

# Financial Transparency, Corporate Governance and Information Disclosure of the Entrepreneur's Corporation in Rastin Banking

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## Abstract

**Purpose:** This paper aims to define a set of operating regulations for financial transparency, corporate governance, and information disclosure for the entrepreneur that applies to bank to receive financial resources.

**Design:** Corporate governance, financial transparency, and information disclosure are amongst the most important solutions to attract public trust to financial operations. In order to reach this goal, a new set of regulations must be designed to solve the problem. In this regard, Rastin Banking regulations can provide a base to obtain a better circulation of information and a higher clarity.

**Findings:** A draft of regulations for financial transparency, corporate governance, and information disclosure is presented in this paper, which can be employed as a basis for codification of the respective law.

**Research limitations:** Since such kinds of regulations are novel, they are required to be meticulously scrutinized in the first place, and after adaptation, adjustment, and performing the necessary modifications, the code of law can be codified.

**Practical implications:** Banks and companies managers, through granting various concessions to themselves and their own stakeholders, have violated the rights of shareholders, depositors and other stakeholders. This issue, through applying the governance methods, is adjustable to a great extent.

**Social implications:** This procedure is a model that can be adopted in other countries, especially those countries that have large ambiguities in their banking and financial operations.

**Value:** Clearly, lack of transparency in financial operations can gradually weaken the trust of depositors, shareholders and stakeholders, and result in probable abuses and damages to all parties in the bank's contracts. This Article fulfils an identified need and solves the practical problem in financial abuses, corruption and collusion and can provide positive and important effects toward creating public trust in financial operations.

**Keywords:** Rastin Banking, Corporate Governance, Information Disclosure, Transparency, Banking, Financial Law.

**Article Type:** Technical paper.

## Introduction

In general, reducing public trust to financial institutions has a very negative impact on social and economic trends. As Adrian Cadbury defined the fundamental principles of corporate governance in 1992, corporate governance or in other words, governance is a set of criteria that strengthen the atmosphere of transparency, honesty, fairness, accountability, and responsibility in organizational management. Companies must be free in order to be able to develop themselves and achieve their organizational objectives. However, this freedom must be exercised within the framework of responsibility and accountability. Corporate governance is a set of regulations, administrative rules,

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structures, processes, cultures, and systems, which results in achieving goals, such as accountability, transparency, fairness, honesty, and respecting the rights of stakeholders.<sup>3</sup>

Implementation and enforcement of corporate governance principles in the banking operation for the entrepreneur<sup>4</sup> can increase the efficiency of the bank, protect the rights and interests of stakeholders, and result in the stability of active institutions in the money market. In other words, in entrepreneur corporate governance, while the goals of the entrepreneur, including the shareholders' interests, are obtained, the interests of stakeholders are also identified, and the organization's activities and monitoring procedures are established in such a way that through an accurate implementation of the operation, the correctness and lawfulness of the operation are also maintained.

Transparency of the operations<sup>5</sup> and information disclosure<sup>6</sup> are amongst the key and fundamental elements of corporate governance.<sup>7</sup> Therefore, the principles of corporate governance and public disclosure are known as the interrelated elements in monitoring the firm's operations. On the other hand, incorrect and non-transparent information can strongly and negatively effect on the financial markets and lead to their instability. Since stock exchanges are required to provide their data daily to the public, including the statistics of securities (such as daily traded price and volume),<sup>8</sup> banks and large companies should also try to disclose their information based on similar arrangements so that the rights of their shareholders would not be violated and the financial markets would not be destabilized.<sup>9</sup>

Some of the most vital items for information disclosure are as follows: the details of financial statements, sales and purchases of assets, change of board members, property ownership by the executive directors, changes in company ownership, compensation of board members, transactions with the unit beneficiaries, financial operations under the balance-sheet line items, transactions with subsidiaries as well as subsidiaries of subsidiaries, and the company strategy for the future activities.

In order to achieve transparency in the firm's operations, it is required to apply the internal control system in order to attain a vital confidence about financial reports and also about their compliance

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<sup>3</sup> Beal Diana, Michelle Goyen, Abul Shamsuddin, (2008) *Introducing Corporate Finance*, 2<sup>nd</sup> ed., Wiley & Sons, Australia. Robert G. Eccles and Samuel A. DiPiazza (2002), *Building Public Trust, The future of Corporate Reporting*. John Wiley & Sons Inc.

<sup>4</sup> **Entrepreneur** is a natural person or a legal entity, who proposes a project to the PLS bank for financing through the PLS banking system and executes the project up to the end. In addition to encompassing the required legal, financial, technical and performance capabilities, the entrepreneur should have the other capabilities and facilities/possibility to carry out the job.

<sup>5</sup> Robert M. Bushman, Joseph D. Piotroski, Abbie J. Smith, (2004), What determines corporate transparency? *Journal of Accounting Research*, Vol.42, No. 2 May.

<sup>6</sup> Aswath Damodaran, (2007) Information transparency and valuation: can you value what you cannot see?, *Managerial Finance*, Vol. 33 Iss: 11, pp.877-892.

<sup>7</sup> Carse, David, (2000) *The Importance of Corporate Governance in Banks*, BIS Review, Basel, March.

<sup>8</sup> Audited annual financial statements, periodic financial statements, the report of the board of directors to assemblies, and also the auditor's opinion on it, and the information with considerable influence on the price of securities and the decision of investors, are the least items that the publisher is obliged to present them to the mentioned organization according to the executive instructions prepared by the Stock Exchange Organization.

<sup>9</sup> According to Article 43 of the Securities Market Act, approved in December 2005, with respect to the subjects of transparency and announcement in the primary and secondary markets, the responsibility for compensation of the imposed losses on investors, resulted from culpability, delinquency, or incompleteness of the information presented in the process of initial provision, will be on the publisher, finance company, assessors, and the publishers' legal advisors, and the damaged persons can complain, maximum one year after discovery of the delinquency, to the board of directors of the stock exchange or the jury.

According to this law, the responsibility of adopting the necessary measures to provide the public access to the information related to the registry of securities, maximum 15 days after the registry, has been assigned to the Stock Exchange Organization (SEO). The SEO necessitates stock exchanges, publishers, financial brokers, and all active institutions in the capital market to disclose the comprehensive information of their activities according to the national accounting and auditing standards of the country. According to Article 44 of this Act, the SEO can cease the public offering of securities, in case of being informed of the presentation of false, incomplete, or misleading information by the publisher. The publisher is also obliged to prepare and present its financial statements according to the accounting standards, bylaws, and the executive instructions notified by the SEO. The SEO, according to Article 31 of the same Act, is obliged to prepare and publish the list, number, and price of traded securities in trading days, according to the rules and regulations of the SEO. The mentioned list will be considered an official document and stored in the records of the SEO.

with the related laws and regulations. In this way, the efficiency of the organization can be achieved.<sup>10</sup> The entrepreneur (executive firm), according to the definition expressed in Rastin Banking<sup>11</sup>, and also based on the obligations and essentials imposed by the process of Rastin Profit and Loss Sharing Banking operation as well as the regulations related to Rastin Baking, will have a special financial relationship with the depositor<sup>12</sup> through the bank. In this regard, Rastin Certificates<sup>13</sup> demand their own requirements in financial markets. In Rastin Banking, through Rastin Certificates, in practice, some parts of the depositor's interests and capital are tightly interrelated with the entrepreneur's activities. Any risk caused by the entrepreneur to the project's<sup>14</sup> operation will practically affect the depositor's interests. Thus, transparency of activities, information disclosure, and corporate governance of the entrepreneur's company have special significance in Rastin Banking.

The joint report of the "Basel Committee on Banking Supervision (BCBS)" and the "Technical Committee of the International Organization of Securities Commissions (IOSCO)" in October 1999 provided some recommendations regarding the disclosure of information, transparency of trading activities, and the derivative tools of banks and securities firms.<sup>15</sup> These advices were in line with the recommendations, issued in November 1998, which aimed to encourage banks and the providers of securities to disclose adequate information to market partners. The recommendations, offered by the aforementioned committees, were around two central pivots of disclosing clear information of the trading activities and their derivatives, and the studies and actions, which have been accomplished in connection with risk management. Since the financial risks and derivative instruments of business activities are normally similar to the common risks in traditional activities of banks and providers of securities, therefore, transparency based on the meaningful disclosure of information plays an important role in reinforcing supervision and risk management, preventing market rumors, and improving market stability. In total, the committee recommends the following advices:

1. Banks and providers of securities may be exposed to the rumors and malicious interpretations of market participants mostly in times of crisis, and may face the potential consequences. In such situations, information disclosure can assist them in dealing with the management of various risks.
2. Transparency of business activities and the derivatives will result in the stability of the banking institutions and the providers of derivatives.
3. Institutions must publish the qualitative and quantitative details of the identified risks as well as the method of their management.
4. Disclosure must comply with the risk assessment procedures and the performance measurement systems.
5. Disclosure of qualitative data and allowing the access of others to quantitative financial

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<sup>10</sup> BIS, Framework of Internal Control Systems in Banking Organizations, Basel, September, 1998.

<sup>11</sup> **Rastin Banking** is a true operational Islamic banking.

**Rastin Profit and Loss Sharing (PLS)** is an activity in Rastin Banking, which is based on the participation of depositors in the investment and economic activities of the entrepreneur based on the real yield of projects in order to land the interest-free banking according to the Islamic commandments and ethics. In Rastin PLS Banking, bank is a unit, which allocates the resources of depositors to those who look for financing (i.e., entrepreneurs) and according to specific contracts; the obtained profit or loss will be divided between depositor and entrepreneur. By receiving commission (*Jol*), bank provides capital management services for depositors, and invests their resources according to their choices and in return, provides them by Rastin Certificate. Bank has to use all its specialized potentialities to protect depositors' rights.

<sup>12</sup> **Depositor** is a natural person or a legal entity with a certain amount of fund (cash), who asks the PLS bank to participate in Rastin PLS banking products through a direct contact with the PLS bank, or via internet, and buys the Rastin Certificate of one of the PLS banking products.

<sup>13</sup> **Rastin Certificates** are a collection of certificates, designed and issued in the base system and financial subsystems of Rastin PLS Banking. The supervisory feature of the trustee unit of the PLS bank on these certificates, distinguishes them from the other financial papers and they have the prefix of "certificate". Being nameless, negotiable in secondary virtual Rastin Certificates Market, having market price based on the supply and demand of certificates, settlement by the last certificate holder are some of the characteristics of Rastin Certificates. Settlement of these certificates are carried out under the supervision of the trustee unit of the PLS bank.

<sup>14</sup> **Project** is a collection of economic activities with a specified and concrete plan, and also with pre-defined costs and terms, to make profit through Rastin PLS banking offered to the PLS bank.

<sup>15</sup> Basel Committee on Banking Supervision, and Technical Committee of the International Organization of Securities Commissions (IOSCO). Recommendations for Public Disclosure of Trading and Derivatives Activities of Banks and Securities Firms, October 1999, Transparency Group of the Basel Committee on Banking Supervision, Washington, D.C.

- statements and qualitative information are both necessary.
6. The method and amount of using commercial and non-commercial derivatives, the exchange and Over the Counter (OTC) trading transactions, and also any major change in business strategies and risk taking approaches, must be revealed.
  7. The prospect of non-commercial derivative activities as well as the related operational strategies, and the method of applying securities in preventing different risks associated with the banking activities, must be revealed.
  8. The method of managing and controlling the market, credit, liquidity, legal, operational, and contingency risks, including the current and potential gross risks, must be disclosed.
  9. The methods, utilized for accounting purposes and for calculating the revenue of commercial/non-commercial activities, need to be revealed.
  10. The disclosed information on the accounting policies must be understandable to general users.
  11. The accounting procedures and operations for computing the profit or loss, the performance and the anticipated revenue, and the balance of assets and liabilities arising from derivative transactions, must be unveiled.
  12. In the adjustment of the documents' or securities' values to determine the value of commercial and non-commercial derivatives, the nature and justifications of savings, the methods and assumptions used in estimating the market value for derivatives that have no market price, and also, the adjusting and reporting methods of the deferred, overdue, and undue receivables as well as their credit losses, must be explained.
  13. Significant changes in accounting policies must be disclosed. If a bank or a company intends to establish a new accounting method in the future, it is required to reveal the new procedure and its potential influences on the financial statements.
  14. The comparability of the internal and external information helps to achieve the information disclosure and transparency goals.
  15. Disclosure of information must be commensurate with the size and nature of the company's and the company's activities.

In this paper, according to the above-mentioned recommendations and by adopting the related key points from the Executive Bylaw of Rastin Profit and Loss Sharing Banking, a base for financial transparency, corporate governance, and information disclosure is proposed, which can be a ground for formulation of the final bylaw.

### **Financial Transparency of the Entrepreneur**

In order to ensure the compliance of the entrepreneur with the legal rules and the company's own approvals and to prevent various forms of corruption such as delinquency and fraud<sup>16</sup> in relation to financial reporting, the company is obliged to clarify its financial information by conforming the following provisions. In this regard, the chairman and the members of the board of directors as well as the chief executive officer of the entrepreneur company are responsible. The entrepreneur is obliged to prepare, present, or disclose<sup>17</sup> its financial information by considering the accounting standards of the National Audit Organization in a way that the contents are observable. Financial statements and reports must be transparent and accountable with respect to the following items:

1. Conducted transactions, with separation for large transactions.

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<sup>16</sup> **Fraud** is an action, in which the purpose of the doer is to harm the rights or interests of others or to violate the laws and approvals of the company, and includes the following items:

- Preparation and presentation or disclosure of false financial information.
- Hiding the information that their presentation or disclosure is necessary.
- Preparation and presentation or disclosure of unreal, deceitful, or superficial balance sheets, asset statements, profit and loss statements, and cash flow statements.
- Manipulation, forgery, or alteration of documents.
- Presentation, disclosure, or removal of false financial information of transactions or their effects.
- Conducting superficial transactions and recording them without the supporting documentation.
- Not recording transactions or their documents.
- Deliberate and inappropriate application of the accounting procedures.

<sup>17</sup> **Disclosure:** sending the information to the bank, and public and timely dissemination of the information on the company's and bank's websites, according to the terms of the Rastin Banking Bylaw.

2. Accounting operations, including headings, with a transparent classification of accounts.
3. Having a transparent and well-ordered relationship between financial events and documents related to the primary recording sheets, and financial statements and reports.
4. Accounting policies.
5. Organization of managers, employees, and their payments.
6. Report of the markup price.
7. Data integrity.

In preparation of financial statements and reports, the following items must be taken into consideration: disclosure, presentation method, terminology, responsibility of the providers, and application, in such a way that:

1. All the relevant, significant, and important financial information are presented and disclosed.
2. The following points should be carefully observed: correct classification and categorization of items, precision of the order and placement of items in the financial statements, appropriate presentation method, effective method of dividing assets, liabilities, and shareholders' rights into current/non-current items and into the commitments under the balance-sheet line, dividing revenues and costs into operational/non-operational items, presenting assets in the balance sheet based on their fluidity, dividing the cash flow resulted from the operational activities, tax, fixed investment activities, and sales and purchases of assets, return of investments, financing transactions and activities, and comparative asset statements based on book and daily values, etc.
3. Terminology must be understandable for general users.
4. The financial statements and reports that are typically prepared for specific objectives, such as the activity reports of the board of directors to the assembly, the feasibility report of capital increase, the tax statement, etc., are subject to the provisions of this chapter, if they are prepared to be disclosed or presented to the bank.
5. Financial statements and reports must be responsive to the information needs of users, who rely on them for their economic decisions. The major users are shareholders, actual and potential investors, depositors, owners and buyers of stocks, securities, Rastin Certificates, and Rastin Swap Bonds, providers of financial facilities, suppliers and demanders of financial goods, services, and resources, customers, borrowers of financials facilities, the entrepreneur's employees, government, government-dependent organizations including the National Tax Administration and the Social Security Organization, brokers, and financial analysts.
6. Additional information for the purpose of increasing the understanding of financial statements in relation to the above items must be also attached as explanatory notes.

Information in financial statements and reports must be "relevant", "reliable", "comparable", and "understandable". In order to observe the "relevance" feature, it is required to only insert or attach the information, documents, records, and supplementary reports, which are related to the topic of the financial statement or report. In order to ensure the "reliability" of information, the following factors must be deemed:

1. Honest expression: the provided information should honestly and directly indicate the main content.
2. Preference of content over form: financial events should be inserted based on the economic content and reality, and not merely according to the legal forms.
3. Impartiality: information in financial statements and reports must be completely impartial and should not be designed and prepared to provoke any specific impact on the users.
4. Caution: it is required to carefully observe the accuracy and carefulness of estimating the predictive, calendar, estimation, and storing items, as well as the items that their delivery is doubtful, etc.
5. Completeness: all the information must be reflected according to their importance and not more than adequate, and without removing any part that may mislead or deceive the users of financial statements and reports.

In order to make the information "comparable", stability in accounting practices and financial reporting procedures in the activities of the entrepreneur company must be considered in the preparation. In case of any change in the accounting procedures, supplementary reports must be

attached to provide the comparability of financial statements and reports. Moreover, the accounting standards of the National Audit Organization must be observed. It is necessary to determine the method of presentation and classification of information and explanatory notes, in order to ensure the “understandability” of financial statements and reports. If the entrepreneur is a natural person, observance of the provisions of the above items is essential as far as they are conformable to the natural personality. If the cited provisions are not observed by the entrepreneur, it will be obliged to compensate the possible losses. In this regard, the trustee unit<sup>18</sup> of the bank’s PLS office<sup>19</sup> will be responsible for verification of it and determination of the type and amount of losses.

## Corporate Governance of the Entrepreneur

Corporate governance is a set of rules, regulations, structures, processes, cultures, and systems, which through controlling<sup>20</sup> and influencing on the company’s or the organization’s management, leads to lawfulness and ensures the compliance with the laws and regulations, accountability, transparency, justice, and truthfulness, and protects the rights of stakeholders and the contract parties of the company.

The chairman of the board of directors and the chief executive officer of the company must not be a single person (even the legal representatives of the board members). The duties, authorities, and responsibilities of the chairman and the CEO should be explicit, clear, and specific, and do not interfere with each other. The majority of board members must be from non-executive directors<sup>21</sup>. Taking a duty by a board member must be accompanied with the board’s approval, and the concerned director does not have a voting right for this decision. Among the board members, there must be a non-executive financial expert with, at least, a bachelor degree in one of the following majors: accounting, finance, and management. This member will be the head of the audit committee. In order to have a proper and healthy management and take better company-related decisions, the board of directors in large companies<sup>22</sup> must not be composed of less than seven members. At least two members of the board must be chosen from the independent directors<sup>23</sup>. An executive board member cannot be the CEO or the executive board member of another company. The assessment unit<sup>24</sup> of the bank’s PLS office is obliged to obtain the necessary information concerning the provisions of this rule from the eligible authorities before signing the contract.

If the bank’s PLS office determined its necessity, the board of directors of a large company is required to own a secretariat, who is the administrative responsible for data collection and also the expert inspections, requested by the board members, and for ensuring that the board’s decisions are accomplished. This secretariat must comply with the following requirements:

1. The secretariat is directed by the secretary of the board of directors, who is suggested by the chairman and appointed with the board’s approval, and serves under the supervision of the

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<sup>18</sup> **Trustee unit:** It is a unit that exercises supervision over the processes of participation in Rastin Banking on behalf of the bank by using fundamental indicators and examining financial statements. It exercises supervision for the followings: good implementation of project, control of executive operations as expressed by planned projects, methods for allocation of resources, optimization of resources, etc.

<sup>19</sup> **PLS office:** It is a bank department that along with subordinate units manages the participation processes in Rastin Banking.

<sup>20</sup> **Control:** the authority of making the policies and guiding the financial and administrative operations of an economic unit in order to obtain the benefits out of its activities.

<sup>21</sup> **Non-executive director:** the part-time member of the board of directors, who has no executive responsibility.

<sup>22</sup> **Large company:** large companies are defined and specified according to the custom of each society.

<sup>23</sup> **Independent director:** the director who:

- Is not appointed by the major shareholder in the assembly, or is not his/her representative.
- Is not appointed by a group of shareholders, who constitute more than fifty percent of the participants, or is not their representative.
- Does not have any direct or indirect financial relationship with the parent company, the subsidiary company, or the subsidiary of the subsidiary.
- Has not been a member of the board of directors for more than three periods.
- Does not have any executive responsibility.

<sup>24</sup> **Assessment unit:** is a unit in the PLS office that considers the possibility of project execution by assessing the project proposal and examining the capacity of the entrepreneur.

- chairman.
2. The secretary of the board of directors is responsible for drafting negotiations and follow-up of the approvals of the board.
  3. The chief executive officer must provide and deliver the secretary with his/her needed information, which are requested by the CEO him/herself or through the board.

The board members must not make use of hidden information<sup>25</sup> to benefit themselves or others (including their dependent individuals<sup>26</sup> and unit beneficiaries<sup>27</sup>). The board of directors must take the necessary measures to ensure that the hidden information would not leave the company by means of employees and the holders of the company's hidden information could not apply these information to trade the Rastin Certificates or securities of the company. In this regard, the board of directors must apply an effective internal control mechanism for monitoring purposes and preventing such transactions. In addition, in case of discovery of any transaction based on hidden information, the trustee unit of the bank's PLS office must be accordingly informed. The bank's PLS office will make a decision about the disclosure/non-disclosure of the information.

In order to observe the business operations between the entrepreneur and the other natural or legal

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<sup>25</sup> **Hidden information:** the information on the current and future position of the company or the organization, whose holder can affect the company's or the organization's financial flow and also his/her own (or others') personal interests.

**Holders of hidden information:** the individuals, described in Note 1 of Article 46 of the Securities Market Act, are considered as holders of hidden information of the company and are listed in below:

- Company directors, including the members of the board of directors, the members of the board of governors, the chief executive officer, and their deputies.
- Inspectors, consultants, accountants, auditors, and lawyers of the company.
- Shareholders who, alone or along with their dependents, own more than ten percent of the company shares, and their representatives.
- The chief executive officer, the members of the board of directors, and the relevant managers, or the representatives of the parent companies (holding companies), who own at least ten percent of the company stocks or at least have one member in the board of directors of the investor company.
- Other individuals, who have access to hidden information due to their obligations, authorities, or positions.

<sup>26</sup> **Dependent individuals:**

- The members of the board of directors, the chief executive officer, and also the institutions and companies, in which the company's members of the board of directors or the chief executive officer are their partner, or member of the board of directors, or chief executive officer.
- According to Article 862 of the Civil Law, all the first-grade relatives or the relatives by marriage, of the members of the board of directors, the chief executive officer, the members of the board of governors, their deputies, and senior managers of the company.

<sup>27</sup> **Unit beneficiaries:** natural or legal persons, who are subject to shared interests due to ownership, financial, or managerial relationships.

**Ownership relationships:** two or more natural or legal persons will have ownership relationships with each other:

- If they are members of a corporate group.
- A natural person and a company will have an ownership relationship, if the mentioned person owns more than 50 percent of the company's shares.
- If they benefit from the shared asset(s).

**Managerial relationships:** two or more natural or legal persons, or members of a corporate group, will have managerial relationships, if any of the below factors is present among them:

- Control.
- Considerable influence.
- At least two-thirds of the members of the board of directors are common.
- The chairman of the board of directors is common.

**Financial relationships:** two or more natural or legal persons will have financial relationships, if:

- They are dependent individuals.
- They are natural or legal persons, who have mutual financial relationships with each other.
- They are members of the unit consortium that more than 50% of their annual gross income is supplied from their activities in the consortium.
- They are individuals that more than 50% of their annual gross income is supplied from another person.
- They are the business representative of a legal person that more than 50% of his/her annual gross income is supplied from the parent company.
- Two or more of them have received some facilities from a bank, a bank/non-bank credit institution, or a legal person, and one or more of them have been appointed as the sponsor.
- A bank, a bank/non-bank credit institution, or a single natural person, has created a commitment in favor of two or more persons.

persons, the board members and the CEO of the entrepreneur's company must declare their own complete information, and also the details of their affiliated individuals, parent and subsidiary companies<sup>28</sup>, subsidiaries of subsidiaries, unit beneficiaries, and the individuals with considerable influence<sup>29</sup>, to the trustee unit of the bank's PLS office. The banks' PLS office must avoid disclosing the mentioned information according to trusteeship principles. Making decisions on the following issues must be brought to the notice of the trustee unit of the bank's PLS office:

1. Selection of the CEO and the directors of the parent company<sup>30</sup>, as well the members of the board of directors of the subsidiary companies, and the subsidiaries of subsidiaries.
2. Approval of policies, administrative rules, and internal regulations of the entrepreneur's firm.
3. Approbation of the company's major transactions with dependent parties, unit beneficiaries, parent companies, subsidiaries, subsidiaries of subsidiaries, and individuals with considerable influence.
4. Buying, selling, and pricing of properties, main products, and the assets unrelated to the project, along with the corresponding terms and conditions.

The following decisions must be approved by the trustee unit of the bank's PLS office prior to their enforcement:

1. Buying, selling, and pricing of properties, main products, and the assets related to the project, along with the corresponding terms and conditions.
2. Setting or changing the salaries, bonuses, and authorities of the board members and the other company's directors, and also the unusual rewards.
3. Borrowings from banks or other non-bank resources.
4. Applying for a new participation through Rastin profit and lost sharing banking in the agent bank or other banks.
5. Actions, which in some way, may affect the interests of depositors.

In all the above cases, in companies that the depositor, like a shareholder, is a partner in the financial performance of the entrepreneur's firm, the trustee unit of the bank's PLS office must have been already informed and must have verified the company's activities. Any discrimination in the distribution of profits or interests between shareholders and owners of Rastin Certificates (depositors), in such a way that the depositor becomes partner like a shareholder in the entrepreneur firm's financial performance, is impermissible. In order for the entrepreneur to perform its transactions, it must prepare the regulations of transactions and receive the approval of the board of directors. The board of directors must establish an appropriate internal control system for asset protection, proper reporting, and compliance with laws and regulations. If the depositor, like a shareholder, is a partner in the financial performance of the entrepreneur's firm, the board of directors must, at least annually, review the internal control system and report to the trustee unit of the bank's PLS office. In large companies, this review must be performed by an independent auditor. In large companies, the board of directors must assign an audit committee, comprised of the majority of non-executive board members, in a way that there would be at least one member of this committee with financial knowledge and experience. The audit unit will function under the supervision of the audit committee. The board of directors must specify, in a written form, the duties of the audit committee that should include the following points:

1. Monitoring the accuracy of annual and mid-term reports, as well as the other official announcements related to the financial performance of the company.
2. Monitoring the selection and change of accounting policies and financial software, by the management, according to the national accounting standards of the National Audit Organization.

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<sup>28</sup> **Subsidiary company:** the company that the majority of its stocks are directly or indirectly owned by the parent company, or the majority of the members of its board of directors are selected by the parent company.

<sup>29</sup> **Persons with considerable influence:** a natural person (along with his/her dependents) or a legal person will have a considerable influence, if s/he directly or indirectly owns more than 20% of the company's shares or assets, or based on an agreement with the other shareholders or partners, owns more than 50 percent of the other company's voting right, or owns the right of appointing or discharging the majority of the board of directors' members by him/herself or by his/her representative, or overall, for any reason can directly or indirectly control the company.

<sup>30</sup> **Parent company:** the company that owns one or more subsidiary companies.

3. Inspecting the company's transactions with dependent individuals, unit beneficiaries, parent companies, subsidiaries, subsidiaries of subsidiaries, and individuals with considerable influence.
4. Studying major projections made by the management for preparing annual and mid-term reports, proposing them to the assembly for selection, and maintaining or changing the independent auditor and also the independent auditing contract terms.
5. Monitoring the auditor's independence and also the effectiveness of the independent auditing processes, under the code of the professional behavior of independent auditors, and the auditing standards of the National Audit Organization.
6. Ensuring the establishment of an appropriate internal control system.
7. Monitoring the performance and ensuring the effectiveness of the internal audit system.
8. Appointing and dismissing the internal audit manager.
9. Ensuring the existence of a written code of moral values (the company's code of ethics) and the devotion of employees to them, by the executive management.
10. Reviewing risk management policies and the method of identifying and dealing with the possible risks.
11. Ensuring the full access of the independent and the internal auditors to the necessary information and documents.
12. Establishing communications between the independent and the internal auditors and the board of directors.

In the elections of the assemblies' boards the major shareholder selects, at most, only one of the assembly's board members. One member of the assembly board will be selected from the minority shareholders<sup>31</sup> and with the majority of their votes. One member from the minority shareholders will present in the assembly and will be elected with the majority of their votes under the supervision of the assembly board. Compensation of each member of the board of directors must be approved by the assembly. The assembly board, prior to the assembly meeting, must review and verify the ownership or representation of the persons present in the assembly. Representation of legal persons in the assembly will be valid through a formal written correspondence with the company. The board reports to the assembly, and the reports of the statutory inspector and the independent auditor will become permanently available to the public through the company's and the bank's websites before the meeting.

Main financial statements must be advertised on the entrepreneur's and the bank's websites, not later than ten days after holding the assembly. The majority of board members must be present in the assembly meeting; otherwise, they should announce the reasons for their absence to the assembly in a written note, and inform the shareholders and holders of Rastin Certificates through the company's website. Shareholders must exercise their vote in person, or absently through a formal attorney or delegation to the stock custodian<sup>32</sup>. Sufficient and reasonable time must be available for shareholders and the bank's trustee unit to question the board of directors prior to the beginning of the approval process. The right of the non-executive board members to attend the general assembly will be decided by the board of directors. The board of directors is obliged to provide credible and transparent information, as well as the periodic, annual, and mid-term company reports that are requested by the trustee unit of the bank's PLS office, according to the measures, which have been specified in information disclosure chapter, on the bank's and the company's websites.

The CEO and the board members of the entrepreneur's company have a shared responsibility to provide the trustee unit of the bank's PLS office with transparent and complete information. The information, provided to the trustee unit of the bank's PLS office or to be published on the company's website, as well as the method of preparation must be previously approved by the board of directors. The annual reports, which express the past, present, and future prospects of the company, should be

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<sup>31</sup> **Minor shareholder:** a person, who is not in alliance with the major shareholder, and possesses less than one thousandth of the company's shares.

<sup>32</sup> **Stock custodian:** an institution with a license from the Securities and Exchange Organization for providing stock services. **Stock services:** storing the securities, cash, and bonds owned by customers, receiving dividends, bonus shares, priority rights, and other interests of the company's shareholders, stock subscription, participation in assemblies, buying, selling, and managing stock portfolios, and so forth.

disclosed on the company's and the bank's websites after verification of the trustee unit of the bank's PLS office. The reports must at least include the following items:

1. General information about the company's organizational structure, products, human resource, and social and environmental responsibilities.
2. Analysis of different parts of the operations, clarification of the competitive conditions and the management structure, comparison of the primary objectives with the operational results, and elucidation of the research and development activities, threatening risks, significant contracts, and future perspectives.
3. A summary of the 3-year financial information of the entrepreneur's firm.
4. Physical progress reports of plans.
5. Financial statements, which have been prepared in accordance with the accounting standards, and also the reports of the independent auditor and the statutory inspector.
6. The information related to the observance of the regulations, which have been established for the protection of the environment, including the amount of pollutant gases and their reduction, the amount of industrial wastewater and their purification, the amount of dust emissions and their filtration, the amount of solid wastes and their recycling, the amount of energy consumption and its saving, the amount of electromagnetic wave transmission and its controlling, etc.
7. The information related to the observance of corporate governance principles, including the reports on the performance of the audit committee and also information disclosure.
8. Information on the members of the board of directors.

The full names and details of the members of the board of directors as well as the CEO, including the executive/non-executive and the independent/dependent directors, the amount of their shares in the company, their membership in the board of other companies, and also all their receivables, which include salaries and benefits, overtime working, internal and external missions, loans, and bonuses, must be disclosed in a separate section in the company's annual report. The details of considerable transactions with third parties, and also the purchase or sale of varieties of materials, goods, assets, services, technical knowledge, and technology to dependent individuals, unit beneficiaries, parent companies, subsidiaries, subsidiaries of subsidiaries, and the persons with considerable influence, must be disclosed in the annual report. In case of deviation of the entrepreneur from the provisions stated in this chapter and its verification by the trustee unit of the bank's PLS office, the following actions can be accordingly taken by suggestion of the trustee unit and approval of the bank's PLS office:

1. The relevant notices must be given to the entrepreneur company in writing.
2. The entrepreneur company's credit level must be reduced according to the rules.
3. The company must be restricted or totally banned from reusing the Rastin profit and loss sharing banking services.
4. The company's name must be introduced on the bank's website.

However, the bank, after verification of the case, is allowed to calculate the entire losses imposed on the project's financial flow, according to the provisions of the Rastin Banking Bylaw, and collect from the income share of the entrepreneur, as well as the collaterals and received guarantees.

### **Information Disclosure of the Entrepreneur's Company**

In order to make the market of Rastin Certificates<sup>33</sup> clear and provide equal conditions for all players of the market and create transparency in trading of Rastin Certificates, the entrepreneur after approval of the proposal by the assessment unit and during the stages of implementation of the project until the final payoff, according to the followings, is obliged to disclose the project's financial and executive details as well as the information on the physical progress of the project and other important information<sup>34</sup>, based on the provisions of this chapter, and publish them on the company's and the

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<sup>33</sup> **Rastin Certificate Market** is a web-based settlement system for the transaction and transfer of Rastin Certificates and other valuable papers of Rastin banking.

<sup>34</sup> **Important information:** the information related to the decisions of the entrepreneur as well as its related events and decisions, which significantly influence on the price of the Rastin certificates related to the entrepreneur and the decision of depositors, buyers and sellers of the Rastin certificates related to the entrepreneur.

bank's websites for public information. If the entrepreneur is a natural person, in case the provisions of this chapter are conformable to his/her performance, the related information will be required be disclosed on the bank's website. Bank, alongside the entrepreneur's company and at the same time, must disclose the information stated in this chapter, in order to enable the active players of the market of Rastin Certificates to make their decisions using these information. The financial engineering unit of the bank's PLS office, according to the provisions of Chapter 2 of the Rastin Banking Bylaw (organization), will be responsible for monitoring the events in the market of Rastin Certificates, and will pursue and monitor the procedure of information disclosure by the entrepreneur. The disclosed information by the entrepreneur must be real, explicit, reliable, timely, and without any bias. The information with negative impact must be disclosed and released with the same speed and accuracy as the positive information. The entrepreneur is obliged to report its financial statements and reports in accordance with the national standards, and must prepare and disclose the other details stated in this chapter within the given deadlines. Information disclosure by the entrepreneur must cover the following items:

1. The proposal and its analytical documents, by the bank and on the bank's website.
2. Historical information and the latest trading price and volume of the Rastin Certificates related to the entrepreneur company, by the bank and on the bank's website.
3. Physical progress reports, by the bank and on the bank's website.
4. Company general information, on the company's and the bank's websites.
5. Company announcements on the company's website, and in case of request of the trustee unit, on the bank's website.
6. Historical information and the latest trading price and volume of the shares of the entrepreneur's company on the company's website.
7. Latest composition of the company's shareholders on the company's website.
8. The statistics of transactions must be archived on the company's website with the request of the trustee unit of the bank's PLS office.
9. The public must be informed regarding the acceptance of the company in the stock exchange through the company's website.
10. The set of internal regulations, rules, and instructions of the company, on the company's website.
11. Annual audited financial statements of the parent and consolidated company of the group, at least 10 days before the usual convening of the general assembly, and maximum 4 months after the end of the financial year, on the company's and the bank's websites.
12. Report of the board of directors to assemblies, and also the auditor's opinion on it, at least 10 days prior to the convening of the general assembly, on the company's and the bank's websites.
13. Unaudited 3-, 6-, and 9-month mid-term information and financial statements, maximum 30 days after the end of each three-month period, with the request of the trustee unit of the bank's PLS office, on the company's website.
14. Audited 6-month mid-term financial statements, maximum 60 days after the end of the 6-month period, and for the companies that are required to prepare the consolidated financial statements, maximum 75 days after the end of the 6-month period, with the request of the trustee unit of the bank's PLS office, on the company's website.
15. Unaudited annual financial statements, maximum 60 days after the end of the financial year, and for the companies that are required to prepare consolidated financial statements, maximum 90 days after the end of the financial year, with the request of the trustee unit of the bank's PLS office, on the company's website.
16. The management's future plans and prediction of the annual performance of the parent and consolidated company of the group, at least 30 days before the beginning of the new financial year, and the auditor's opinion on it, maximum 20 days after presentation of the entrepreneur, with the request of the trustee unit of the bank's PLS office, on the company's website.
17. Forecast of the annual performance of the parent and consolidated company of the group, according to the actual 3-, 6-, and 9-month performance, maximum 30 days after the end of each quarter, and the auditor's opinions on it according to the actual 6-month performance, maximum 20 days after presentation of the entrepreneur, with the request of the trustee unit of the bank's PLS office, on the company's website.
18. Audited performance in the cases resulted in a significant change in predicting the performance,

maximum 20 days after submission of the unaudited information by the entrepreneur, with the request of the trustee unit of the bank's PLS office, on the company's website.

19. The details of the investment portfolio of the investment and holding companies, at the end of each month, maximum 10 days after the end of the month, with the request of the trustee unit of the bank's PLS office, on the company's website.
20. Annual audited financial statements of the subsidiary companies, at least 10 days before convening the ordinary annual general assembly of the parent company, with the request of the trustee unit of the bank's PLS office, on the company's website.
21. Audited 6-month mid-term financial statements for the under-control companies, maximum 60 days after the end of the 6-month period, and for the companies that are required to prepare the consolidated financial statements, maximum 75 days after the end of the 6-month period, with the request of the trustee unit of the bank's PLS office, on the company's website. In case of a request from the entrepreneur and approval of the trustee unit of the bank's PLS office, presentation of unaudited financial statements will be adequate.
22. The details of the investment portfolios of the under-control companies, whose main activities are investment in securities, in the periods of 3, 6, 9, and 12 months, maximum 30 days after the end of the 3-month period, with the request of the trustee unit of the bank's PLS office, on the company's website.

Any of the above items can be also disclosed on the bank's website, in case of the request of the trustee unit of the bank's PLS office. Periodic reports must include the required financial information, their audit method, and the applied accounting standards. If the annual and mid-term financial statements and reports have been prepared before the pre-specified time, they must be immediately disclosed by the entrepreneur. The trustee auditors, after submitting the financial statements and reports by the entrepreneur, are obliged to provide their comments and opinions and issue the audit reports within the deadlines specified in the Rastin Banking Bylaw. An immediate disclosure of important information is applicable to the following items, and must be done by the entrepreneur itself, or based on the recognition of the trustee unit on the company's website, and in case of request of the trustee unit of the bank's PLS office, on the bank's website:

1. Signing important commercial contracts.
2. Merger or purchase the shares or assets of any other company.
3. Major transactions.
4. Changes in the market of materials and products, as well as the events and changes in the market conditions that significantly influence on the price of the Rastin Certificates related to entrepreneur's project.
5. Clarification or confirmation of rumors<sup>35</sup> and reports.
6. Unusual transactions.

The entrepreneur must avoid disclosing the below information for the purpose of advertisement, and also any detail more than the necessary amount needed for making decisions about the investment:

1. False reports.
2. Public announcements that do not explain the actual developments of the company's project.
3. Exaggerated reports and forecasts.

In case of dissemination of rumors or any report that contains false, misleading, or fraudulent documents, the entrepreneur is obliged to immediately send sufficient information and explanations on the rumor or report to the bank's PLS office and also disclose to the public. The financial engineering unit of the bank's PLS office can disclose the received information and explanations from the entrepreneur on the bank's website, by coordinating with the trustee unit. When an unusual market activity<sup>36</sup> indicates that trading of Rastin Certificates, without a sound reason, has been influenced by rumors, the bank's PLS office will ask the entrepreneur to publish an appropriate notice. The bank's PLS office can temporarily stop the trading of the Rastin Certificates related to the project or the entrepreneur, for the purpose of stability and transparency of the market conditions, until the time of

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<sup>35</sup> **Rumor:** the news (that regardless of their trueness or falseness) indicate some important information, which have been unofficially reported, and are significantly effective on the price of Rastin certificates.

<sup>36</sup> **Unusual market activity:** an unusual fluctuation in the trading price or volume of Rastin certificates.

disclosing the mentioned notice. If the entrepreneur is informed about a rumor or a report, that regardless of its trueness or falseness, will affect the trading price and volume of Rastin Certificates of the entrepreneur or the project, or can probably influence in the future, the company is obliged to immediately investigate the situation and take the necessary measures with regard to the rumor or report (e.g., publishing or disclosing the necessary information). An immediate disclosure of information is essential in the following events:

1. Major changes in the ownership and structure of the company.
2. Borrowing or obtaining significant bank facilities.
3. Any change in the company's objectives.
4. Important claims in legal proceedings for or against the entrepreneur.

The entrepreneur is obliged to announce the time, date, location, and agenda of the public assemblies in widely circulated newspapers and on the company's website, at least 10 days before the convening of the meeting. The agenda of the general assemblies should be explicit and clear. Important issues such as selection of the board members, the auditor, and the statutory inspector, the profit sharing, savings, and changing the activity subject, must be stated specifically on the agenda and is not allowed to be mentioned in the "other items" section. The entrepreneur is obliged to publish the decisions of the general assemblies on the company's website, maximum within a week after the meeting. The entrepreneur is obliged to disclose the date of special general assemblies for capital increase, at least ten days prior to convening the meeting, and also in the organized agenda, within three working days after the assembly, which is published on the company's website. The entrepreneur is obliged to disclose the timetable for paying cash dividends and compensation of the board members and other employees clearly in the separated categories of their names, the amount, cash dividends, and bonuses on the company's website, prior to convening the ordinary general assembly. Assembly resolutions, in conformity with the provisions of corporate governance chapter, must be disclosed on the company's website, maximum within 30 days after the date of the assembly.

The entrepreneur must release the important information concerning its activities, immediately after obtaining the information, or in the cases when the important information have been previously obtained. In addition, in the cases where the release of important information may be delayed due to confidentiality reasons, the trustee unit must have been already informed about the reason for postponement and must have also verified it. Examples of the important information, which are related to the events effective on the company's operation, financial status, and performance results, are as follows:

1. Suspension or stoppage of all/some parts of the entrepreneur's activities.
2. Change in the principal activity of the entrepreneur.
3. Direct or indirect acquisition of shares of other companies, which has a significant impact on the current/future performance of the entrepreneur.
4. Organization of or participation in important tenders and biddings, and the final results.
5. Change in the accounting method or procedure, along with its financial causes and effects.
6. Change of the entrepreneur company's CEO or change in the composition of the members of the board of directors.
7. Ratification, dissolution, or any other critical change in important contracts.
8. Serious cases filed for/against the entrepreneur, intervening in serious cases or attracting them, referring important disputes to arbitration, and announcing the outcome of the final judgments of the courts and other legal authorities, and also other important legal actions and events that affect the price of the Rastin Certificates related to the project(s) of the entrepreneur.
9. Specifications of the company's investment plans and any major change in them.
10. Cessation of the activity of customers or suppliers of the main materials/products to work with the entrepreneur, or any change in the company's major customers or suppliers.
11. Inability to implement the company's commitments and contracts, declaration of the bankruptcy of the entrepreneur or its parent company.
12. Declaration of the amount of sinking funds, blocked in the registry box or the justice department, under any title.
13. Decisions made by the general assemblies of the entrepreneur's company, the parent company,

and the corporate group<sup>37</sup>.

14. Decisions and major transactions of the entrepreneur, the parent company, and the corporate group.
15. Discovery of natural resources and reserves, or discovery of substantial resources by the suppliers of raw materials of the entrepreneur.
16. Production of new products, offering new services, and accessing to new primary sources, and new technologies, sales markets, or customers.
17. Approval, suspension, or cancellation of the commercial license, and transfer, acquisition, change, or revocation of the name or the trademark.

Examples of the important information, related to the decisions and conditions, affecting the entrepreneur company's capital structure and provision of financial resources, are as below:

1. Changes in the capital of the entrepreneur company or the companies under the control of the entrepreneur company.
2. Dissemination of a new Rastin Certificate of the entrepreneur, in every bank.
3. Any change in the entrepreneur company's dividend policy.
4. The factors effective on the other parts of the capital structure, such as guarantees, or provision of important bank guarantees, and off-balance-sheet financing.
5. Borrowing or repaying substantial sums, compared to the total turnover in all financial operations of the entrepreneur.

Examples of the important information, related to the changes in the ownership structure of the entrepreneur, are as below:

1. Major alterations, which change the company's authority.
2. Changes that lead to a merger, acquisition of capital, or alteration of the composition of shareholders.

Examples of other important information, affecting the prices of the Rastin Certificates, related to the entrepreneur or its project, are as follows:

1. Performing any transaction that influences the entrepreneur company's assets.
2. Placing collateral or releasing the mortgage of the important properties of the entrepreneur.
3. Creating or settling important debts.
4. Significant changes in the anticipation of the performance or the future plans of the entrepreneur company's management, in conjunction with their reasons.
5. Anticipation of a significant increase or decrease in the entrepreneur company's revenues or costs in the future, alongside the reasons.
6. Significant damages due to natural disasters (such as fire, flood, earthquake, etc.), or as a result of the operational/non-operational activities of the entrepreneur.
7. Significant annual adjustments.
8. The request for entering or exiting from the companies, listed on the stock exchange and other OTCs, and the related reasons.
9. Any event or change in the companies under control, which has a significant impact on the activity, financial status, and performance outcome of the parent company.

The entrepreneur is obliged to immediately disclose the prediction of its performance or the management's future plans, and present the report to the bank's PLS office, maximum within 10 working days. In case of the following restrictions, the entrepreneur, with a permission from the bank's PLS office, can reveal the important information with a delay after removal of the restrictions:

1. If an immediate disclosure is harmful or with no significant profit for the entrepreneur.
2. If the entrepreneur is conducting negotiations, and no agreement has been reached yet.
3. If the subject of disclosure is constantly changing.

If the delay in information disclosure leads to spreading rumors, or trading based on the hidden information, or an unusual market activity in relation to the Rastin Certificates of the entrepreneur or its project, necessary measures, such as immediate information disclosure under the supervision of the

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<sup>37</sup> **Corporate group:** the group, which includes the parent company, the subsidiary companies, and the subsidiaries of subsidiaries.

trustee unit of the bank's PLS office, can be adopted by the entrepreneur in order to avoid any probable damage or loss. In order to prevent the disclosure of non-disclosed information, the entrepreneur is obliged to restrict the access to the mentioned information to the company's directors and eligible employees. The access to these information must be merely according to the duties and responsibilities of the relevant parties, including the employees, attorneys, accountants, auditors, and financial advisors of the entrepreneur, or other eligible individuals. The secrecy of these information and their restriction for personal application in trading based on hidden information must be stressed.

The entrepreneur is obliged to disclose any information requested by the bank's PLS office. In order to detect unusual activities, the financial engineering unit of the bank's PLS office must continuously monitor the events, effective on the market of Rastin Certificate. Whenever necessary, after consulting with the trustee unit, the financial engineering unit will ask the entrepreneur to disclose the required information or issue an announcement. The financial engineering unit, after receiving the information from the trustee unit and explaining and developing, must quickly disclose an announcement including the important information on the website of the market of Rastin Certificates. The financial engineering unit is obliged to freely and publicly disclose the information on the website of the market of Rastin Certificates. The bank can disclose the correspondences between itself and the entrepreneur for public information.

### **Delinquency**

In case of deviation of the entrepreneur from the provisions of this chapter and its verification by the trustee unit and the financial engineering unit, the following actions can be accordingly taken by suggestion of the mentioned units and approval of the bank's PLS office:

1. The relevant notices must be given to the entrepreneur in writing.
2. The entrepreneur company's credit level must be reduced, which has been explicated in the entrepreneur chapter and guarantees, collaterals, and contributions chapter.
3. The company must be restricted or totally banned from using the Rastin profit and loss sharing banking services.
4. The company's name must be introduced on the bank's website.

However, the bank is allowed to calculate the entire losses imposed on the project's financial flow, according to the provisions of the Rastin Banking Bylaw, and collect from the income share of the entrepreneur, as well as the collaterals and received guarantees.

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