development of a code for banks, and should consider the option of making new Code mandatory for all banks.

Medium Priority

Develop a "corporate governance tier" on the Macedonian Stock Exchange.

To build interest in listings, the MSE should create a new corporate governance listing tier. Companies listed on that tier would commit to complying with all corporate governance provisions of the new Code. Over time, this differentiation should voluntarily encourage companies to upgrade to international standards.

Build a training capability for directors. Future resources and donor support should be invested in training non-executive directors and supervisory board members. A number of institutional options are possible to deliver training, including working through Universities, or setting up a free-standing "institute of directors". Developing a demand for training will require a combination of incentives, including recommendations for training in the Code, more support from the corporate and investor communities, and continued work to develop relevant curricula. The government could support the Institute by requiring formal training of board members in companies where the State has participation.

Summary of Key Recommendations

High Priority	Medium Priority	Lower Priority
<ul style="list-style-type: none"> ▪ Revise the Securities Law ▪ Overhaul entire disclosure framework; harmonize with Company Law and Listing Rules ▪ Develop new annual report format in line with Company Law and OECD Principle VI A) ▪ Require companies to report on compliance with the corporate governance code ▪ Fully implement EU requirements on direct and indirect ownership disclosure ▪ Increase authority of the MSEC, and especially its powers to impose sanctions ▪ Any restrictions on the transferability of shares should be null and void ▪ Enact the draft audit law 	<ul style="list-style-type: none"> ▪ Revise the Company Law to capture lessons learned and evolving international best practice 	<ul style="list-style-type: none"> ▪ Revise the Takeover Law to meet the EU Takeover Directive ▪ Regulate the corporate governance role of the new pension funds
<ul style="list-style-type: none"> ▪ MSEC: Develop a strategy to improve corporate governance and shareholder rights ▪ MSEC: Revise listing rules in line with Code and new Securities Law ▪ NDS: Publish up to date lists of the significant owners of listed companies 	<ul style="list-style-type: none"> ▪ MSEC: Greatly increase the amount of resources (staff and budget) available to the MSEC ▪ MSE: Fully implement the new SEO-NET system 	
<ul style="list-style-type: none"> ▪ Draft a corporate governance code of best practice 	<ul style="list-style-type: none"> ▪ Develop a “corporate governance tier” on the MSE ▪ Build a training capability for directors 	

Summary of Observance of OECD Corporate Governance Principles

Principle	O	LO	PO	MO	NO	Comment
I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK						
IA Overall corporate governance framework		X				➤ Rapidly reforming corporate governance framework
IB Legal framework enforceable /transparent		X				➤ New Company Law (2004)
IC Clear division of regulatory responsibilities			X			➤ Relatively clear division of authority
ID Regulatory authority, integrity, resources				X		➤ MSEC has very limited authority and resources
II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS						
IIA Basic shareholder rights		X				➤ Basic rights observed
IIB Rights to part. in fundamental decisions		X				➤ Fundamental decisions decided w/ 66% majority
IIC Shareholders AGM rights			X			➤ Notice period 20 days; some problems w/ access
IID Disproportionate control disclosure				X		➤ Limited ownership disclosure requirements
IIE Control arrangements allowed to function				X		➤ Mandatory bid at 25%; law unclear
IIF Exercise of ownership rights facilitated		X				➤ Modern voting practices (but no inst. Investors)
IIG Shareholders allowed to consult each other			X			➤ No legal obstacles to consultation
III. Equitable Treatment of Shareholders						
IIIA All shareholders should be treated equally			X			➤ Eq. treatment, redress possible
IIIB Prohibit insider trading				X		➤ Insider trading illegal, no enforcement
IIIC Board/Mgrs. disclose interests			X			➤ Significant approval / disclosure requirements
IV. Role of Stakeholders in Corporate Governance						
IVA Legal rights of stakeholders respected		X				➤ Limited direct involvement of workers
IVB Stakeholder redress		X				➤ Stakeholder have access to legal process
IVC Performance-enhancing mechanisms			X			➤ Shares and options available, but rare
IVD Stakeholder disclosure				X		➤ Stakeholders have access to public information
IVE "Whistleblower" protection					X	➤ Limited whistleblower protection
IVF Creditor rights law and enforcement			X			➤ Relatively weak creditor rights in int'l comparisons
V. Disclosure and Transparency						
VA Disclosure standards				X		➤ Weak disclosure compliance
VB Standards of accounting & audit			X			➤ IFRS required for co. consolidated statements
VC Independent audit annually			X			➤ ISA implemented for 2005
VD External auditors should be accountable			X			➤ Limited accountability, no lawsuits
VE Fair & timely dissemination				X		➤ Most info to shareholders, few info channels
VF Research conflicts of interests			X			➤ No specific provisions
VI. Responsibilities of the board						
VIA Acts with due diligence, care		X				➤ Fiduciary duties codified in law
VIB Treat all shareholders fairly			X			➤ Limited legislative guidance on equitable treatment
VIC Apply high ethical standards			X			➤ CSR and codes of ethics at early stage
VID The board should fulfill certain key functions			X			➤ No Code of Best Practice
VIE Exercise objective judgment			X			➤ Independence provisions in new Comp. Law
VIF Access to information		X				➤ Board has legal access to information

Principle - By - Principle Review of Corporate Governance

This section assesses FYR Macedonia's compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed. **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

SECTION I: ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

Principle IA: The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

Assessment: Largely Observed

Capital markets. Market capitalization at the end of 2004 was MD 18.6 billion, or US\$ 413.1 million, a 4.9 percent increase since the end of 2003. Market capitalization at the end of 2004 was 7.9 percent of GDP.² The market is smaller than those in most emerging and transition markets. In 2004, the top 10 companies in the market represented 66.4 percent of total market capitalization, and the top 10 most traded companies accounted for 36.6 percent of total trading volume. The turnover ratio was 44 percent in 2004.

At the end of May 2005 there were 62 companies listed on the Macedonia Stock Exchange (MSE), down from 68 at the beginning of the year, and 98 at the beginning of 2004. This decline reflects the removal of mandatory listing requirements since the beginning of 2005. Mandatory listing was imposed in 2003 and resulted in approximately 100 companies listed on the exchange. Many observers expect the number of listed companies to gradually trend downwards to approximately 20-25 companies.

Ownership framework. FYR Macedonia's privatization program was dominated by management-employee buyouts. As a result, most large companies today are controlled by managers, and in many companies control has not changed since privatization. Formal ownership remains relatively dispersed, with shares owned by current and former employees and management. For example, the average free float of the listed companies on the Macedonian Stock Exchange (whose definition excludes management and registered 10 percent shareholders) was 68.6% at the end of March 2005. Foreign investment remains relatively limited, although over the last year investors from Slovenia and elsewhere in the region have begun taking positions in a number of companies.

Although a variety of privatization measures were implemented throughout transition, the State remains an important owner of Macedonian companies. As of the end of 2004, the government owned 24 enterprises.

Institutional Investors. FYR Macedonia has no active institutional investors acting in a fiduciary capacity. Two private pension plans are now in formation that are expected to become important shareholders in the medium to long term.

Principle IB. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

Assessment: Partially Observed

Corporate legal framework. All domestic companies are incorporated under the *Company Law (CL) 2004*. The Law governs all types of companies, their relationship to shareholders, partners, etc., periodic disclosure and audit requirements. All companies are required to comply with the new law by 30 June 2005.

Company types. Corporate forms allowed under Macedonian law include the joint stock company (*Akcionersko Drustvo*, abbreviated AD), the limited liability company (*Drustvo so ogranicensa odgovornost*, abbreviated DOO), and a variety of partnership forms. The limited liability company and the joint-stock company are the two main corporate forms. Only ADs may issue shares publicly. ADs have a minimum share capital of EUR 25,000 (50,000 for public companies). There are currently approximately 800 joint stock companies registered with the company registrar, of which 677 keep their shares with the CSD, 180 are registered with the MSEC and considered to be "public" companies, of which 62 are listed.

Securities law framework. Public offerings and the equity markets are governed by the *Securities Law (SL)*, most recently

² Source: Macedonia Stock Exchange data.

updated in 2004; a revised law is now in preparation. The Law is implemented by secondary regulation issued by the MSEC. Under the Securities Law, joint stock with more than 100 shareholders and more than million dinars in capital, or which have issued shares through a formal public offering, must be included in a special registry maintained by the MSEC.³ At the end of May 2005, there were 180 companies registered with the MSEC, of which 62 were listed.

Listing rules. There are three segments on the Macedonian Stock Exchange. The Official Market is the market for shares of listed companies. Official market (listed) companies must have more than 2 million in share capital, at least 200 shareholders, and a free float of at least 25 percent, and must submit an application and be approved by the MSE.⁴ Listed companies must be “sponsored” by an MSE member (bank or brokerage company). The listing sponsor helps the issuer in fulfilling the listing responsibilities, and assumes some disclosure obligations to the MSE.

The Unofficial Market consists of shares of unlisted public companies. The “Free market” segment consists of shares of all other joint stock companies. No action is required by the issuer.

Banking Law. The Law on Banks sets a variety of specific corporate governance rules for banks, including a special single-tier board structure, and an “auditing committee” (a shareholder-elected body with limited authority and responsibility). The banking law is expected to be significantly amended by the end of 2005; the draft currently under discussion will remove a number of these special provisions and harmonize banking corporate governance with the company Law.

Codes. There is currently no Code of Corporate Governance or similar set of best practice recommendations. A Code is currently under development, in conjunction with the USAID-sponsored Corporate Governance and Company Law Project and the Dutch government.

Principle IC. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Assessment: Partially Observed

The division of responsibilities among financial sector regulators is clearly articulated. No regulator or government agency is clearly responsible for compliance with the Company Law.

Securities regulator. The Macedonian Securities and Exchange Commission is an autonomous and independent organization responsible for the implementation of the Securities Law, the Investment Funds Law and the Takeover Law (SL, §157). It oversees market intermediaries (legal entities and individuals), the stock exchange, the central securities depository, and securities issuers. The Commission consists of a president and six members. At least two members work full-time as employees (SL, §158). Members are nominated by the Government, and appointed (and dismissed) by the Parliament (SL, §159). The law provides for seven year terms, and has some clauses designed to protect the Commission from early dismissal. The draft Law on Securities contains additional protection against political interference and forced removals. The MSEC is financially independent, and is funded by license fees and charges on trading. The MSEC has independent authority to issue regulations.

The MSEC also keeps a registry of public and other large companies. Per the Law on Securities, companies with more than 100 shareholders, or 100 million dinars in capital, or which have issued shares in a public offering, are required to file with the MSEC.

Stock exchange. The Macedonia Stock Exchange (MSE) is the country’s stock exchange. Founded in 1995, it has 20 shareholders, and trading is conducted by 14 members (6 banks and 8 brokerage houses). Although the exchange has some enforcement powers towards issuers, in fact most enforcement and regulatory authority rests with the MSEC. The MSE has been very involved in corporate governance reform, and is working to issue a corporate governance code (see above).

Central depository. The Central Securities Depository (CSD) is the central registry for all joint stock companies, and is responsible for all clearing and settlement. Operational since 2001, the basic functions of the CSD are: (i) maintaining the register of securities for each issuer; (ii) clearance and settlement of securities transactions; (iii) the provision of additional services to issuers of securities (SL, § 133). The CSD had 60 direct participants at the end of 2003, including custodian banks and brokers, and maintains the accounts for 677 companies, and 220,000 shareholders.

Banking and other regulators. The National Bank of the Republic of Macedonia Bank (NBRP) is the central bank and banking supervisor. The National Bank regulates the corporate governance of banks in the banking law. In addition, Supervisory Circular No. 4 (January 2002) gives detailed descriptions and guidance on the corporate governance of banks and explains in some detail the functions of board committees, their role in the corporate governance and the expected results from their activities.

Company Registrar. Companies are currently required to register with one of three court registers and to file financial statements and important documents with the central register. The current system is inefficient, and suffers from low filing

³ SL, §55a. This assessment adopts the terminology used by some (but not all) market participants and refers to the companies registered with the MSEC as “public” companies.

⁴ Free float as calculated by the MSE is defined as shareholders that exclude holdings by the directors, 10 percent shareholders, and securities held by the State.

compliance and operational weaknesses. FYR Macedonia is currently transitioning to a new central company registry with support from the international donor community. The Central Registry is assuming responsibility for the company registry as part of the implementation of a “one stop shop” registry project. The entire process should be completed by the end of 2005.

Principle ID. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

Assessment: Materially Not Observed

Authority, integrity and resources of regulators. Authority, integrity, and resources of the MSEC are inadequate under current law and operating procedures. MSEC’s authority is relatively strong over brokerage companies and other market participants, because of its licensing authority. However, it has relatively limited formal authority over listed companies and their board members and managers. MSEC has the power to conduct “supervision of companies listed on the stock exchange, regarding the issuance, trading and listing of the securities” and to “conduct control over the complete documentation of the issuers of securities ... for the protection of interests of persons that are owners of or are investing in securities and prevents dishonest and illegal activities related to trading in securities”. The MSEC approves the prospectus for public issue of shares, and takeovers. However, there are few sanctions that the MSEC can impose on listed companies beyond delisting (which harms minority shareholders). The MSEC does not have the power to collect fines. In practice, MSEC can take relatively few actions under the current Securities Law.

MSEC collects revenue from fees charged to market participants, and its revenue base appears to be adequate for its needs. However, the number of staff is currently much too low to carry out its operations. The MSEC currently has nine full time staff, five part-time staff, and two consultants, plus the seven members of the Commission. The number of staff is reportedly held down for budgetary reasons by the Ministry of Finance. Salaries are comparable with those of the National Bank, if less than the private sector, but are reportedly adequate to attract qualified candidates.

Courts. Recent assessments of the private and financial sectors have indicated that the functioning of the judiciary is a constraint to the development of the private and financial sectors. Court efficiency (though not specifically reviewed for this assessment) is considered to be relatively weak in international comparisons, particularly relative to other OECD countries. One indirect way to examine court efficiency is to compare the procedures and time required to enforce a standard contract. FYR Macedonia’s procedures take longer than in many other countries (See *Doing Business 2005* at rru.worldbank.org). The government recently drafted and adopted a Judicial Reform Strategy.

Indicator	FYR Macedonia	Regional Average	OECD Average
Number of procedures	27	29	19
Time (days)	509	412	229
Cost (% of debt)	32.8	17.7	10.8

Shareholder rights groups. The shareholder rights group Akcioner plays an important role as shareholder advocate, drawing attention and media scrutiny to corporate governance abuses. Akcioner owns a few shares in every listed company, attends shareholder meetings, asks questions, and brings a large number of lawsuits against companies.

SECTION II: THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

The corporate governance framework should protect and facilitate the exercise of shareholders’ rights.

Principle IIA: The corporate governance framework should protect shareholders’ rights. Basic shareholder rights include the right to:

Assessment: Largely Observed

(1) Secure methods of ownership registration	Since 2001, all joint stock companies (including listed and unlisted companies and all banks and insurance companies) have been required by law to keep their share registers in the central registry at the Central Securities Depository (CSD) (CL, §274). Evidence of ownership is entry into the CSD’s database (CL, §283(3)). The CSD is responsible for the accuracy of all data (SL, §135). Each account holder is treated as the ultimate beneficial owner under law; there is no legal concept of nominee owner.
(2) Convey or transfer shares	All securities, except bills issued by the National Bank of the Republic of Macedonia, are issued, transferred and maintained as electronic records in the CSD in dematerialized form. Clearing and settlement of transactions executed on the MSE is handled by the CSD. Share settlement is DVP Model 1 (gross share settlement and net cash settlement), with settlement occurring on T+3. The system meets ISSA 2000 standards. ⁵ The system

⁵ This assessment is based on information received from the CSD. The CSD is still waiting for 17f6 certification from the US SEC, which

	<p>functions according to international standards, with no reported problems.</p> <p>By law and listing rules, all listed securities must be fully paid up and fully transferable (SL §94(3)). However, the Company Law does not clearly state the extent to which the transferability of shares can be restricted in the company articles, and private contractual agreements restricting the transferability of shares are generally allowed. The CSD reports that agreements that previously regulated the transferability of shares (which are recorded as pledges in the CSD) are now expiring and are no longer a major concern.⁶</p>
(3) Obtain relevant and material company information on a timely and regular basis	The company is required to keep a variety of by-laws and documents, and make them available to shareholders, including the charter and other by-laws; the minutes and all other documents pertaining to all the general meetings of shareholders; the minutes of the management body and the supervisory board; the annual accounts and other financial statements; all written communication of the company with the company's shareholders; an updated list of the full names and addresses of all board members; audit and appraisal reports (CL, §319-320).
(4) Participate and vote in general shareholder meetings	All shareholders have the right to attend general meetings of shareholders (CL, §382). All holders of common shares (and preferred shares with voting rights) have the right to vote.
(5) Elect and remove board members	<p>Process. The supervisory board (or the board of directors if the company has elected a one-tier system) is elected and removed by AGM resolution (CL, §383). If a two-tier system is selected, the management board is appointed and removed by the supervisory board. Any shareholder regardless of ownership may nominate a director (CL, §394). The GM may dismiss all members of the board of directors (or the supervisory board) or any specific member, prior to the end of their term of office, by a simple majority vote, unless the company charter stipulates a greater majority or different terms (CL, §363).</p> <p>Cumulative voting/proportional representation. Cumulative voting is optional, under the new company law (CL, §344). There is no evidence that any companies have yet opted for cumulative voting in their charters since the recent introduction of this option in the new Company Law.</p>
(6) Share in profits of the corporation	Shareholders are entitled to dividends when they are declared. Dividends are determined and distributed by a GM resolution; dividends can only be paid after contributions to required reserves (CL, §382 and 483). There is no minimum mandatory dividend. There were no reports of significant problems with dividend payments.
Principle IIB. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:	
Assessment: Largely observed	
(1) Amendments to statutes, or articles of incorporation or similar governing company documents	Amendments to company's charter require a two-thirds majority of the voting shares present at the general meeting, unless the charter requires a greater majority (CL, §418). In a census of JSC carried out in 2003 for the Corporate Governance and Company Law project, 88.6 percent of companies reported that the GM approved changes to the charter.
(2) Authorization of additional shares	<p>Issuing share capital. Standard capital increases require an amendment to the company articles (and a two-thirds supermajority vote). (CL, §421)</p> <p>The company charter may also authorize the management body to increase the charter capital up to a certain nominal value (authorized capital) for a period of up to five years. The level of authorized capital cannot be more than 50% higher than the level of capital at the time of authorization (CL, §436). In practice, the use of authorized capital is relatively common.</p> <p>Pre-emptive rights. Existing shareholders have pre-emptive rights (CL, §422, 430). The GM can waive pre-emptive rights with a two-thirds supermajority vote, if the resolution has been placed on the agenda of the GM, and the management board presents a detailed</p>

has been hampered by a lack of interest in joining by global custodians (because of limited investor interest).

⁶ MSEC recently went to court to cancel one shareholder agreement. According to market participants, the directors of MakPetrol had encouraged employee-shareholders to sign a shareholders' agreement that limited the transferability of the shares, so that shares could only be sold to members of the existing shareholder group. The SEC instructed the central securities depository not to accept the shareholders' agreement and then went to court to request that the agreement be cancelled. The court duly cancelled the agreement but according to market participants, a form of informal agreement remained in place and no "outsiders" have been able to purchase MakPetrol shares, even though the company is publicly listed on the Macedonian stock exchange.

	justification, including a justification of the proposed price for the issue of the shares. The charter may stipulate additional conditions for the adoption of the resolution. In addition, preferred shareholders must pass a special resolution with a two-thirds supermajority. (CL, §425)
(3) Extraordinary transactions, including sales of major corporate assets	<p>Sales of major corporate assets. Large transactions have special approval rules, depending on transaction value (CL, §456). Transactions valued at more than 50 percent of asset value must be decided by a 2/3 supermajority vote by shareholders with voting rights.</p> <p>Related party transactions can be approved only by disinterested members of the board / supervisory board. Large related party transactions (representing more than 2% of company assets) must be approved by disinterested shareholders at the GM. Related parties include members of the boards, managers, 20% shareholders, and family members (CL §457).</p>
Principle IIC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:	
Assessment: Partially observed	
(1) Sufficient and timely information on date, location, agenda, and issues to be decided at the general meeting	<p>Meeting deadline. The annual GM must be convened no later than three months after the preparation of the annual accounts, but no later than six months after the end of the calendar year and 14 months after the last annual meeting.</p> <p>Meeting notice and available information. The GM may be called by written invitation, and/or by publication of a public notice to the shareholders, with at least 21 days notice (CL, §387).⁷ The invitation or the public notice for calling the meeting must contain: the business name and registered office of the company; the date and location of the meeting; other procedural formalities stipulated by the charter pertinent to the shareholders' presence at the meeting and the manner of voting; the agenda of the meeting; and where to locate other materials prepared for the meeting. The charter may stipulate additional data to be contained in the invitation (CL, §388).⁸</p> <p>Quorum rules. The quorum requirement is more than 50% of voting shares. The charter can stipulate a higher majority. If quorum is not reached, a second meeting must be scheduled within 15 days. (CL, §393).</p>
(2) Opportunity to ask the board questions at the general meeting	<p>Forcing items onto the agenda. The GM may only pass resolutions on issues included in the agenda. Any shareholder has the right to submit proposals for inclusion on the agenda before the meeting is called. 5 percent shareholders may make a written request to add items to the agenda of meetings that have already been called, within eight days as of the date of the meeting invitation. The body that called the meeting must republish the new agenda item in the same manner in which invitations were sent, at least eight days before the meeting.</p> <p>Questions. Any shareholder may ask questions about the company's "state of affairs and its relations with other companies", if the question is relevant to the agenda (CL, §406). If the shareholder is unhappy with the answer, he or she may request that the question and the reasons for denial be entered into the minutes of the meeting, or file a claim in court within 15 days of the meeting.</p>
(3) Effective shareholder participation in key governance decisions including board and key executive remuneration policy	<p>Shareholders have exclusive power over key corporate decisions, including amendments to the company charter (see Principle IIB). The remuneration of the board is either set by GM resolution, or in the charter. Only the GM has the right to grant profit sharing rights to supervisory board members. Management / executive remuneration (remuneration policy) is set by the board (CL, §384).</p> <p>In general, most companies show relatively little interest in the opinions of minority</p>

⁷ There is no difference in law between general and extraordinary shareholders meetings (CL, §385).

⁸ The 2003 survey carried out by the Corporate Governance and Company Law project contained some useful information about the conduct of shareholder meetings. Nearly 95% of the 390 joint stock companies that held an AGM notified all their shareholders of the annual meeting. In most cases, companies placed notifications of the annual meeting in daily newspapers (78%). Of those surveyed, 50% of the companies notified shareholders at least 21 days before the meeting (in compliance with the law), and another 34% did so well in advance of this, 22 days before or more. Only 16% failed to notify their shareholders according to the legally specified period.

	<p>shareholders that are not part of the controlling group.</p> <p>The opinions of market participants on the conduct of shareholder meetings were mixed. Some felt that dissenting minority shareholders in many companies continue to have problems attending GMs, including the rejection of their identity as shareholders, and their exclusion by bodyguards “protecting” the meeting. Other observers are convinced that the shareholder meeting situation has greatly improved over the past few years, and abuses will be further reduced by the protections in the new Company Law.</p>
(4) Ability to vote both in person or in absentia	<p>Proxy regulations. Shareholders have the right to be represented by proxy (CL, §392). Proxies must be in writing and require notarization. Representatives do not have to be shareholders. As noted below (Principle IID), shareholder agreements have been a major issue. The new Company Law regulates these shareholder agreements; representatives cannot be members of the board, officers of the company, or members of the boards of related / controlled companies. By default, proxies can only be issued for one general meeting.</p> <p>Postal and electronic voting. The charter may allow shareholders to vote by telephone and/or by “other appropriate electronic means” (CL, §400).⁹ The shareholder who voted by phone and/or by other electronic means shall be considered to be present at the meeting and shall be considered as part of the operating quorum necessary for passing resolutions at the general meeting. In practice few companies use this option because of the required investment in electronic infrastructure.</p> <p>Submission of proxies by mail is permitted; voting by mail is not allowed.</p>
<p>Principle IID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.</p>	
<p>Assessment: Materially not observed</p>	
<p>Classes of shares. Companies can issue ordinary shares and multiple classes of preferred shares. Ordinary shares always have voting, dividend, and liquidation rights, and are “one-share / one-vote” (CL, §277, 278). Voting caps are not allowed. Preferred shares can also have voting rights, and can have a number of special rights, including dividends (preferred or cumulative). Non-voting preferred shares can acquire voting rights if dividends have not been paid. Preferred shares are relatively common.</p> <p>A major corporate governance issue has been the regulation of agreements between the company / managers / controlling shareholders, and employee-shareholders. Based on the (old) 1996 company law, management of joint stock companies were allowed to sign shareholder agreements with employees of the company, who were by default also shareholders of the company. These agreements were used to transfer basic rights of minority shareholders to the management of the company, such as the right to vote during general meetings of shareholders, the right to dividends and the right to transfer shares. The duration of an agreement under the old Company Law was typically five years. One quarter of Macedonian joint stock companies (mostly non-listed) had signed agreements with their shareholders in 2003 (USAID CG&CL Project: 2004). The agreements turned over voting rights to management in 71% of the companies where agreements were signed. Other rights given to management included the right to appoint members of the board of directors (4.9%) and the right to transfer (sell or assign) their shares (6.8%). These agreements allow controller-managers to remain in control with a relatively small amount of capital.</p> <p>Ownership disclosure by companies. In general, there is limited disclosure of ownership and control information. According to the Listing Rules, companies must disclose significant (10%) owners annually to the stock exchange. However, compliance with this rule is unclear, and the filings are not made public. Each shareholder can inspect the shareholder registry of the company in which he/it is a shareholder at the CSD (CL, §283 (6)). However, by law, no copy can be made. Data obtained from the inspection shall be used exclusively for the purpose of exercising the shareholders’ rights.</p> <p>Ownership disclosure by shareholders. There are no requirements for shareholders to disclose ownership and control positions. Although there was no mention of the Takeover Law by market participants, Article 64(1) appears to require disclosure by shareholders at the 5% level. The draft Securities Law is reported to significantly boost disclosure requirements, and brings FYR Macedonia into compliance with the EU Transparency Directive.</p> <p>Disclosure of shareholder agreements. The annual report must contain information (in the activity report) about agreements which are significant to the issuer’s economic activity, including agreements known to the issuer made by the shareholders, and insurance or cooperation agreements. In practice, shareholder agreements are not disclosed.</p>	

⁹ By law, allowable systems must be part of the public communications network, and must allow the company to verify the identity of each shareholder, the voting right and the manner of establishing the communication link between the company and the shareholders in such a way that voting is accessible to each shareholder and the conducted voting may be recorded with certainty.

Principle IIE: Markets for corporate control should be allowed to function in an efficient and transparent manner.	
Assessment: Materially not observed	
(1) Transparent and fair rules and procedures governing acquisition of corporate control	<p>Basic description of market for corporate control. FYR Macedonia has a relatively inactive mergers and acquisitions market. There have been four successful takeovers over the past four years; none have been hostile. Management control over most companies makes hostile takeovers difficult or impossible. Because most companies were privatized through management-employee buyouts, privatization has not been a major source of M&A activity.</p> <p>Tender rules/mandatory bid rules. The Takeover Law (2002) applies to all Macedonian companies with more than 25 shareholders and at least 2 million Euros in capital. Article 4 of the law states that shareholders (alone or acting in concert) who have "...acquired securities [which] together with other existing securities in its portfolio, ensures it a voting right of not less than 25%, shall submit a public takeover bid to acquire these securities..." The wording of this provision is vague, and has been subject to various interpretations. The dominant interpretation appears to be that the law requires a mandatory takeover bid with a 25% threshold. FYR Macedonia has not yet implemented the 2004 EU Takeover Directive. Privatization transactions are not covered by these provisions in the law (LSL, Art. 158).</p> <p>Delisting/going private procedures. There are no formal voluntary delisting procedures. One company recently requested delisting, and was granted special (informal) approval to do so. Companies which no longer meet the listing (or MSEC registration) requirements are automatically delisted from the relevant list; no action is required on the company's part.</p> <p>Conversion from joint stock company form to a limited liability company requires a 2/3 supermajority vote. The company is required to buy out shareholders who do not wish to participate in the new company at the book value of the shares (CL, §512).</p> <p>Abuse of buy-backs/treasury shares. Companies can buy back up to ten percent of their shares over a 12 month period, following a 2/3 supermajority shareholder vote. Shares must be purchased through a standard procedure, and proportionately from all employees.</p>
(2) Anti-take-over devices	As noted above, the market for corporate control is limited by concentrated ownership and control. Other potential anti-takeover devices include the introduction of authorized capital and share buy-backs.
Principle IIF: The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.	
Assessment: Largely observed	
(1) Disclosure of corporate governance and voting policies by institutional investors	<p>General obligations to vote/disclosure of voting policy. As noted above, there are currently no institutional investors. There are no rules to require the disclosure of voting or voting policy by institutional investors acting in a fiduciary capacity.</p> <p>Special Rules for Institutional Investors / Pension Funds. None</p> <p>Blocked shares/record date. Shareholders must register their intention to vote before the shareholder meeting. Shareholders are eligible to vote if they are contained on a list prepared by the CSD 48 hours before the date of the meeting. There is no blocking of trades before the general meeting.</p>
(2) Disclosure of management of material conflicts of interest by institutional investors	No rules or regulations are in place, beyond the legal requirements for disclosure of conflicts of interest as noted elsewhere in the report.
Principle IIG: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.	
Assessment: Partially Observed	
<p>Rules on shareholder cooperation in board nomination/election. None.</p> <p>Rules on communication among minority shareholders. All shareholders are allowed to see the entire shareholder list at any time at the NDC, but are not allowed to make paper copies.</p>	

<p>Proxy solicitation or other formalities required. No special rules for institutional shareholders.</p> <p>Rules on communication among institutional investors. None.</p>	
<p>SECTION III: THE EQUITABLE TREATMENT OF SHAREHOLDERS</p>	
<p>The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.</p>	
<p>Principle IIIA: All shareholders of the same series of a class should be treated equally.</p>	
<p>Assessment: Partially Observed</p>	
<p>(1) Equality, fairness, and disclosure of rights within and between share classes</p>	<p>Availability of share class information. Share class information is available in the company charter, which is available from the company register and from the company. However, until the “one-stop shop” system of company operation is fully operational (which is not expected until late 2005 or 2006), the current system is in transition and availability will be limited by obsolete court registers. In addition, share rights are maintained in a CSD database which is accessible to CSD member brokers and by individual shareholders who annually receive a statement of their holdings.</p> <p>Equal rights within classes. Shareholders of the same class of shares have the same rights (CL, §278).</p> <p>Approval by the negatively impacted classes of changes in voting rights. When a resolution (including a resolution amending the charter) changes or restricts any right attached to a certain class of shares, the share class must approve the change in a special vote (CL, §404).</p>
<p>(2) Minority protection from controlling shareholder abuse; minority redress</p>	<p>Shareholders have a number of redress possibilities.</p> <p>Ability to call meeting. Shareholders holding at least 10 percent of voting rights can request the company to call a shareholder meeting at any time (CL, §385). The request must be submitted to the management body at the company’s registered office. In the event that the board / supervisory board fails to call a meeting, the shareholders may submit a proposal for calling the general meeting to the court.</p> <p>Withdrawal rights. Withdrawal (redemption) rights are relatively limited. Only a merger requires a buy-out offer to those shareholders who do not wish to participate (CL §535). The price is set by the company. However, shareholders can file a claim in court to have his shares valued. The court then determines the value, based on the report of an “expert appraiser”.</p> <p>Ability to sue to overturn meeting decisions. A GM resolution may be contested by: (1) a shareholder who participated in the GM and who declared his objection to the resolution in the minutes; (2) a shareholder who did not participate in the GM because he was not allowed to participate in its operations contrary to the law and/or the charter due to the general meeting of shareholders not having been properly called, and/or if the issue subject to the resolution at the meeting was not properly announced; and 3) any shareholder, where the GM adopted a resolution with the intention for shareholders who voted for the resolution to benefit for themselves and/or for a third party, at the expense of the company and/or other shareholders. The claim should be filed within thirty days as of the date of adoption of the resolution. The court may issue an interim measure to prevent the implementation of the resolution, if there is likelihood that the resolution would cause irreparable damage to the company or to a shareholder (CL, §410-413).</p> <p>Any shareholder may also file a claim against the company requesting a resolution to be declared null and void, if it violates one of a number of provisions of the law (CL, §409).</p> <p>Redress from regulators. Shareholders can complain to the MSEC, and the MSEC sometimes investigates complaints. However, the MSEC does not function as a shareholder tribunal for the investigation of shareholder disputes.</p> <p>Ability to sue directors. Under the new Company Law shareholders can directly sue directors, without waiting for the company to act. However, there have been few or no suits in practice, suggesting a procedural and evidentiary difficulty in bringing a case.</p> <p>Inspection Rights. Shareholders cannot request an inspection or special audit.</p>
<p>(3) Custodian voting by instruction from beneficial owners</p>	<p>Because of the basic shareholder recordkeeping structure, custodians as such do not formally exist, because nominee ownership does not exist; the owner of the shares is the holder of record in the accounts of each participant of the CSD.</p>

	If the proxy does not contain restrictions and/or orders, the proxy representative may vote at his own discretion, provided that he always takes into consideration the interests of the shareholder granting the proxy.
(4) Obstacles to cross border voting should be eliminated	There is relatively little foreign investment, and potential problems have not yet emerged. Global custodians are not present. Other than a tax on short term holdings of foreign investors, there is no discrimination against foreign investors, and the modern shareholder recordkeeping system should pose relatively few obstacles to cross border voting.
(5) Equitable treatment of all shareholders at GMs	As noted above, some market participants reported problems with access to shareholder meetings, including the rejection of their identity as shareholders, and their exclusion from the meeting (see Principle IIC(3)).

Principle IIIB: Insider trading and abusive self-dealing should be prohibited.

Assessment: Materially Not Observed

Basic insider trading rules. Insider trading is regulated by the Securities Law (2000) (SL, §152-155). The MSEC is responsible for enforcement. However, secondary regulations required to implement the law have not yet been issued by the Commission.

Inside information is defined as any information related that is not yet public and that (if it did become public) might have significant impact on prices of securities or on a purchase or a sale decision of third parties. Insiders include entities, shareholders, members of management and supervisory boards or boards of directors and employees of legal entities or individuals working for legal entities under a contract, and individuals who by professional duty have access to inside information (and their close relatives). Insiders cannot “acquire material benefit” on the basis of insider information. Individuals who have obtained inside information cannot disclose it to any other person or advise others to buy or sell securities on the basis of the information.

Insider trading disclosure. The issuer must inform MSE once a year (when submitting the audited financial statements) about the changes in the share ownership of the officers (individually) and of the members of the company’s boards (Listing Rules, Rule 6.07).

Criminal/civil/administrative penalties. Criminal penalties for those who illegally disclose information to “obtain property” range from 3 to 10 years (SL, §165(1)). There are no administrative procedures or fines available. There have been no cases or convictions.

Principle IIIC: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Assessment: Partially Observed

RPT disclosure rules. FYR Macedonia has adopted IFRS in full, including IAS 24 (related party transactions). Market participants report that in practice many companies do not disclose related party transactions.¹⁰

RPT approval rules/rules for approval of board/AGM. All related party transactions are subject to the prior approval by the board of directors / supervisory board or the GM of shareholders (CL, §460). A related party transaction requires approval by the general meeting of shareholders by a majority vote of all disinterested shareholders who own voting shares if “the value of assets involved in the transaction and/or series of related transactions is 2% and/or more of the book value of the company’s assets, based on the company’s most recent audited financial statements and/or based on the offered price in case of purchasing property”.¹¹

Boards are generally liable for monitoring conflicts of interest and have the authority to approve or disapprove them. Board resolutions to approve related party transactions that may involve a conflict of interest must be decided by a simple majority of disinterested members. If all members of the board / supervisory board are interested parties, the transaction must be approved by the GM. The board of directors / the supervisory board must specify the price of the assets and/or services sold and/or purchased through the transaction during the procedure for approval of the interested party transaction (CL, §455).

¹⁰ Examples cited by market participants: one company granted loans to its directors, without disclosing them to the public or the Stock Exchange. Another company granted discounts on its products to its directors. Another bank granted enormous loans to related companies that caused its insolvency, which was not publicly disclosed.

¹¹ Similar provisions apply to share transactions and transactions with convertible bonds.

¹² Members of the board of directors / the management board may not, without the approval of the board of directors / the supervisory board: (1) perform activities within the scope of operations of the company; (2) perform any activity or action, paid or unpaid, in another company having the same or a similar scope of operations; (3) be a member of a management body and/or supervisory board, or controller in another company having the same or similar scope of operations as the company; or 4) perform activities in the premises of the company on their own behalf and/or on behalf of a third party.

Conflict of interest rules and use of business opportunities. Members of the management / supervisory board may not compete with the company (CL, §348).¹² Any members of management or a board with a conflict of interest must declare it (CL, §349(2)). However, these rules do not apply to family members, supervisory board members, or to significant shareholders who are not board members.

Shareholders may not vote at the GM on resolutions which exempt them from liabilities or debts to the company, or which give them certain advantages or privileges, or on resolutions to initiate court proceedings against them (CL, §399(1,3)). Companies may not grant loans to members of the management body, the supervisory board, or to a manager and to their close family members, or to a member of the management body, supervisory board, or manager of a controlled company and/or to their close family members (CL, §365(7)).

SECTION IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

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

Principle IVA: The rights of stakeholders that are established by law or through mutual agreements are to be respected.

Assessment: Largely Observed

List of relevant codes for stakeholders. Stakeholder rights are protected by contract or specific laws, such as the labor act, environmental law or the insolvency regime. Employees are significant shareholders, and play a major role in corporate governance. Labor unions and other stakeholders have limited direct involvement in the corporate governance process. There is no codetermination or other required involvement of workers on boards.

Principle IVB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: Largely Observed

Redress mechanisms available to stakeholders. In general, all stakeholders may seek redress in a court procedure. Employees may object a decision of the employer to the board, but the ultimate forum is the court, through a lawsuit by the employee. Employees may also seek protection from the Labor Inspection department of the Ministry of Labor and Social Policy.

Creditors may seek court protection by temporary orders, to restrict, for example, the debtor's right to dispose with its assets. Environmental groups may initiate procedures at the Ministry for Protection of Environment. Customers may seek protection by the Market Inspectorate with the Ministry of Economy.

Principle IVC. Performance-enhancing mechanisms for employee participation should be permitted to develop.

Assessment: Partially Observed

Rules on employee stock option plans. Employees can own shares, and in fact employees (and former employees) are major owners of shares (see above). The company charter may provide for the establishment of a fund from which employees may acquire shares free of charge or at a preferential price (CL, §281). The shares that employees may acquire from the fund shall not exceed one-tenth of the charter capital. A GM resolution lays out the program through which the employees acquire shares. Options are not regulated, and are not prohibited, but are not used in practice.

Principle IVD: Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

Assessment: Materially Not Observed

Stakeholders of public companies (employees, creditors, suppliers, and others) can access publicly available information. However, public information is limited, and most information is available only to shareholders.

Annual report discloses significant facts on employees. There are no specific requirements to disclose significant facts about employees in the annual report, beyond what is required for the reporting of material events. There are no other regulations on communication with employees. The EU Directive on employee information remains to be implemented.

Information is timely and regular. Compliance with periodic disclosure requirements by listed companies is quite low.

Principle IVE: Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

Assessment: Not Observed

Whistleblower rules. Legal experts were not aware of any other protections to “whistleblowers” under the law, or of any jurisprudence or case law.

Principle IVF: The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

Assessment: Partially Observed

Effectiveness of bankruptcy, security/collateral, and debt collection/enforcement codes. Creditor rights (though not specifically reviewed for this assessment) are considered to be relatively weak in international comparisons. A variety of standard measures developed by the World Bank for 130 countries compare FYR Macedonia to its regional neighbors and the OECD average. In these comparisons legal rights are somewhat stronger than in other countries in the region, but access to credit information and the coverage of credit registries is considerably weaker. See *Doing Business 2005* at ru.worldbank.org. A new bankruptcy law is being drafted at this moment and will be in force possibly by the end of 2005.

Creditor Rights Indicator	FYR Macedonia	Regional Average	OECD Average
Cost to create collateral (% of income per capita)	15.9	7.7	5.2
Legal Rights Index (out of a possible 10)	6	5.4	6.3
Credit Information Index	2	2.0	5.0
Public credit registry coverage (borrowers per 1000 adults)	6	6.3	76.2
Private bureau coverage (borrowers per 1000 adults)	0	46.7	577.2

SECTION V: DISCLOSURE AND TRANSPARENCY

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

Principle VA: Disclosure should include, but not be limited to, material information on:

Assessment: Materially Not Observed

(1) Financial and operating results of the company	<p>Annual report. All companies must prepare annual reports to “objectively present” and explain the operations of the company for the preceding business year. Financials must be prepared in line with applicable accounting rules (see Principle VB below), and must be audited (see Principle VC). Consolidation is required. “Public” companies must file the annual audited financial statements with the MSEC. Reports are also available at the company for review by shareholders.</p> <p>Semi-annual report. Companies registered with the MSEC must make semi-annual filings, consisting of non-audited semi-annual financial reports. Listed companies must file unaudited semi-annual financial statements to the MSE.</p> <p>Quarterly report. Companies registered with the MSEC must make quarterly filings, including basic data, changes in equity, legal status and a list of price sensitive information. Listed companies must also file unaudited quarterly financial statements to the MSE.</p> <p>In general, annual report requirements and formats are limited.</p> <p>The companies must submit the information in electronic format (MS Word or Excel), together with a management declaration on the accuracy and authenticity of the data. The quarterly and semi-annual information must be submitted not later than 30 days after the end of the period. The information sent with the year-end data are submitted not later than 60 days after the end of the period. The annual information must be submitted not later than 15 days after the audited report is accepted by the company’s assembly.</p>
(2) Company objectives	In the annual report, companies are required to disclose the main factors and circumstances which influenced operations; any changes in the environment in which the company operates the response of the company to these changes and their impact; investment, dividend, debt and risk management policies, and the sources of the company’s assets.
(3) Major share ownership and voting rights	The annual report does not include information on significant share ownership or share voting rights. These are available at the CSD or from brokers (see Principle IID).

(4) Remuneration policy for board and key executives, and information about directors	The annual report must disclose the earnings of each executive member of the board of directors / member of the management board (specifically including salary, allowances, bonuses, insurance and other rights) and the remuneration of the non-executive members of the board of directors / members of the supervisory board (CL, §283(7)).
(5) Related party transactions	Companies are required to explicitly report on major and related party transactions, as well as share buy-backs, in the annual report (in addition to their responsibilities under IAS 24). Compliance is reportedly limited; see Principle IIIC.
(6) Foreseeable risk factors	In the annual report companies are required to disclose the prospects of future development of the company and its business ventures, and its activities in the field of research and development.
(7) Issues regarding employees and other stakeholders	Aside from creditors, there are no specific requirements for disclosure of issues regarding employees or other stakeholders (aside from the basic requirement to disclose all events that might affect share price).
(8) Governance structures and policies	Comply-or-explain in force. There are no explicit requirements to disclose governance structures, and no Code of Corporate Governance is in place. A Code is under development by the stock exchange and a variety of other stakeholders. Regulator enforcement practice. Not applicable.
Principle VB: Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.	
Assessment: Partially Observed	
Compliance with IFRS. The new Company Law, listed companies, banks, insurance companies, and all other large and medium sized companies preparing consolidated financial statements, must prepare those statements in accordance with IFRS. IFRS were recently translated and placed in the Official Gazette (CL, §4 (CL, §469)). ¹³ Review/enforcement of compliance. Compliance with accounting and auditing standards will be very mixed for some time as companies complete the transition to IFRS, and as procedures to enforce compliance with the standards are put in place. A full discussion of the transition issue is in the Accounting and Auditing ROSC for Macedonia. ¹⁴	
Principle VC: An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.	
Assessment: Partially observed	
A full discussion on audit enforcement and auditor qualifications is presented in the Accounting and Auditing ROSC (2003). Compliance with ISA. According to the 2004 Company Law, the certified auditor must carry out the audit in accordance with International Standards of Audit (ISA). (CL, §479(6)). ISA were recently translated and placed in the Official Gazette. Approximately 23% of the 2003 audits of listed companies are carried out by the local affiliates of international network firms. Who must be audited? All listed companies and large and medium sized companies must be audited by a certified auditor (CL, §478). All banks and savings houses are separately subject to an annual audit requirement (Banking Law, §70). Auditor independence. The adoption of ISA includes the full adoption of the IFAC Code of Ethics. The Audit Law prohibits a statutory auditor from performing bookkeeping, appraisal, or tax services for a client contemporaneously with the audit of the financial statements of the client (Audit Law Part III, Paragraph 27). However, market participants report widespread noncompliance with this auditing profession requirement for independence. ¹⁵ There is no general requirement for auditor rotation for listed firms. For banks, the same auditing company may not conduct more than three successive audits (Banking law, §72). Audit committee. There is no requirement or practice of audit committees of the board (or supervisory board). The draft banking law introduces an audit committee for banks. Under the draft law, bank audit committees (of the supervisory board) can include outside experts (although a majority must be board members), and assume a variety of responsibilities, including responsibility for the audit process, internal controls, and the internal auditor (Draft Law on Banks, §61).	

¹³ By law, any revisions to IFRS must be adopted in Macedonia on an annual basis.

¹⁴ See Accounting and Auditing ROSC for Macedonia at http://www.worldbank.org/ifa/rosc_aa_mcd.pdf.

¹⁵ According to the 2003 Accounting and Auditing ROSC, One audit firm in FYR Macedonia reportedly audits the financial statements of a company where one of its audit partners serves on the Board of Directors. Also, certain audit partners incorporate two separate legal entities (for example, an audit firm and a consulting company) to circumvent the letter of the law.

Requirements for oversight of audit. Auditors are appointed by the GM of shareholders. Traditionally, the GM approves the selection of the auditor based on a recommendation from the board of directors / management board.

Competent and Qualified Audit Enforcement. The institutional framework for audit oversight and enforcement is relatively limited. There is no public oversight mechanism, and no professional body that regulates auditors. The draft revised Audit Law establishes a new institutional framework for the audit oversight of the audit profession.

Auditor qualifications. The Audit Law establishes the qualifications for certified auditors.

Discussion of statutory auditors' role and responsibilities. Under Company Law, there is no requirement for any type of shareholder oversight body. However, under the Banking Law, the GMs of banks have elected "auditing committees" which are designed to carry out oversight roles. However, these bodies suffer from the weaknesses of such bodies in other countries, specifically: they are dominated by controlling shareholders (who appoint them), have no independence or objectivity, and have no real power. Bank auditing committees are restructured under the draft banking law into actual committees of the supervisory board (see above).

Principle VD: External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

Assessment: Partially Observed

Auditor accountability. Auditors are appointed by shareholders, and owe a basic duty to the company to fulfill contractual obligations.

However, Macedonian law relating to the accountability and liability of audit firms and auditors is vague and untested. Under the Audit Law, an auditor or an audit firm is obliged to provide auditing services duly and carefully and to observe the rules of the profession. Auditors have so-called "objective liability" for any damages incurred in connection with the services the auditor provides, but may be released from such liability only if he/she proves having exercised all reasonably required efforts. The law fails to specify if third parties (e.g., creditors, shareholders, or any person relying in good faith on the auditor's opinion) may have a direct recourse against the auditor. In general, legal experts believe that third parties would have difficulty proving before a Macedonian court that they have privity and legal standing to pursue a claim for damages against an auditor. It is also uncertain whether the auditor is liable for damages vis-à-vis the regulatory authorities other than the National Bank. In practice, market participants reported no court decisions or claims against auditors.

Auditor insurance. The Audit Law requires audit firms to take out professional indemnity insurance, but the amount of insurance coverage is not in the public domain. In the event that the auditor's insurer does not satisfy the plaintiff's claim for damages, plaintiff may initiate judicial proceedings against the audit firm and against any or all of the auditors (individuals) who have participated in providing the audit services. Audit firms are incorporated as a limited liability company with very low share capital, which offers little protection to claimants.

Principle VE: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

Assessment: Materially Not Observed

In theory, information is available to the public through several channels.

- The company is required to keep a variety of by-laws and documents, and make them available to shareholders, including the charter and other by-laws; the minutes and all other documents pertaining to all the general meetings of shareholders; the minutes of the management body and the supervisory board; the annual accounts and other financial statements; all written communication of the company with the company's shareholders; an updated list of the full names and addresses of all board members; audit and appraisal reports (CL, §319-320).
- Information filed with the court registry systems (including company charters) should be freely available for a small fee to the public. In practice, because of operational problems and compliance problems, charters are difficult to obtain. By late 2005-2006, the Central Registry will become a valuable source of basic information about all companies, and company charters and financial statements should gradually become publicly available.
- Companies registered with the MSEC (including listed companies) are required to submit annual financial statements within one week of acceptance by the GM, and quarterly and semi-annual statements within one month of period end, in electronic format, to the MSEC and to the MSE (for listed companies). Both the MSEC and MSE intend to publish the filings on their respective websites. However, lack of compliance with filing requirements has resulted in very limited information being available. The most recent financial statements published on the MSEC website dated to 2001, and no reports appeared to be available on the MSE website.

In practice, law and practice tend to result in most information disclosure in most companies being limited to shareholders, and available directly from the company.

Material facts. Public companies are required to issue current reports on information about any events that may substantially affect the price or the value of the securities, to the MSEC and the MSE. The companies are also obliged to submit all other current price sensitive information, especially: changes of the members of the board of directors, supervisory board, intentions for takeover and takeovers, signing of any significant contract. Reports must be submitted "promptly" and

not later than 15 days of their occurrence.

Published information (papers, web). Some leading companies do maintain comprehensive websites and publish financial statements (e.g. Alkaloid, Toplicakacija).

Principle VF: The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

Assessment: Partially Observed

Disclosure of conflicts of interest by analysts, brokers, rating agencies, etc. There are no specific provisions regulating the conflict of interest by analysts. Brokers are regulated by a variety of laws and regulations designed to protect customers and reduce conflicts of interest.

SECTION VI: THE RESPONSIBILITIES OF THE BOARD

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

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

Assessment: Largely observed

Basic description of board. Joint stock companies have the option of choosing one-tier or two-tier boards. Under the two-tier system, there is a supervisory board and a management board. The function of company secretary does not exist in law (although some are appointed in practice). In a census of JSC carried out in 2003 for the Corporate Governance and Company Law project, 53.8 selected the two-tier form.

Size requirements and typical size. The one-tier board of directors must have between three and fifteen members (CL, §367(1)). Under a two-tier system, both boards must have between three and eleven members (CL, §378). According to the 2003 JSC Census, 81.2 percent of one-tier boards had between 4-7 members, and 76.8 percent of supervisory boards in two tier systems had less than seven members.

Nomination and election. If the company elects the two-tier system, the supervisory board is elected by the AGM, which in turn appoints the management board. Under the one-tier system, the AGM elects the board, and from among the elected members, appoints one or more "executive members" (who are senior management). The number of executive members must be lower than the number of non-executive members. The company can choose to elect directors through [cumulative voting](#).

Eligibility requirements. Members of the management board cannot sit on the supervisory board (CL, Art. 374(5)). Executive board members (in the one-tier system) cannot serve on any other boards. No person can serve as a board member if a "protective measure is pronounced" against them. Other than the restrictions on the number of boards on which a member can serve, the law imposes no restrictions on board members. Legal entities can be appointed as board members (CL, 343(2)). Board members do not have to be shareholders. Board terms are set by the charter, but are four years by default, up to a maximum of six years.

Adequacy of duties of loyalty and care. The new company law contains relatively strong board duties of loyalty and care. Members of the board(s) are obliged to fulfill their duties ... in the interest of the company and in the interest of shareholders, with due care and diligence. Board members may not transfer their responsibility to other members of the management or supervisory board (CL, §361). In the event that the members of the management body violate their obligations, they are liable to the company for damages, if they have failed to operate and act with due care and diligence (CL, §362).¹⁶ If the board does not act, shareholders can sue members of the board. Board members who point out legal violations or who note objections in the minutes are not liable for damages (CL, §362). Lawsuits against directors are rare to non-existent.

Insurance for directors. There is no practice of providing insurance for board members.

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

¹⁶ Board members are specifically liable if they: 1) return a shareholder's contribution to the company; 2) pay interest and/or dividends to the shareholders; 3) subscribe, acquire, accept as a security and/or withdraw the shares of the company; 4) divide the assets of the company; 5) make payments after the company has become insolvent or over indebted; 6) submit false annual accounts and financial statements; 7) abuse and dispose of the assets of the company without authorization; and 8) in case of the conditional increase of the charter capital, they issue shares contrary to its purpose and/or issue shares before the full payment of shares from the previous issue has been received.

Assessment: Partially observed	
Board members are required to act in the interest of all shareholders (although there is no specific requirement to treat all shareholders equally). In practice, according to market participants, most boards continue to act in the interest of those the controlling shareholders that appoint them.	
Principle VIC: The board should apply high ethical standards. It should take into account the interests of stakeholders.	
Assessment: Partially Observed	
The development of corporate social responsibility and company codes of ethics is at a relatively early stage.	
Principle VID: The board should fulfill certain key functions, including:	
Assessment: Partially observed	
(1) Board oversight of general corporate strategy and major decisions	<p>Board functionality by law, in practice, as recommended by Code. In a one-tier framework, the board of directors has broad authority to manage the company, and can act in all areas except those explicitly granted to the non-executive members of the board of directors. The non-executive members exercise the right of supervision over the management by the executive members, and are entitled to inspect and verify the books and documents of the company, and may oblige any employee in the company and/or another expert to carry out certain expert matters related to supervision.</p> <p>In a two-tier framework, the management board is responsible for all management functions and day-to-day activities of the company, except for authorizations explicitly granted to the general meeting of shareholders and the supervisory board. The supervisory board supervises the management of the company. The supervisory board may inspect and verify the books and documents of the company, and may oblige certain members of the board, the certified auditor and/or experts, to carry out certain expert matters related to supervision.</p> <p>Director training, IOD. There are no institutionalized director training programs in FYR Macedonia. The Corporate Governance and Company Law Project has delivered a large number of training programs on corporate governance and the role of the boards.</p>
(2) Monitoring effectiveness of company governance practices	There is no systematic oversight of company governance practices.
(3) Selecting / compensating / monitoring / replacing key executives	In a one-tier system, senior management is appointed from among the board members. In a two-tier system, the supervisory board appoints and recalls members of the management board.
(4) Aligning executive and board pay with long term company and shareholder interests	The remuneration of the executive directors / the management board is determined by the board / supervisory board.
(5) Transparent board nomination / election process	<p>There are no rules governing the role of the board(s) in the nomination process.</p> <p>Before the board election, the company is required to publish information about each candidate, including age, gender, education and other professional qualifications, working experience and how it was gained, in which companies he is and/or has been a member of the management body or the supervisory board, other important positions held by him, the number of shares he owns in the company and in other companies, and any loans and other liabilities towards the company (CL, § 344(3)).</p>
(6) Oversight of insider conflicts of interest, including misuse of company assets and abuse in RPTs	Boards have a statutory role in approving related party transactions and conflicts of interest between board members and the company (see Principle IIC).
(7) Oversight of accounting and financial reporting systems, including independent audit and control	The annual accounts and financial statements must be signed by an executive member of the board (or an officer appointed by the management board, or by the president of the management board or the manager) (CL, §476(6)). The non-executive members of the board of directors (or the supervisory board must review the annual accounts and financial statements. At their request, the auditor must attend the board / supervisory board meeting

systems	(CL, §480). There does not appear to be any specific responsibility assigned for internal control policies and systems.
(8) Overseeing disclosure and communications processes	There is no systematic involvement of non-executive directors / the supervisory board in disclosure. As noted above, in a two-tier framework, the management board is responsible for financial reporting and other disclosure.
Principle VIE: The board should be able to exercise objective independent judgment on corporate affairs.	
Assessment: Partially Observed	
(1) Director independence	<p>Director independence in law and in Code. The 2004 Company Law introduced the concept of director independence.¹⁷</p> <p>If the company chooses a one-tier system, the number of executive members must be lower than the number of non-executive members (CL, §367(4)). The independent directors must be elected from among the non-executives. If the company has chosen a two-tier board structure, independent directors must be elected to the supervisory board. The company must specify which directors are elected as independent. (CL, §378).</p> <p>If the number of non-executives on the one-tier board of directors (or a supervisory board) is four or less, at least one must be independent. If the number of non-executives/size of the supervisory board is greater than 4, then 25% must be independent (CL §367(5)).</p> <p>Director independence in practice. Because the independence provisions will come into effect on June 30, 2005, companies are now electing new boards (and changing company statutes) to comply with the new law. Market participants report that most companies are moving to comply with the law by the end of June 2005. In practice, real independence remains rare, as the controlling shareholders nominate and elect boards.</p>
(2) Clear and transparent rules on board committees	<p>Audit committees. Boards have the right (but not the obligation) to establish “one or more” committees (CL §359). Committees cannot make decisions on matters that fall under the authority of the board. There are no special rules for banks or other financial institutions to establish true audit committees of the board. In practice, audit committees of the board appear to be very rare, and market participants were not aware of any companies that had yet established one. The draft banking law introduces audit committees of the supervisory board – see Principle VC.</p> <p>Other committees. Banks must establish risk management committees, and “auditing committees” (which are elected by shareholders and are not true board committees). Outside of banks, committees are very rare.</p>
(3) Board commitment to responsibilities	<p>Restrictions on the number of board seats. Members of boards may not serve on more than five other boards as the non-executive members (one-tier board) / members of the supervisory board (two-tier board). Executives (management board members) may not serve as executive board members / members of management boards, except in banks and insurance companies (CL, §346).</p> <p>Board meeting requirements. For two-tier boards, supervisory boards must meet at least four times a year (CL §381). Management boards must “hold meetings when required for the carrying out of operations that fall within the scope of its competencies.” One-tier boards appear to have no meeting frequency requirements.</p> <p>Public availability of board attendance. Board attendance is recorded in the minutes (CL, §360). Board minutes are available to shareholders at the company (CL, §319).</p>
Principle VIF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.	
Assessment: Largely Observed	
Management must submit a written report on the operations of the company to the board of directors / the supervisory	

¹⁷ Independent directors are individuals who (along with their family members): (1) has not had any material interest or business relation with the company directly as a business partner, a member of the management body, supervisory body or an officer of the company within the five preceding years; (2) has not within the five preceding years received and does not receive from the company any additional income to his salary; (3) is not a relative of any of the members of the management body, supervisory board or the officers of the company; and (4) is not a shareholder who owns more than one tenth of the shares in the company or who represents a shareholder who owns more than one tenth of the shares in the company (CL, §3)

board, at least once every three months, including the annual financial statements and annual report at the end of the business year (CL, §352). At the request of the non-executive members of the board of directors / the supervisory board, management must prepare a special report on the company and/or on any specific issues.

The non-executive members of the board of directors / the supervisory board may “undertake actions for the purpose of carrying out an inspection over the operations of the company”. One-third of the non-executive members of the board / the supervisory board can demand that management prepare “all documents and notifications required for the supervision over the operations.”

Terms/Acronyms

Acquis Communautaire The body of legislation of the European Communities and the European Union. Applicant countries must accept the acquis before they can join the EU.

GM: General Shareholders Meeting

MSE: Macedonian Stock Exchange

SL: Securities Law (last amended 2003)

CL: Company Law 2004 (Company law regulating all commercial legal entities in the country)

MSEC: Macedonian Securities and Exchange Commission

Co-determination: Term used to describe labor representation (employees and union representatives) on supervisory boards (particularly of German companies and prior to the enactment of the CL on Macedonian boards).

Cross Shareholding: Cross shareholding refers to reciprocal shareholdings between two companies.

Cumulative voting: Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two groups of shareholders; one shareholder holding 80 percent of the votes and a group of minority shareholders holding 20 percent. Five directors need to be elected. Without a cumulative voting rule, shareholders vote separately for each director. The majority shareholder can elect five directors since s/he can outvote the minority shareholders by 80:20. Cumulative voting would allow a group of educated minority shareholders to cast all votes (five times 20 percent) for one board member, thereby allowing the chosen candidate to win that seat.

GDP: Gross Domestic Product.

ISA: International Standards on Auditing

IFRS: International Financial Reporting Standards

CSD: Central Securities Depository

Pre-emptive rights: Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued if they have the financial means to acquire newly issued shares.

Proportional representation: Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.

Pyramid Structures: Pyramid structures are structures of holdings and sub holdings by which ownership and control are built up in layers. They enable certain shareholders to maintain control through multiple layers of ownership, while at the same time they share the investment and the risk with other shareholders at each intermediate ownership tier.

RPT: Related party transactions. The OECD Principles of Corporate Governance hold that it is important for the market to know whether a company is being operated with due regard to the interests of all its investors. It is therefore vital for the company to fully disclose material related party transactions to the market, including whether they have occurred at arms-length and on normal market terms. Related parties can include entities that control or are under common control with the company, and significant shareholders, such as relatives and key managers.

Shareholder agreement: An agreement between shareholders on the administration of the company, shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.

Share Parking: The practice of temporarily holding shares under a variety of names to disguise a large ownership position.

Squeeze-out right: The squeeze-out right (sometimes called a "freeze-out") is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.

Withdrawal rights: Withdrawal rights (referred to in some jurisdictions as the "redemption rights", or the "dissenters", "oppressed minority," "appraisal" or "buy-out" remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities, and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OECD Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate governance practices
- provide a benchmark by which countries can evaluate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- provide the basis for a policy dialogue which will result in the implementation of policy recommendations

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