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**European Bank**  
for Reconstruction and Development

# **Corporate Governance in Transition Economies**

## **Bosnia and Herzegovina Country Report**

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The report is based on information available at the end of April 2015.

If you believe that the information has changed or is incorrect, please contact Gian Piero Cigna at [cignag@ebrd.com](mailto:cignag@ebrd.com)

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This Report – along with all other country reports prepared within this initiative – is available at: <http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html>

## **Foreword**

As part of its Legal Transition Programme, the European Bank for Reconstruction and Development (“EBRD”) has been assessing the state of legal transition in its countries of operations. These assessments provide an analysis of the progress of reform and identify gaps and future reform needs, as well as strengths and opportunities.

In 2012, the Legal Transition team within the EBRD Office of the General Counsel (LTT) developed with the Assistance of Nestor Advisors a methodology for assessing corporate governance frameworks and the governance practices in the EBRD countries of operations. This assessment was implemented in 2014-2015 (the “Assessment”).

The Assessment aims at measuring the state of play (status, gaps between local laws/regulations and international standards, effectiveness of implementation) in the area of corporate governance

The Assessment is meant to provide for (i) a comparative analysis of both the quality and effectiveness of national corporate governance legislation (including voluntary codes); (ii) a basis to assess key corporate governance practices of companies against the national legislation; (iii) an understanding whether the legal framework is coupled with proper enforcement mechanisms (e.g., sanctions) and/or with authorities able to ensure proper implementation; (iv) a support to highlight which are the major weaknesses that should be tackled by companies and legislators for improving the national corporate governance framework; and (v) a tool which will enable the EBRD to establish “reference points” enabling comparison across countries.

This country report is part of a series of 34 country reports. A general report synthesising all countries will close the Assessment.

## Methodology

This Assessment is based on a methodology designed to measure the quality of legislation in relation to best practices requirements and the effectiveness of its implementation as evidenced by companies' disclosure, also taking into consideration the capacity of the institutional framework (e.g., courts, regulators) to sustain quality governance. The analytical grid developed for assessing the governance framework is based on international recognised best-practice benchmarks (e.g., OECD Corporate Governance Principles, Development Financial Institutions, EBRD, IFC and World Bank ROSC governance methodologies). The methodology is applied identically across all the countries reviewed. The process for gathering, analysing and reporting information is applied identically for each of the countries assessed, which allows comparing countries to each other across a long a set of benchmarking points.

For the purpose of the Assessment, the corporate governance framework and the practices were divided in five key areas: (i) Structure and Functioning of the Board; (ii) Transparency and Disclosure of company information; (iii) Internal Control; (iv) Rights of Shareholders; and (v) Stakeholders and Institutions. Each of these key areas is further divided in sections (for instance, the area "Structure and Functioning of the Board" is divided in five sections: Board composition; Gender diversity at the board; Independent directors; Board effectiveness; and Responsibilities of the board). Each section is further divided in subsections (for instance, the section "Independent Directors" is divided in three subsections: "Requirement to have independent directors"; "Definition of Independence"; and "Disclosed practices").

The assessment started by sending a questionnaire to law firms, audit firms, national regulator(s), ten largest (listed) companies, and stock exchange(s) in each country. Questions were different according to the respondents, which were asked to provide information on the legislation and on how they believe the legislation is implemented.

Responses were assigned to the corresponding subsection(s) and validated by the EBRD corporate governance specialists by looking at the applicable framework and at the disclosure offered by the ten largest (listed) companies in each country. In this respect, the working hypothesis was that the ten largest listed companies are those offering the best disclosure in each country. As such, we presumed that when certain practices were not disclosed by them, they were unlikely to be disclosed by smaller or unlisted companies. The ten largest companies were identified according to their market capitalisation. When a country did not have a stock exchange, there were less than ten listed issuers or there were no data on capitalisation of issuers, the ten largest companies were identified according to their revenues and size of the labour force. In case the largest companies were mostly of one sector (e.g., financial institutions), then the sample of ten companies was corrected to reflect other sectors of the economy.

The validation of responses was undertaken by the corporate governance specialists within the Legal Transition Team through desktop research. This research was conducted both on legislation and on the practices disclosed by the largest (listed) companies (e.g., companies' websites, annual reports, stock exchanges database etc.). In addition, the relevant reports by international financial institutions (e.g., IMF, World Bank, IFC, Transparency International, etc.) were analysed and taken into consideration. Answers received by respondents that were not grounded by specific references to legislation or consistent with the disclosed practices were not taken into consideration.

Following the validation process, each subsection was compiled by adding specific references to legislation and practices. Conclusions were then formulated for each subsection, each rated as per their adherence to international governance standards. The score ranges from 1 (very weak) to 5 (strong). The rating for each section was then calculated by averaging the ratings of the subsections.

Because understanding corporate governance requires a "holistic perspective", where each component needs to have a place in the overall picture – pretty much like a puzzle - in case one of the subsection was rated "weak" or "very weak", the resulting average was decreased by 0.2; in case

more than one subsection was rated “weak” or “very weak”, the resulting average was decreased by 0.5. This is because if just one component is not fitting well with the others, then all others are weakened. Similarly, the overall strength diminishes if there are more weak components.

Conversely, in order for the framework to be strong, all components need to be well fitting with each other. Hence, in case all subsections were scored “moderately strong” or “strong”, then the resulting average was increased by 0.5. However, this “positive” adjustment was used with some care as the assessment looked at the top ten largest companies in the country, hence findings tended to be often overly optimistic.

Key areas were then rated according to the same criteria.

The ratings are presented through the colours detailed in the box below and they demonstrate the adequacy or need of reform in respect to each governance area and section.

#### **Ratings:**

**“Strong to very strong” (DARK GREEN)** - The corporate governance framework / related practices of companies are fit-for-purpose and consistent with best practice.

**“Moderately strong” (LIGHT GREEN)** - Most of the corporate governance framework / related practices of companies are fit-for-purpose but further reform is needed on some aspects.

**“Fair” (YELLOW)** - The corporate governance framework / related practices of companies present some elements of good practice, but there are a few critical issues suggesting that overall the system should be assessed with a view of reform.

**“Weak” (ORANGE)** - The corporate governance framework / related practices of companies may present few elements of good practice, but overall the system is in need of reform.

**“Very weak” (RED)** - The corporate governance framework / related practices of companies present significant risks and the system is in need of significant reform.

We believe corporate governance cannot be captured and measured simply by numerical values. Hence, alongside the “quantitative” assessment obtained according to the methodology described above, a “qualitative” assessment was also undertaken, by classifying our findings for each section as “strengths” and “weaknesses”. Because understanding corporate governance requires a “holistic perspective”, when the “quantitative” assessment was finalised, the assessment team compared it with the “qualitative” assessment, and when any inconsistency (i.e. material weaknesses or strengths) was noticed, the average scores of the sections were adjusted by up to  $\pm 0.5$ .

A preliminary version of the Assessment was made public for consultation. The comments and corrections received during the process were analysed by the corporate governance specialists. When confirmed, the corrections were reflected in the final ratings and in this Assessment.

## Overview

### **Legislative framework**

Bosnia and Herzegovina is composed of two autonomous Entities: the Federation of Bosnia and Herzegovina ("FBH") and the Republika Srpska ("RS"). It also includes a relatively small third region, the Brčko District. Each Entity has its own company law, regulates its own corporate governance regime, and has its own Securities Commission and Banking Authority. The FBH and RS have their own stock exchanges, the Sarajevo Stock Exchange and the Banja Luka Stock Exchange, respectively. Brčko regulates its own joint stock companies and has a separate Securities Commission, but does not have a stock exchange. Joint stock companies in Brčko can be traded in either Entity and tend to adopt the corporate governance practices of the Entity where they are traded. For this reason, as well as the relatively small size of the Brčko District, this briefing will focus on the FBH and the RS.

#### *The Federation of Bosnia and Herzegovina*

Corporate governance in the FBH is essentially governed by the Law on Companies;<sup>1</sup> the Law on Banks and the Law on Accounting and Audit. To note also a Joint Stock Company Regulation issued by the Securities Commission and a number of Decisions and Guidelines issued by the Banking Agency of the Federation of Bosnia and Herzegovina. In 2009, the Sarajevo Stock Exchange issued its own [Corporate Governance Code](#), although an English translation is not available. The Code is meant to be implemented under the "comply or explain" approach, however it does not seem to be taken as a reference.

#### *Republika Srpska*

Corporate governance in the RS is essentially governed by the Law on Companies, the Law on Banks and the Law on Accounting and Audit. To note also a number of Decisions and Guidelines issued by the Banking Agency of Republika Srpska. In 2006 the Securities Commission issued the [Standards of Corporate Governance](#), which were revised in 2011. The Standards can be considered the Corporate Governance Code in place in RS. They are meant to be implemented under the "comply or explain" approach, but their implementation is very limited.

### **Structure and Functioning of the Board**

Joint stock companies in the FBH are organised under a two-tier board system.

Companies in the RS are organised under a one-tier board system, however if there are more than two executive directors, then a separate executive board must be established.

Banks in both Entities follow a two-tier system.

Boards appear to be small, and possibly lacking the appropriate mix of skills. In companies, the law does not clearly restrict legal entities from serving as board members; however companies do not seem to adopt such practices. For banks, it appears that only natural persons can be members of the board.

It appears that in both Entities there are no legal requirements concerning qualification of companies' board members. In banks, *fit and proper* requirements apply. Gender diversity at the board is very limited.

In FBH, companies are recommended to have independent directors; in the RS, this is a legal requirement. There are different definitions of independence in both Entities. Only two of the ten largest listed companies in the country disclose having independent directors on their boards.

In FBH, companies are required to create audit committees (in RS, the creation of the audit committee is optional). In companies, the audit committee's members are appointed by the general shareholders' meeting from among persons who are not members of the board and who are independent from the company. In practice, these committees cannot be classified as "board" committees. We do not think this is the right solution.

Banks are required to establish audit boards, with members appointed by the supervisory board, but again audit boards cannot comprise supervisory board members. Other committees - such as nomination and remuneration committees - are not common in Bosnia.

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<sup>1</sup> In October 2015, a new Law on Business Companies was adopted in the Federation of Bosnia and Herzegovina. The new law entered into force in December 2015. While acknowledging this legislative novelty, this was after the cut-off date of the report and it has not been considered in the report. Further, the new law does not seem to differ substantially from the previous one when it comes to most corporate governance issues.

The law does not clearly assign to the boards all of its key functions. There is no practice of performing board evaluations. Only one company discloses having a corporate secretary. It was not possible to determine how boards work in practice since only two companies among the largest listed companies in the country disclose the number of their boards' meetings and information on their activities is very limited.

In both Entities the law provides for fiduciary duties and for board member liability. Finally, conflicts of interest situations appear to be regulated by law.

### ***Transparency and Disclosure***

Companies are required to publish annual reports including non-financial information; however, disclosures are generally patchy. On average information posted on websites is incomplete, out-dated, and often difficult to find. In FBH, there is no mandatory requirement for listed companies to disclose their compliance with the Corporate Governance Code (even if the Code recommends companies to do so), while in RS companies must disclose compliance with either the Standards of Corporate Governance issued by the Securities Commission or their own code. Information on board and committee members' qualification and activities, independent directors and directors' dealings with the company's shares is very limited. Seven out of the ten largest listed companies post their Articles of Association on their websites. The majority of companies disclose their major shareholders and in some cases beneficial ownership. Eight out of the ten largest listed companies provide up-to-date information on their capital.

The majority of the largest companies in both Entities publish their financial statements on the web. Financial statements are in line with IFRS. Reporting to the market and shareholders seems to be regulated in detail but in practice the availability of information is limited.

In both Entities, companies are required to have independent external auditors and to disclose their names and reports. Companies seem to comply with these requirements. Provision of non-auditing services by the external auditor is allowed but restricted. We could not assess if this restriction is well observed as disclosure on this matter is very limited.

### ***Internal Control***

In both Entities, companies with shares admitted to trading are required to have an internal audit function; however, it is not clear if they have it in place since disclosure on this point is limited. Banks do not seem to be required to establish a standalone compliance function.

Companies in FBH are required to set up audit committees, while in RS this is optional. Six companies appeared having such committee in place and disclosed the names of their members, but only one disclosed their qualifications. The audit committee mentioned in legislation is not a "board" committee as it is appointed by and reports to the general shareholders' meeting (GSM) – in banks it is appointed by the supervisory board – and cannot include board members. We have doubts about this body's ability to ensure fit-for-purpose internal control system.

In both Entities, companies are required to have independent external auditors and to disclose their names and reports.

Financial statements must be prepared in accordance with IFRS.

The provision of non-auditing services by the external auditors is allowed but restricted and external audit firms are subject to rotation obligation. None of the companies of our sample discloses any information on these matters, hence it is not possible to confirm that these restrictions are well-implemented.

Related party transactions and conflicts of interest are regulated in both Entities; however, it seems that related-party transactions remain an issue in practice.

Four out of the ten largest listed companies disclose having a code of ethics, but it is not clear how these are implemented in practice. A new law on whistleblowing protection has recently been approved in FBH.

### ***Rights of Shareholders***

Basic shareholders rights are granted by law. Shareholders representing 10% of the capital may call a general shareholders' meeting. Shareholders have the right to nominate directors and enjoy pre-emptive rights in case of capital increase. Supermajority is required for major corporate decisions. Shareholders have the right to access corporate documentation and are provided with judicial mechanisms to enforce their rights, which

appear to be well used in practice. Cumulative voting seems to be available in the RS and in banks of both Entities, but the practice is scarce. Shareholders agreements are not regulated by law or subject to any formalities. In both Entities, the share register of listed companies is required to be maintained by an external and independent organisation. Significant shareholding variations must be reported to regulators and to the company, which must then disclose such information.

Conflicts of interest and insider trading are regulated; but there is not much evidence of enforcement.

**Stakeholders and Institutions**

Stock exchanges exist in both Entities; however, their liquidity appears limited. Trade on both exchanges is organised in different segments which establish different transparency requirements.

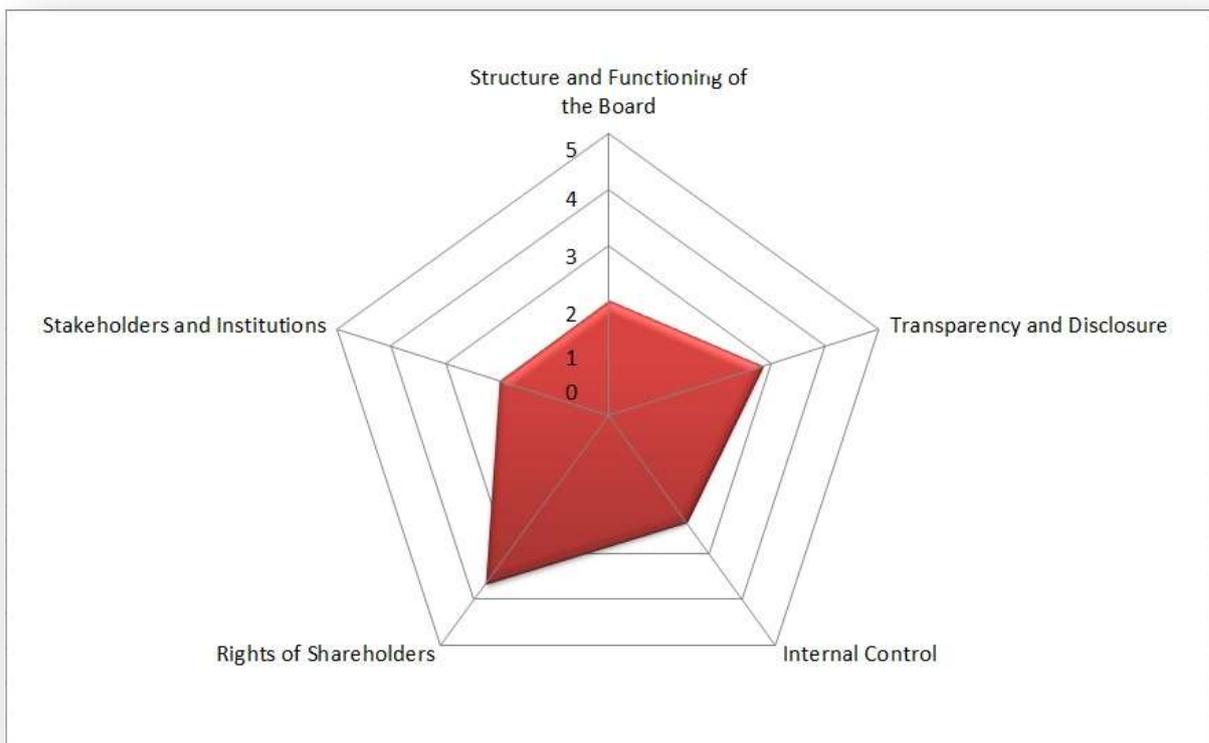
International audit firms have a material presence in the country, but the presence of international law firms and rating agencies is limited.

Corporate Governance Codes exist in both Entities; however their implementation is very limited. We could not find any evidence of monitoring in place on how companies comply with the Codes.

Inconsistencies between different laws and regulations are reported. Case law does not appear to be timely aggregated and easily accessible.

International organisations indicators reveal that the framework is in need of reform, since corruption is still perceived as a problem.

**Corporate Governance Legislation and Practices in Bosnia and Herzegovina**



Source: EBRD, Corporate Governance Assessment 2016

Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in best practices and international standards (e.g., OECD Corporate Governance Principles). The fuller the ‘web’, the closer the corporate governance legislation and practices of the country approximates best practices.

Key: Very weak: 1 / Weak: 2 / Fair: 3 / Moderately Strong: 4 / Strong to very strong: 5

Key Areas and Rating	Strengths and Weaknesses
<p><b>1. Structure and Functioning of the Board</b> Weak</p>	<p><i>Bosnia and Herzegovina is divided into two semi-autonomous political entities: the Federation of Bosnia and Herzegovina (“FBH”) and the Republika Srpska (“RS”). Both entities (“Entities”) have their own Parliament, judicial system, Securities Commission, Banking Agency and stock exchange.</i></p> <p><i>Joint stock companies in FBH are organised under a two-tier board system. Companies in RS are organised under a one-tier board system, however if there are more than two executive directors, then a separate executive board must be established. Banks in both Entities follow a two-tier system.</i></p> <p><i>Boards appear to be small, and possibly lacking the appropriate mix of skills. In companies, the law does not clearly restrict legal entities from serving as board members; however, companies do not seem to adopt such practices. For banks, it appears that only natural persons can be members of the board.</i></p> <p><i>It appears that in both Entities there are no legal requirements concerning qualification of companies’ board members. In banks, fit and proper requirements apply.</i></p> <p><i>Gender diversity at the board is very limited.</i></p> <p><i>In FBH, companies are recommended to have independent directors; in RS, this is a legal requirement. There are different definitions of independence in both Entities. Only two of the ten largest listed companies in the country disclose having independent directors on their boards.</i></p> <p><i>In FBH, companies are required to create audit committees; in RS, the creation of the audit committee is optional. In companies, the audit committee’s members are appointed by the general shareholders’ meeting from among persons who are not members of the board and who are independent from the company. In practice, these committees cannot be accurately classified as “board” committees. Banks are required to establish audit boards, with members appointed by the supervisory board, but again audit boards cannot comprise supervisory board members, which is not in line with best practices. Other committees - such as nomination and remuneration committees - are not common in Bosnia.</i></p> <p><i>The law does not clearly assign to the boards all of its key functions.</i></p> <p><i>There is no practice of performing board evaluations. Only one company discloses having a corporate secretary. It was not possible to determine how boards work in practice since only two companies among the largest listed companies in the country disclose the number of their boards’ meetings and information on their activities is very limited.</i></p> <p><i>In both Entities the law provides for fiduciary duties and for board member liability. Finally, conflicts of interest situations appear to be regulated by law.</i></p>
<p><b>1.1. Board Composition</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• <i>In banks of both Entities and non-banking companies in the FBH, the roles of the chair of the board and CEO are split by law.</i></li> <li>• <i>In both Entities, only natural persons can be members of the board of banks.</i></li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• <i>Boards are generally small (average 5 members) and evidence has shown that smaller boards tend to perform better, provided that they have the right mix of skills and support (e.g., corporate secretary) – however, this does not seem to be the case in Bosnia and Herzegovina.</i></li> <li>• <i>The law of neither of the Entities seems to restrict legal entities from serving in boards of companies. Even if none of the ten largest listed companies seems to have corporation on their board, we have doubts about the soundness of this solution, since it weakens board members’ fiduciary duties and does not ensure that these members are fit for purpose.</i></li> <li>• <i>In the RS, boards of listed companies must have a majority of non-executive members, and at least two independent members. The Corporate Governance Codes of both Entities also recommend that boards include independent members. However, it seems that most companies do not have any independent directors on their boards (see below).</i></li> <li>• <i>Audit committees – when established - cannot be made of board members (see further below).</i></li> <li>• <i>It seems that there are no qualification requirements for board members in companies in neither of the Entities and disclosure on the board members’ qualifications is very limited.</i></li> </ul>
<p><b>1.2. Gender Diversity at the Board (10.4%)</b> Weak</p>	<ul style="list-style-type: none"> <li>• <i>Only five companies out of the ten largest listed companies in Bosnia and Herzegovina appear to have women in their boards. Among these companies, the average of female representation amounts to 18.71%.</i></li> <li>• <i>In total, there are 5 women among 50 board members.</i></li> <li>• <i>The average of female representation on boards of the ten largest listed companies is 10.4 %.</i></li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>1.3. Independent Directors</b> Very Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In RS, boards of listed companies are required to have at least two independent members. The Corporate Governance Code further recommends that the majority of the board should be independent. In FBH, the Code recommends that unlisted companies should have at least one independent member and listed companies should have at least 1/3 of independent members. However, these provisions do not seem to be well implemented (see below).</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>From the eight companies that disclose their board composition, six do not make any reference to independent directors, while two (one being in the RS) clearly have no independent members, as all members are said to be “shareholder representatives”. We should add that naming a board member as a “shareholder representative” is a bad practice in itself, as board members – because of their fiduciary duties - should represent all shareholders and the company and not only the shareholder that nominated/appointed them.</li> <li>In FBH, the definition of independence is provided only by the Corporate Governance Code. In RS, there are two definitions of independence (one provided by law and another, stricter definition, provided by the Code). Having two different definitions of independence might be misleading. Companies should be required to clearly state which definition applies.</li> <li>The definitions of “independence” in both Entities are only made up of a long list of negative criteria defining “non-affiliation”, without spelling out which positive requirements (i.e., objectivity of character and mind) are required from independent directors. It should be pointed out that the concepts of “non-affiliation” and “independence” are different. While non-affiliation can be established by negative criteria only, independence necessarily needs objectivity of mind and character, which is a positive characteristic that should be demonstrated, disclosed and explained in practice.</li> <li>Members of audit boards in FBH are required to have no financial interests in the company and members of the audit committee in RS must be appointed from among independent persons. However, no company discloses that their audit board/committee members meet such independence requirements.</li> </ul>
<p><b>1.4. Board Effectiveness</b> Very Weak</p>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>There is no practice of board evaluation, despite the Codes’ recommendations in this respect. None of the companies of our sample disclose performing a board evaluation.</li> <li>Companies are required to have a corporate secretary to assist the board and general shareholders’ meeting (GSM) activities. However, only one company discloses having a corporate secretary.</li> <li>Only two companies disclose the number of board meetings per year, one being 4 and the other 33 in the previous year, which indicates some dysfunctionality (i.e., an average of 3 meetings per month is excessive for a two-tier board and is a clear indication that the board is dealing with operational issues, which should not be on the board agenda). There is very little information on the board activities.</li> <li>In FBH, companies are required to establish audit committees (in RS, the creation of the audit committee is optional). In all cases, audit committees’ members are appointed by the general shareholders’ meeting (GSM), and they cannot be board members. In practice, these are not “board” committees. We have doubts about this body’s ability to support the board with its activities. Banks are required to have audit boards, members of which are appointed by the supervisory board; however again they cannot be board members. Six companies among the ten largest listed disclosed having an “audit committee” in place; however, in all cases the committee is made up of non-board members.</li> <li>In RS, the law recommends listed companies to create a nomination and a remuneration committee at the board level. In FBH, the Corporate Governance Code recommends that supervisory boards establish nomination and remuneration committees and that they be chaired by an independent member. No company discloses having these committees or any other board committee in place.</li> </ul>
<p><b>1.5. Responsibilities of the Board</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In both Entities, liability and fiduciary duties of board members are well detailed in the law and it seems that the duty of care has been interpreted by courts as an obligation to act after due diligence on a fully informed basis. However, the fact that in practice some board members are named as “shareholder representatives” – see above - raises some doubt on the implementation of the concept of fiduciary duties.</li> <li>Conflicts of interest are regulated by law, and “related-party transactions” should be approved by a majority of disinterested board members.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>The law does not clearly assign to the board all of its key functions. In FBH, boards are not assigned with the responsibility for the corporate strategy (however, it seems that the new 2015 law has now clarified this point).</li> <li>In both Entities, it seems that the law does not require boards to approve the budget (which details the way resources are deployed to achieve strategic objectives). This might undermine the strategic role of the board.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>2. Transparency and Disclosure</b> Fair</p>	<p>Companies are required to publish annual reports including non-financial information; however, disclosures are generally patchy.</p> <p>On average information posted on websites is incomplete, out-dated, and often difficult to find.</p> <p>In FBH, there is no mandatory requirement for listed companies to disclose their compliance with the Corporate Governance Code (even if the Code recommends companies to do so), while in RS companies must disclose compliance with either the Standards of Corporate Governance issued by the Securities Commission or their own code. In practice, in both Entities the Corporate Governance Codes do not seem to be well implemented.</p> <p>Information on board and committee members' qualification and activities, independent directors and directors' dealings with the company's shares is very limited.</p> <p>Seven out of the ten largest listed companies post their Articles of Association on their websites. The majority of companies disclose their major shareholders and in some cases beneficial ownership. Eight out of the ten largest listed companies provide up-to-date information on their capital.</p> <p>The majority of the largest companies in both Entities publish their financial statements on the web. Financial statements are in line with IFRS.</p> <p>Reporting to the market and shareholders seems to be regulated in detail but in practice the availability of information is limited.</p> <p>In both Entities, companies are required to have independent external auditors and to disclose their names and reports. Companies seem to comply with these requirements.</p> <p>Provision of non-auditing services by the external auditor is allowed but restricted. We could not assess if this restriction is well observed as disclosure on this matter is very limited.</p>
<p><b>2.1. Non-Financial Information Disclosure</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In both Entities, companies are required to prepare and publish an annual report including non-financial information. The procedure for publication and disclosure, however, is not clearly stated.</li> <li>Companies are required to disclose their articles of association. Most companies in our sample disclose their articles either on their website or on the stock exchange's website.</li> <li>Eight out of the ten largest listed companies disclose up-to-date information on their capital and on their ownership structure, including information on their major shareholders. Six companies seem to go into detail also disclosing their beneficial owners, despite the lack of a legal requirement to do so.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Nine out of the ten largest listed companies published their annual report. However, only three companies in our sample provide non-financial information in their annual reports. Information on board composition, number of meetings and attendance is very limited. Only two companies disclose information on board members' qualifications.</li> <li>Overall, information provided by the companies' websites is incomplete, out-dated and often difficult to find. There seems to be little monitoring of the quality of non-financial disclosure.</li> <li>In RS, listed companies must either adopt the Standards of Corporate Governance issued by the Securities Commission (i.e., the RS Corporate Governance Code) or issue their own code. In either case, companies must disclose a statement certifying their compliance or explaining the reasons for non-compliance. In FBH, listed companies are only recommended to implement the Corporate Governance Code under the "comply or explain" approach. In practice, only two companies of our sample (both from RS) submit a corporate governance statement. Few explanations for non-compliance appear to be meaningful. Moreover, we think that the possibility for companies in RS to adopt a code and then explain the non-compliance with it is not entirely appropriate. If companies adopt their own code, then the code becomes mandatory for them – similarly to all other corporate documents - and companies should be bound to adhere to it. Deviations should not be allowed.</li> <li>Despite the right of shareholders to have access to the GSM's minutes, the law does not require the minutes to be disclosed. Only four companies of our sample disclose their minutes online.</li> <li>Only one of the ten largest listed companies discloses directors' dealings involving company's shares.</li> </ul>
<p><b>2.2. Financial Information Disclosure</b> Moderately strong</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Companies are required to prepare their financial statements in line with IFRS. Eight out of the ten largest listed companies seem to comply with this requirement.</li> <li>The majority of the largest listed companies of both Entities publish their financial statements on their website, even though there is no explicit legal requirement to do so.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>A recent IMF report states that "most domestic banks have implemented IFRS 2009, but several auditors refer in their audit opinion to the local law instead of IFRS, complicating the comparison between different financial statements and leaving the quality of the external audit open to question. Also, the external auditors are appointed only for a year which may have an adverse effect on the continuity of the auditor and the quality of the audit" and "Despite commendable efforts towards better transparency since 2006, further improvements are</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
	<p>warranted to enhance the overall quality of disclosures beyond the simple appearance of compliance. Supervisory agencies need to enforce more effectively IFRS for companies under their supervision”.</p>
<p><b>2.3. Reporting to the Market and to Shareholders</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Companies in both Entities are required to disclose their annual report and nine out of the ten largest listed companies comply with this requirement.</li> <li>• Failure to publish annual reports is subject to fines.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Only three of the ten largest listed companies include non-financial information in their annual reports, and only four companies disclose online their GSM minutes.</li> <li>• Overall, information provided by the companies’ websites is incomplete, out-dated and often difficult to find.</li> <li>• In both Entities, the law requires disclosure of price sensitive information; however, issuers may take up to 8 days to disclose such information. This is a major shortcoming.</li> </ul>
<p><b>2.4. Disclosure on the External Audit</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Companies are required to have external auditors appointed by the GSM and to disclose their names and reports, and most companies seem to comply with these requirements.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Both the FBH and the RS laws impose a rotation obligation for external audit firms. However, there is no information publicly available to confirm that these rules are well implemented in practice.</li> <li>• In both Entities, provision of non-auditing services by the external auditor is allowed but restricted. In some cases, provision of non-auditing services is allowed, but we could not find any disclosure on this matter.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>3. Internal Control</b> Weak</p>	<p>In both Entities, companies with shares admitted to trading are required to have an internal audit function in place; however, it is not clear if they have it in place since disclosure is limited.</p> <p>Banks are not required to establish a standalone compliance function.</p> <p>Companies in FBH are required to set up audit committees, while in RS this is optional. Six companies disclosed having such committee in place and disclose the names of their members, but only one discloses their qualifications. The audit committee mentioned in legislation is not a “board” committee as it is appointed by and reports to the general shareholders’ meeting – in banks it is appointed by the supervisory board – and cannot include board members. We have doubts about this body’s ability to ensure fit-for-purpose internal control system.</p> <p>In both Entities, companies are required to have independent external auditors and to disclose their names and reports. Financial statements must be prepared in accordance with IFRS. The provision of non-auditing services by the external auditors is allowed but restricted and external audit firms are subject to rotation obligation. None of the companies of our sample discloses any information on these matters, hence it is not possible to confirm that these restrictions are well-implemented.</p> <p>Related party transactions and conflicts of interest are regulated in both Entities; however, it seems that related-party transactions remain an issue in practice.</p> <p>Four out of the ten largest listed companies disclose having a code of ethics, but it is not clear how these are implemented in practice.</p> <p>A new law on whistleblowing protection has recently been approved in FBH.</p>
<p><b>3.1. Quality of the Internal Control Framework</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>The Institute of Internal Auditors promotes training and development of internal auditors in the country.</li> <li>Whistleblowing has been recently (2014) regulated in FBH.</li> <li>The audit committee – required for all joint stock companies in FBH but only recommended for listed companies in RS - exercises control over the financial activities of the company, which include assessment of the quality of financial statements. It is also responsible for the oversight of the effectiveness of internal control system.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>In both Entities, companies with shares admitted to trading are required by law to establish internal audit function. However, there is little evidence of its functioning. Only two companies of our sample (both banks) clearly disclose having an internal audit function in place.</li> <li>Banks are not required to establish a compliance function. It seems that in FBH only a minority of large banks have a compliance function in place.</li> <li>The audit committee is not a “board” committee, but rather an advisory body for shareholders and appointed by them. In fact, none of the audit committees amongst the ten largest listed companies includes board members. We have doubts about this body’s ability to ensure fit-for-purpose internal control system (further details below). Disclosure on the qualifications of the members of these committees is very limited and no company defines the members as being independent.</li> <li>The Corporate Governance Codes of both Entities encourage companies to have a code of ethics/conduct. However, it appears that only four out of the ten largest listed companies have one in place. None of them discloses how they are implemented in practice.</li> </ul>
<p><b>3.2. Quality of Internal and External Audit</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Companies are required to have external auditors and to disclose their names and reports. Eight of the largest listed companies comply with these requirements.</li> <li>Auditors are required to be independent and the auditors of the eight largest companies that disclose their auditor’s name declare to be independent.</li> <li>In RS, the law establishes that the board or the audit committee must oversee the auditor’s independence. In FBH, the Corporate Governance Code recommends that the audit committee should be responsible for the auditor’s “independence test”.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Companies are required by law to establish an internal audit function. However, information publicly available is very limited, it is thus not possible to assess internal audit’s effectiveness.</li> <li>In both Entities the provision of non-auditing services by the external auditor is allowed, but restricted. Auditing firms that have previously provided non-auditing services to the company cannot be appointed as external auditor. In the RS, companies are required to disclose the non-auditing services provided by the external auditor over the past five years along with information on the fees received for such services. In FBH, the Corporate Governance Code recommends that non-auditing services by the external auditor should not be provided. Despite these restrictions, none of the largest listed companies discloses any information on that, making it impossible to confirm that they are well-implemented in practice.</li> <li>External audit firms are subject to a rotation obligation. Based on information publicly available, we could not confirm that this requirement is well implemented in practice.</li> <li>A recent IMF report states “Preliminary results in implementing statutory audit quality assurance systems in both</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
	<p>Entities point to a decrease in audit quality and numerous instances of non-compliance with ISA and IFRS. Some of the roots for low audit quality are the constant downward pressure on audit fees, rapid rotation, and late appointment of statutory auditors”.</p>
<p><b>3.3. Functioning and Independence of the Audit Committee</b> Weak</p>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• In FBH, all joint stock companies are required to establish an audit committee (in RS, only listed companies are recommended to do so), to oversee the preparation of financial statements. Both approaches raise some doubts: in FBH, we think that the requirement is excessive, as not all joint stock companies (especially if not listed and/or not acting in strategic sectors) might need such a committee. In RS, listed companies should be required (and not only recommended) to have an audit committee in place. A better solution – in line with the European legislation – would be to require “public interest entities” to have an audit committee in place, as these companies have higher exposure to the public and hence higher need for internal control.</li> <li>• In both Entities, the law requires that members of the audit committee (both for companies and banks) cannot be board members. This solution raises some doubts. We believe it is important that the audit committee include only board members if the functions delegated to the committee are typical board functions. Secondly, it is essential that those members sitting in the committee and recommending specific actions to the board, then can follow up on such recommendations and vote on them at the board meeting, therefore reinforcing their positions and the board “objective judgement”. Further, we believe that audit committee members should have a full vision of the business of the company in order to express their determinations – while “outsiders” might only have a partial understanding. Finally, committees that include outsiders might create problems with confidentiality and accountability issues, since such outsiders might not be bound by duties of loyalty and care required to board members. While it is legitimate that the audit committee might need external advice or expertise on specific issues, it should be able to request such advice, but it should not allow the advisor(s) to replace the committee in its determinations and recommendations. In practice, it appears that six companies among the ten largest listed disclosed having an “audit committee” in place; in all cases the committee is made up of non-board members.</li> <li>• None of the companies define any of the audit committee members as being independent.</li> <li>• Disclosure on the audit committee’s qualifications and activities is very limited. Only one company of our sample discloses the members’ qualifications. None of the companies disclose the committees’ activities.</li> </ul>
<p><b>3.4. Control over Related Party Transactions and Conflict of Interest</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• In Bosnia, companies are required to follow IFRS, including IAS 24 which defines Related Party Transactions (RPT) and requires these transactions to be disclosed in the financial reports.</li> <li>• Related party transactions (RPT) and conflicts of interests are regulated in both Entities. Board members are prohibited from voting on issues in which they have a conflict of interest and they must further declare their conflict of interest. In the RS, RPT must be approved by a majority of non-conflicted board members, and absent such a majority, RPT must be approved by non-conflicted shareholders. In the FBH, board members are only required to seek the consent of the chair of the board.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Some of the ten largest listed companies do not disclose their related party transactions.</li> <li>• A 2015 IMF Report on banks highlights that supervision powers, related-party lending and identification of the ultimate beneficial owners of banks are problematic in the country.</li> <li>• We could not find any evidence of material sanctions imposed for breaches of obligations to disclose conflict of interest.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>4. Rights of Shareholders</b> Fair/Moderately strong</p>	<p>Basic shareholders rights are granted by law. Shareholders representing 10% of the capital may call a general shareholders' meeting (GSM). Shareholders have the right to nominate directors and enjoy pre-emptive rights in case of capital increase. Supermajority is required for major corporate decisions. Shareholders have the right to access corporate documentation and are provided with judicial mechanisms to enforce their rights, which appear to be well used in practice. Cumulative voting seems to be available in the RS and in banks of both Entities, but the practice is scarce. Shareholders agreements are not regulated by law or subject to any formalities. In both Entities, the share register of listed companies is required to be maintained by an external and independent organisation. Significant shareholding variations must be reported to regulators and to the company, which must then disclose such information. Conflicts of interest and insider trading are regulated; but there is not much evidence of enforcement.</p>
<p><b>4.1. General Shareholders' Meeting (GSM)</b> Moderately Strong</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In both Entities, shareholders representing 10% of the shares are entitled to call a GSM.</li> <li>In FBH, the GSM announcement and agenda are required to be published at least 30 days before the meeting; in RS, they must be sent to each shareholder not later than 30 days before the assembly. In case of an extraordinary shareholders' meeting, shareholders must be sent a written notification at least 15 days before the date of the meeting.</li> <li>Shareholders representing 5% in FBH and 10% (5% for banks) in RS are entitled to request items to be added to the GSM agenda.</li> <li>Shareholders may ask questions in advance of the GSM and during the meeting.</li> <li>Voting by proxy and by electronic means is permitted.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Only three out of the ten largest listed companies disclose information about voting rights.</li> </ul>
<p><b>4.2. Protection against Insider Trading and Self-dealing</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Insider trading is prohibited and punishable by fines and imprisonment.</li> <li>Acquisitions of the company's shares by directors are restricted and conflicts of interest are regulated by law.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>There is no evidence that insider trading regulation is well enforced in practice in RS. In FBH, a few cases were fully investigated and closed.</li> <li>The law in both Entities seems to impose disclosure obligations on directors' dealings with the company's shares. However, none of the ten largest listed companies disclose on this matter.</li> </ul>
<p><b>4.3. Minority Shareholders Protection and Shareholders' Access to Information</b> Fair/Moderately strong</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In both Entities, minority shareholders have the right to nominate candidates to the board, call a general shareholders' meeting and to add items to the GSM agenda.</li> <li>Qualified majority is required for major corporate changes. Minority shareholders in both Entities may block major corporate changes with a 33.33%+1 vote.</li> <li>Shareholders are assigned pre-emptive rights which can only be waived by a qualified majority vote at the GSM.</li> <li>Shares carry voting rights in proportion to their value. Multiple voting rights and voting caps are not allowed by law.</li> <li>Shareholders have a general right to inspect the corporate documents.</li> <li>Shareholders are provided with judicial mechanisms to enforce their rights, and it seems that there have been several suits over the past two years.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Annual reports are largely available, but disclosure of non-financial information is generally poor and access to corporate information not always easy.</li> <li>In FBH, the law does not provide for cumulative voting (however, this seems to have been tackled by a new 2015 law). In RS, the law establishes that in open joint stock companies the board members shall be elected by means of cumulative voting, unless the articles require otherwise. Law on banks of both Entities provides for cumulative voting. Only one of the ten largest listed companies provides for cumulative voting in its articles. It seems that cumulative voting is rarely used in practice.</li> </ul>
<p><b>4.4. Registration of Shareholdings</b> Moderately strong</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Registration of shareholding is required by law and in listed companies such responsibility shall be performed by an external and independent organisation.</li> <li>The free transferability of shares cannot be restricted.</li> <li>Significant shareholder variations must be reported to the company, the securities commission and to the stock exchange.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Shareholder agreements are not regulated by law or subject to any formalities. It is not clear if they are enforceable.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>5. Stakeholders and Institutions</b> Weak</p>	<p>Stock exchanges exist in both Entities; however, their liquidity appears to be limited. Trade on both exchanges is organised in different segments which establish different transparency requirements.</p> <p>International audit firms have a material presence in the country, but the presence of international law firms and rating agencies is limited.</p> <p>Corporate Governance Codes exist in both Entities; however their implementation is very limited. There is no monitoring in place on how companies comply with the Codes.</p> <p>Inconsistencies between different laws and regulations are reported. Case law does not appear to be timely aggregated and easily accessible.</p> <p>International organisations indicators reveal that the framework is in need of reform, since corruption is still perceived as a problem.</p>
<p><b>5.1. Corporate Governance Structure and Institutions</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Both Entities have a stock exchange. In FBH, securities are traded at the Sarajevo Stock Exchange, either on the Official Market or on the Free Market. The Official Market imposes higher transparency standards and requires certain conditions to be met (e.g., free float, capital size, etc). In RS, securities are traded at the Banja Luka Stock Exchange, either on the Official Market or on the Free Market. The Official Market has three listing segments for companies: Prime Market, Standard Market and Entry Market, each of them with different requirements. The Prime Market provides for the strictest rules, including a requirement that issuers have a website and provide information in English as well.</li> <li>The stock exchanges' websites are quite informative, but issuers' information is not always complete or easy to find.</li> <li>Rulings of regulatory agencies are documented, but not always easily accessible or available in English.</li> <li>International audit firms have a significant presence in the country.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>International law firms have limited presence in the country, while rating firms are not active in the country.</li> <li>Neither of the stock exchanges appears to be very liquid.</li> </ul>
<p><b>5.2. Corporate Governance Code</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In FBH, the Corporate Governance Code was adopted by the stock exchange in 2009. In RS, the Securities Commission adopted in 2006 the Standards of Corporate Governance (which takes the form of a Code), which were revised in 2011. The Codes are both based on the OECD Principles of Corporate Governance.</li> <li>Both Codes are to be implemented on a "comply or explain" basis and adherence to their recommendations is recommended by both stock exchanges. However, there are no clear mandatory requirements to this end.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Only the Code in RS was revised since its adoption. The FBH Code has never been revised or translated in English. Further, it is quite difficult to locate it.</li> <li>Only three companies out of the ten largest listed companies submit a corporate governance statement. Overall, explanations do not seem to be meaningful.</li> <li>The oversight of the implementation of the Corporate Governance Codes is assigned to the Securities Commissions and to the Stock Exchanges; however, no monitoring reports have been issued. Additionally, considering the few corporate governance statements being published, it seems that there is very limited monitoring (if any) of companies' compliance with the Codes.</li> <li>In FBH, listed companies are recommended to adopt their own corporate governance code. In RS, in order to have their securities admitted to trading on the Official Market, companies must meet the requirement of either adopting a written code of conduct or accepting the Standards of Corporate Governance adopted by the RS Securities Commission (i.e., the RS Corporate Governance Code). This is not a weakness per se, however we should point out that adopting a code is only the start of a process and not an end in itself. We do not think that a simple adoption of a code or general endorsement of compliance, without a real effort to translate the code's provision into practice should be considered as a strength.</li> <li>Judicial practice on corporate governance is limited and there is no case law referring to the Corporate Governance Codes.</li> </ul>
<p><b>5.3. Institutional Environment</b> Weak</p>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>There are some inconsistencies in the law and in the Codes, and some key corporate governance issues are not comprehensively regulated.</li> <li>Case law does not appear to be timely aggregated and easily accessible. According to the <a href="#">2015 EBRD Assessment on Accessibility of Court Decisions</a>, one of the major issues in this regard was the inefficiency of relevant court employees.</li> <li>Both Corporate Governance Codes have been adopted with the active assistance of the regulators; however, it does not seem that the Codes implementation is being actively monitored, or that the adequacy of the Codes' provisions is regularly reviewed.</li> <li>Indicators provided by international organisations reveal that corruption and competitiveness seem to be critical problems.</li> </ul>