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

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Abstract

The influence of local culture on the way business is conducted has been recognized by a whole array of literature (e.g. Hofstede, 2001). Due to the focus on the financial industry throughout the last several years, other vital sectors such as the extractive industry have been neglected by academic research. This is even more surprising given the fact that the extractive industry is a particularly exciting subject of study. Its main capital is mining rights to explore and exploit the natural resources in a specific geographic area. Once a corporation decides to start exploitation, the venture is most likely to employ lots of workers from the communities around the plant. This unavoidably entangles the companies closely with local and national politics.

This paper inquires into the reporting of corporate governance in the extractive industry. For the purpose of this study, four Russian companies in the Oil and Gas sector and four South African gold producers were chosen. Despite obvious differences in the mining process, both sectors are vital to the economies of both nations and both are under strong influence of regulations and politics. Both groups report about their corporate governance on a very high level. The paper concludes that the notion of closed and opaque Russian companies does not hold any longer.

Keywords: Corporate Governance Reporting, Extractive Industry, Russian Federation, South Africa, Oil and Gas, Gold Mining

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Introduction

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

Insights into the corporate governance mechanisms of companies can be of vital interest to investors, particularly if the company is situated in a country that is not at the same stage of accepted accountability practices as the investor would expect. One could argue that with the spread of internationally accepted standards of accountability and corporate governance, these systems would be widely comparable. The answer to such a position must be yes and no. Yes, the listing requirements on the major European and US stock exchanges force companies to comply with the relevant and applicable regulation; for example SOX or the UK Corporate Governance code for companies listed on the London Stock exchange. On the other hand, these sets of standards largely address formalisms and run the risk of eliciting a box-ticking or copy-and-paste exercise instead of being a true reflection of business conduct.

Yet, there are sector-specific differences in the extent of the influence dependant on the degree of internationalization. The banking sector or the airline sector with lots of shared business interests with other partners are probably a good example of fairly internationalized sectors. In contrast to the openness and international approach of, for example, the airline industry, the extractive industry is much more secretive. Its main capital is mining rights to explore and exploit the natural resources in a specific geographic area. Once a corporation decides to start exploitation, the venture is most likely to employ many workers from the communities around the plant. This entangles the companies, closely and unavoidably, with local and national politics.

The influence of local culture on the way business is conducted has been recognized by a whole array of literature (e.g. Hofstede, 2001). A nation’s tradition is part of its people’s mindset and holds strong explicatory power on social values. This perception of what is good or bad influences whether the public sees a company’s action as legitimate and
will thereby influence how companies operate and report (Lehman, 1995; Deegan and Rankin, 1996).

This paper inquires into the reporting of corporate governance in the extractive industry. For the purpose of this study, Russian companies in the Oil and Gas sector and South African gold producers were chosen. Despite obvious differences in the mining process, both sectors are vital to the economies of both nations and both are under strong influence of regulations and politics.

South Africa

South Africa, the largest economy in Africa with its historically Anglo-Saxon shaped administration, applies a very westernized approach to corporate governance such as the market-based model of corporate governance and its dominant shareholders’ view. Its companies use single-tiered boards without any representation of stakeholders such as employees. The steps South Africa decides to take in pursuance of their economic policy are often echoed throughout Africa. The current Corporate Governance Code, King III, takes an interesting route and tries to strike a balance between international developments and African particularities. South Africa, together with the 56 countries of the Commonwealth and the 27 EU members, chose a code of principles and practices on a ‘comply or explain’ basis. Thereby, companies should have enough freedom to balance the cost of compliance with their immanent business needs (Gstraunthaler, 2010).

Despite the strong focus on the attraction of foreign direct investments into South Africa and a strongly market-oriented economic system, there is pressure for a more ‘social’ redistribution of wealth (e.g. the Congress of South African Trade Unions) or the pursuit of socialist ideologies (e.g. South African Communist party). Rejecting free markets as the driver of economic growth, they instead suggest strong government interventions to overcome the debilitating legacy of uneven development and extreme socioeconomic inequalities (Andreasson, 2007). This has inspired some authors to take extreme positions, rejecting the shareholder wealth maximization model as “incongruent with South Africa’s commitment to situating the corporation within civil society” (Sarra, 2004: 21).

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

uBuntu is usually translated as “I am, because we are; and since we are, therefore I am” (Mbiti, 1989, p. 110). Every individual is an extension of others, and therefore reaching the fullness of his/her potential without the concrete act of relating to other individual persons is impossible. Yet, little is known about how these African values would shape private corporations. One possibility is decision-making by consensus (Nash, 2002; Wiredu, 1977), discussing matters with everybody concerned.

Russia

After the fall of the Soviet system, the Russian economy went through turbulent times. It collapsed in 1991-92 and did not take off until 1998, only to collapse again. Nevertheless, from 2000 until 2008 the GDP and other indicators improved. The currency has devalued frequently throughout the last several years and the government has defaulted on its debt (dollar and ruble denominated). In 2010, due to the higher price for oil, the ruble strengthened. However, corruption is still rampant in the country, tax collection is abysmal, and new investment – for the reasons just mentioned – rare. For other than the extractive industries, the fundamental expectations for growth are quite doubtful.

One of the most decisive events in Russia’s recent economic history was the phase of privatization it went through. The driving idea was that profit incentives, unleashed by privatization, would soon revive the faltering companies held by the state and thus close the gap with their western peers. Yet, this never happened.

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

The mass privatizations in a country with few possibilities to control self-dealing, offered opportunities for managers and controlling shareholders to accumulate assets. Also, new business creation was prevented through a punitive tax-system, official corruption, organized crime and an unfriendly bureaucracy. Corporate control should be enforced through the market, the idea being that a good owner would buy a bad owner’s assets and be more efficient, which would, in turn, be more valued by the market. Why then did the market not provide the expected solution?

“Good owners don’t exist in Russia in significant numbers or with the capital to buy large enterprises. If they existed, they wouldn’t pay a bad

owner anything close to fair value, because they couldn’t verify what shape the business was in. Moreover, the business might be worth more to the bad owner, who has a comparative advantage in the important tasks of self-dealing, evading taxes, obtaining favors from the government, not paying workers, and using effective albeit unofficial means (read: the Mafia) to enforce contracts and scare off competitors. In contrast, “an honest owner risks having the government expropriate his investment” (Black, Kraakman & Tarasova, 2000, p. 6). Now, this statement was made a decade ago and certainly needs to be revisited.

**Methodology**

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

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

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

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

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<th>Table 1. Companies included in the study</th>
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<td>LUKOIL</td>
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<td>Village Main Reef Gold Mining Company (1934) Ltd</td>
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The structure of analysis used in the paper is as follows: Firstly, the information about the board structure and the committees is screened. Subsequently, the focus moves on to the reporting on risk management and internal control. Thereafter, social issues such corporate social investments, environmental issues, etc. are analysed.

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

**AngloGold Ashanti**

**About the company**

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

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

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

**The board**

In 2008 the board faced the handling of the global financial crisis, particularly driven by a strong decline in the gold price. In addition, the board was engaged in the successful refinancing of the company’s convertible bond, due in February 2009. The board structure of Anglo-Ashanti is strongly in line with the recommendations of King III. The board is directed
by an independent non-executive director, as is the
deputy. The two executive directors share their
attendance on the board with 10 independent non-
executive directors.

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

Directors are required to retire after three
years at the annual general meeting. This is a suggestion
from the King III report. New directors can be
appointed by the board after being suggested by the
Nomination Committee. These directors have to stand
for election by shareholders at the next annual general
meeting.

The board has the following committees:
• Audit and Corporate Governance Committee,
• Transformation and Human Resources
Development Committee (formerly the
Employment Equity and Development
Committee),
• Investment Committee,
• Nominations Committee,
• Political donation Committee
• Remuneration Committee
• Safety, Health and Sustainable Development
Committee.

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

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

The company offers detailed descriptions about
the set-up and meetings of the committees. However,
little can be gleaned about the actual activities
undertaken throughout the year.

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

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

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

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

Directors’ share trading

Directors, as well as employees of AngloGold
Ashanti who have access to price sensitive
information, are prevented from trading in the
company’s shares during certain closed periods.
Closed periods last from the end of the reporting
period to the date of publication of the quarterly, half-
yearly and year-end results. If directors and key
employees want to deal in the company’s shares, they
are obliged to follow a formal process. Dealing in
warrants and derivatives of the company is forbidden
to them at any time.

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

Audit and Corporate Governance
Committee

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

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

**Risk Management and Internal Control**

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

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

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

The report includes a comprehensive list of all relevant risks related to the gold mining industry in general, such as:

- Global economic conditions could adversely affect the profitability of AngloGold Ashanti's operations.
- Commodity market price fluctuations could adversely affect the profitability of AngloGold Ashanti's operations.
- Uncertainty and costs of mining exploration and acquisition.
- Development risk.
- Ore reserve estimation risk.
- Production or mining industry risk.

And to the operations of AngloGold Ashanti in particular:

- AngloGold Ashanti’s level of indebtedness could adversely affect its business.
- AngloGold Ashanti uses gold hedging instruments and has entered into long-term sales contracts, which may prevent the company from realizing potential gains resulting from subsequent commodity price increases in the future. AngloGold Ashanti’s reported financial condition could be adversely affected as a result of the need to fair value all of its hedge contracts.
- Power stoppages, fluctuations and energy cost increases could adversely affect AngloGold Ashanti’s results of operations and its financial condition.
- Foreign exchange fluctuations could have a material adverse effect on AngloGold Ashanti’s operational results and financial condition.
- AngloGold Ashanti’s new order mining rights in South Africa could be suspended or cancelled should the company breach, and fail to remedy such breach of, its obligations in respect of the acquisition of these rights.
- The introduction of South African State royalties where a significant portion of AngloGold Ashanti’s Mineral Reserves and operations are located will have an adverse effect on its results of operations and its financial condition.
- AngloGold Ashanti’s Mineral Reserves, deposits and mining operations are located in countries that face political, economic and/or security risks.
- AngloGold Ashanti competes with mining and other companies for key human resources.
- AngloGold Ashanti faces certain risks in dealing with HIV/AIDS that may adversely affect the profitability of AngloGold Ashanti’s operations.
- The treatment of occupational health diseases and the potential liabilities related to occupational health diseases may have an adverse effect upon the results of AngloGold Ashanti’s operations and its financial condition.
- The costs associated with the pumping of water inflows from closed mines adjacent to AngloGold Ashanti’s operations could have an adverse effect upon operational results.
- Risks related to AngloGold Ashanti’s ordinary shares and American Depositary Shares are:
  - Sales of large quantities of AngloGold Ashanti’s ordinary shares and ADSs, or the perception that these sales may occur, could adversely affect the prevailing market price of such securities.
  - Fluctuations in the exchange rate of currencies may reduce the market value of AngloGold Ashanti’s securities, as well as the market value of any dividends or distributions paid by AngloGold Ashanti.
  - The recently announced proposal by the South African Government to replace the Secondary Tax on Companies with a withholding tax on dividends and other distributions may impact the amount of dividends or other distributions received by the company’s shareholders.
- One other company reported on operational risks. All companies in the sector gave a detailed analysis of their financial risks, mainly credit risk and liquidity risk. Only one company specifically named commodity price risks. Interesting is the sensitivity analysis that AngloGold Ashanti discloses. As the mining operations consume a lot of oil, the company discloses its price dependency on the rise of oil prices.

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

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

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

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

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

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

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

Shortage of skills

As in so many sectors of the South African economy, there is a prevailing shortage of skills in the mining industry. Being aware of the threat that this situation can impose on a company of this size, AngloGold Ashanti introduces the System for the Management of People (SMP) for the system and structure, called the System for the Management of People (SMP) is being undertaken. Given the changing world of work, the current socioeconomic climate and continued key skills shortages in the mining industry, this is considered a strategic imperative.

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

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

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

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

Environmental concerns

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

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

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

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

Human rights

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

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

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

To actively tackle the technical skills that are linked with disciplines such as mining, metallurgy, and engineering which are key to continued operations, the company offered bursaries within these fields of study. Once these skills are acquired, the company focuses on the retention of these key personnel. The company gives 70% of these bursaries to historically disadvantaged South Africans, but notes that it takes a long time before these students reach the level of top management. On average, the company spends 4-5% of their payroll on skills development. Throughout the commodity boom, the company lost a great number of their employees.

In particular, employees in the official ranks (Geosciences, shift bosses, engineering and metallurgical foremen and selected others, such as training officers in the technical fields and rock engineering officers) were in high demand. For miners and artisans, the company offered a salary increase together with a retention bonus.

LUKOIL

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

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

Throughout the past few years LUKOIL has engaged in a major restructuring program.

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

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

Other companies in the Russian oil and gas sector conducted similar restructuring programs. One example is Tatneft:

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

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

LUKOIL states right at the beginning of the corporate governance section that the system of corporate governance, which has been put in place by LUKOIL, is an effective tool for protecting the rights and observing the interests of company shareholders.

Board of directors and management

LUKOIL has 23 directors, 11 of whom are non-executives (five are independent). The company operates a Strategy and Investment Committee, a Human Resources and Compensation Committee and an Audit Committee. The description of the committees is short, but contains the necessary information, namely the scope of its responsibilities and its members.

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

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

Other companies in the same sector also have quite prominent members on their board of directors.
In Tatneft for example there is the Minister of Land and Property Relations of the Republic of Tatastan and the director of the Almetyevo branch office of the National Non-state Retirement Fund.

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

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

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

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

Risk management and internal control

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

The system of control and internal audit is an integral part of the Company’s corporate governance structure, enabling the company to function efficiently and the interest of its shareholders and investors to be protected. The Group has created a Unified Control and Internal Audit Service, which ensures that management receives objective and accurate information on the business of organizations in LUKOIL Group and of its structural subdivisions.

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

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

Rosneft also operates audit commissions and states their scope.

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

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

Environmental issues

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

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

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

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

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

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

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

New versions of the following corporate system-wide documents came into effect in 2008:
Managers for integrated management system of industrial safety, labor safety and environmental protection of OAO TATNEFT;
- Procedure for management of industrial risks of OAO TATNEFT;
- Manual for internal audit of integrated management system of industrial safety, labor safety and environmental protection in OAO TATNEFT;
- Ecological safety and environmental activity of the Company are regulated by a special corporate Ecological program for the period of 2000-2015. The program is aimed at maintenance of environmental condition of TATNEFT activity regions at the admissible level corresponding to potentiality of self-recovery of natural ecological systems.

LUKOIL faces a shortage of skills in their sector and tries to tackle the situation with individual incentives. The annual report provides insights into some of these. In addition to material incentives, the company uses moral encouragement as a way of developing personnel potential: 33 company employees received national awards for professional excellence, and for conscientious and successful work, while 814 were awarded sectoral marks of distinction for their work. The company also held a competition for the title of “Best Employees and Organizations in LUKOIL group”. The group spent a total of $348m on the overall programme. There is also a strong social package for employees in place.

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

There were 10 comprehensive and 15 targeted inspections at Group organizations in the accounting year to determine the state of industrial safety and labour protection management systems and enforcement of the Management Committee decision on increase of employees’ responsibility for industrial safety and labour protection requirements. These actions were in response to a rise in the number of fatalities within the Company from 7 in 2007 to 13 in 2008.

LUKOIL uses the whole spectrum of modern training aids: workshops, seminars away from the working place, special training programs, work placements abroad, training sessions, courses to gain higher qualifications, professional training days, distance learning, MBA programs, etc. and lots of cooperations, including the Gubkin Russian State Oil & Gas University, the Russian Government Financial Academy, the Oil & Gas Business Institute and the Higher School of Economics.

**Corporate Social Investment**

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

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

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

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

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

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

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

Conclusion

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

Both the reporting about the internal control systems/internal audits and the reporting about environmental concerns were more sophisticated on the part of the Russian oil and gas producers. Three Russian companies reported on internal controls and had an own internal audit activity. One company, Surgutneftegaz, did not report anything about their internal control and internal audit. Their South African counterparts, in turn, only had internal audit activities in two of the four companies.

Another common feature is the shortage of skilled labour. Russian companies seem to follow old established reward systems complementary to payment like national awards for excellence or awarding sectoral marks of distinction. From the South African side nothing is reported but retention bonuses.

Environmental issues were less important for South African companies. Instead, they reported on human rights issues and their compliance with laws and regulations for historically disadvantaged social groups as a means to communicate with the reader about the legitimacy of the company’s action. Also Russian companies reported their concern with important social issues out of their history, like having social programs for veterans of WWI.

It seems that the Russian companies provide more quantitative material in addition to the financial statements. This paper questions the notion of Russian companies as closed and inaccessible to foreign investors. Besides that, more research is needed to understand which part of Corporate Governance sections are of real use to foreign investors and which parts are included to raise the legitimacy of the reporting company.

References