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GOVERNANCE

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TRANSPARENCY

Achieving transparency in banks

There are inherent difficulties in making the riskiness of any enterprise transparent, including banks. For instance, in many countries the value of core banking activities, e.g., as they relate to credit risk and impairment inherent in the credit portfolio, cannot be estimated without some degree of imprecision. Therefore, the financial strength of a bank at any point in time and its financial performance over accounting periods, which are key inputs into any assessment of its riskiness, are subject to a certain degree of uncertainty. Furthermore, the risk appetite of a bank and the quality of its internal controls are crucial to the assessment of its riskiness, but may be difficult to communicate meaningfully, and, hence, difficult to make.

Comparability of financial information across countries is also difficult to achieve, given that accounting and disclosure standards differ considerably not only for technical reasons, but also because of the interdependence between accounting, legal, fiscal and political considerations. Even when standards are similar, there may be considerable scope for interpretation and judgment when applying the principles. This may also lead to problems of comparability within countries.

Furthermore, it is clear that a bank, due to the need to preserve a degree of confidentiality, e.g., in relation to customers, cannot publicly disclose all data that may be relevant to an assessment to its activities and risk exposures. Privacy laws may restrict a bank's ability to disclose information on individual customers. Moreover, disclosure of detailed information on its individual customers and its risk management techniques and strategies, could significantly reduce the value of the bank of investing in these activities. Public disclosure standards should seek to balance the need for market participants to assess the quality of a bank's management with protecting the value to the bank of proprietary data.

Moreover, the usefulness of information depends on how current it is. Since banks' risk profile can change rapidly, transparency requires the timely release of relevant information.

Source: Enhancing Bank's Transparency, Basle Committee on Banking Information

STANDARDS AND CODES

What are "standards and codes" and why are they important?

The term "standards and codes" refers to sets of provisions relating to the institutional environment—the "rules of the game"—within which economic and financial policies are devised and implemented. Countries where the institutional environment is well-regulated and transparent tend to demonstrate better economic performance and greater financial stability. It is thus in countries' own interest to adopt and implement internationally-recognized standards.

The IMF and the World Bank's work on standards and codes is a prominent component of the efforts to strengthen the international financial architecture that followed the emerging market crises of the 1990s. The development, dissemination, and adoption by countries of international standards is expected to assist countries in strengthening their economic institutions, inform market participants so as to allow for more effective market discipline, and inform IMF surveillance and the World Bank's country assistance strategies. The ultimate goal is to promote greater financial stability at both the domestic and international levels.

FRAUD

What is third party fraud?

Third party fraud is fraud committed by someone against another person or business, without an employer/employee relationship.

Third party fraud has a larger average loss than occupational fraud, but is less common. These frauds are generally hidden at the time they are committed but, as the fraudster does not have to maintain a relationship with the victim, the fraud does not need to be hidden forever. Victims will generally discover the fraud some time afterwards.

"Business social responsibility should not be coerced; it is a voluntary decision that the entrepreneurial leadership of every company must make on its own."

--John Mackey

This publication is a result of ADFIAP's cooperation with the Center for International Private Enterprise (CIPE)

COUNTRY INITIATIVE

Papua New Guinea, ADB and Japan partner to promote good governance

The Government of Japan and the Asian Development Bank (ADB) will assist Papua New Guinea in promoting good governance by helping the Pacific island nation re-build public financial management institutions and systems. This partnership includes a $500,000 technical assistance grant expected to be implemented over 12 months, commencing in July 2007 and finishing in June 2008. Funding for the grant will be sourced from the Japan Special Fund.

Following a request from the Papua New Guinea Government, ADB responded with a technical assistance grant to support activities related to the country's Public Expenditure Review and Rationalization Program (PERR). The PERR is a joint Government-donor program coordinated by the multi-agency PERR implementation committee. Key participating development partners on the committee include: ADB, Australian Agency for International Development (AusAID), United Nations Development Programme (UNDP) and World Bank.

"Specifically, the grant will support efforts to promote good governance through more transparent and efficient use of public resources," said Steven van der Tak, Country Director of ADB's Papua New Guinea Resident Mission (PNRM). "This agreement strengthens ADB's commitment to working closely with Papua New Guinea, the Government of Japan, and other development partners."

Two of the nine projects under the PERR program will receive assistance. The two projects will focus on improving the financial oversight and governance of public agencies, and support the preparation of the Government's medium-term financial management strategy.

Papua New Guinea (PNG) comprises a group of islands that includes the eastern half of the island of New Guinea. PNG has been an ADB member since 1971.

TRANSPARENCY

Understanding transparency in a financial context

The definitions of transparency applicable to a financial context include: easily understood or detected; obvious; guileless (free of deceit, cunning, or craftiness); candid; open. In other words, fully revealing the true financial picture of a bank or firm. Transparency insures that reported financial data reflects reality. If there is a change in the financial status of a reporting entity, full transparency requires that that change be reflected accordingly and instantaneously to all concerned.

Transparency is not about cultural differences. Yet it is clear that certain cultures naturally resist attempts to improve transparency. Or worse, they wait until there is a crisis to make the change. At times, this exacerbates the problem and causes the crisis to deepen.

As banks push beyond the basics, sound banking practice of engaging in short-term, self liquidating lending, the need for transparency increases. Balance sheets stacked with long-term commitments, margin lending and direct equity investments are most vulnerable to economics disruptions. The weaker the transparency for

...Understanding transparency...

such banks, the greater the likelihood that they may be trying to hide bad news and the larger the premium they must pay to attract funds. Where local laws permit poor transparency, managers of these institutions intuitively weigh the costs of improved transparency against the benefits of reduced funding costs.

Examples of poor transparency:

- Delays in financial reporting or the absence of quarterly and semi-annual updates
- Lax accounting practices, especially those relating to loss and impairment definitions of financial assets
- No consolidation of the financial results of related companies, and conversely, the lack of separate corporate entity financial statements
- Complex corporate structures, lack of clear ownership interests and hidden related party lending
- Continuing accrual of interest for problem loans
- Undisclosed derivatives activity, such as forward contracts; likewise, missing footnotes
- Lack of timely information about material events when they occur and/or the poor distribution of information that is made public; and
- Restrictions on the freedom of independent third parties to voice opinions of financial issues.

BRIBERY

What is active and passive bribery?

'Active' bribery, as termed in international treaties like the OECD Convention, occurs when a firm tries to bribe a public official to obtain a trading advantage. 'Passive' bribery is when the firm complies with a demand for a bribe. The latter can be 'solicitation,' a simple request for a bribe, or 'extortion,' when the request for a bribe is accompanied by a threat, direct or implied.

"Governance" is a quarterly publication of the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP). It highlights ideas, best practices and trends in good corporate governance. *Copyright, 2007, ADFIAP.* *Article contributions can be sent to robertj@adfiap.org*