Corporate governance of State-Owned Enterprises

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Presentation Outline

- Why state owned enterprises (SOEs) at this session
- Role of SOEs in economies across ECA region
- Quality and reliability of SOEs financial information
- Good governance practices at SOEs

Why state owned enterprises (SOEs) at the A&A session

- Ongoing financial and sovereign crisis around the world and in ECA
- Reducing budget capabilities put pressure on governments to re-visit support of SOEs
- Many SOEs do not operate on market terms requiring governments' assistance
- Financing SOEs becoming scarce, capital costs rising, investors shying away from poor governed and poor performing companies
- Still SOEs bear big potential to lead their domestic markets by building good corporate governance and leading the way

- Many countries demonstrate that good governance of SOEs builds foundation for their positive contribution to economic efficiency and competitiveness
- SOEs that are practicing good corporate governance are able to improve their performance
- Experience shows that market-based model is the most effective way for efficient allocation of resources

Why state owned enterprises (SOEs) at the A&A session

» **Defining an SOE:** An SOE is any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership*.

» **Ownership and control:** SOEs under the control of the state, either through majority ownership or other measures that confer a large degree of influence.

» **Commercial orientation:** SOEs are entities that pursue “economic activities”, which involves offering goods or services on a given market and which could, at least in principle, be carried out by a private operator to make profits.

** - as per OECD Guidelines 2015*

Why state owned enterprises (SOEs) at the A&A session

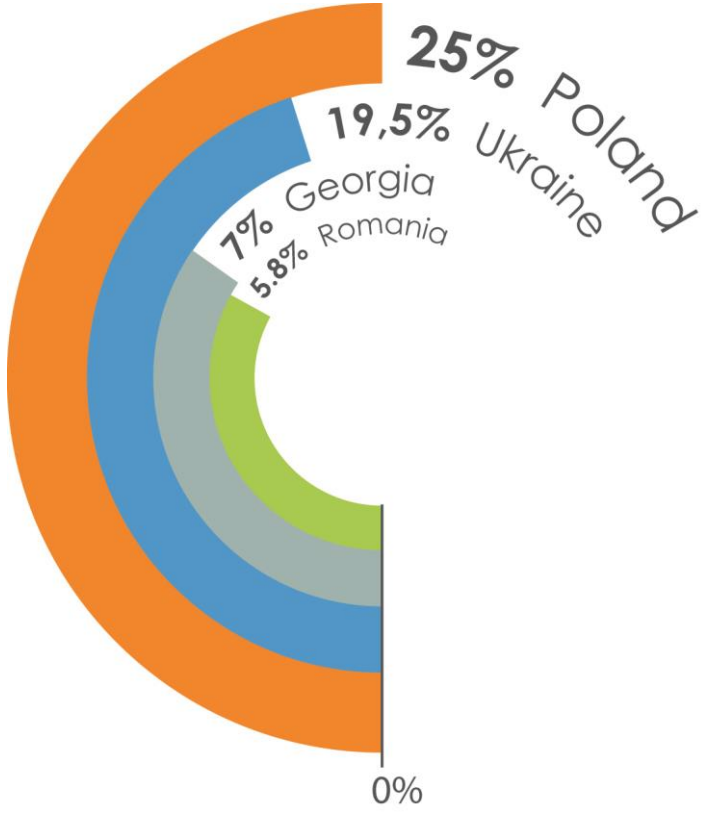
In our region SOEs remain significant players in many areas:

- » providing sizable contributions to GDP
- » creating jobs
- » supplying essential services to citizens, such as light and power, healthcare, water, transportation and education
- » leading the markets in financial discipline and transparency

SOEs performance has a direct impact on social, political, and economic development of a country and on people's everyday lives.

Role of SOEs in Europe and Central Asia region

SOEs are significant contributors to GDP:

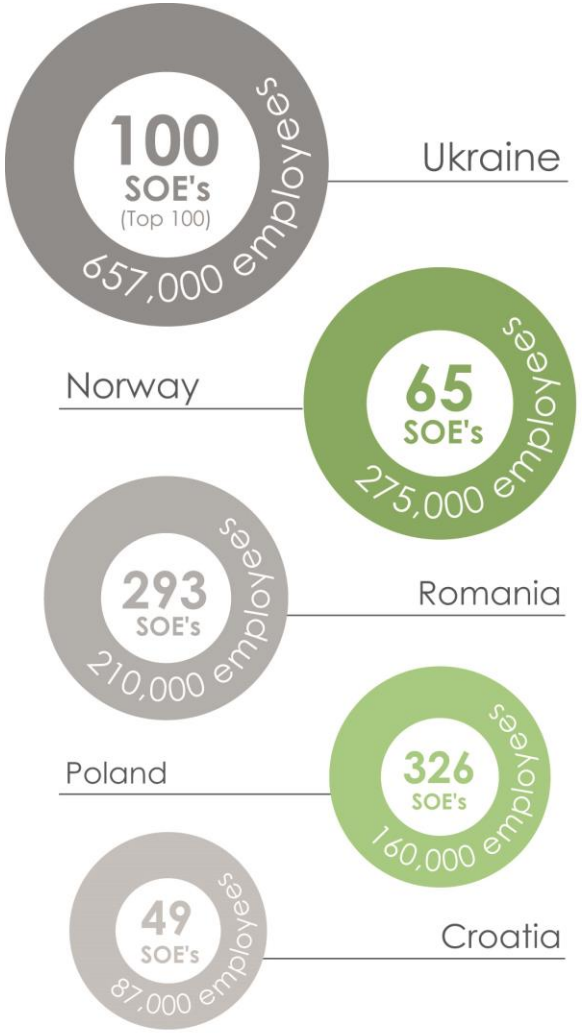


In the main sectors:

- Energy
- Transport
- Telecommunications
- Financial sector
- General manufacturing

Role of SOEs in Europe and Central Asia region

SOEs are among largest employers:



Public Importance of SOEs

» SOE = Public Interest Entity (PIE), *in most cases*

» *PIE**:*

i. Market listed

ii. Credit institution

iii. Insurance company

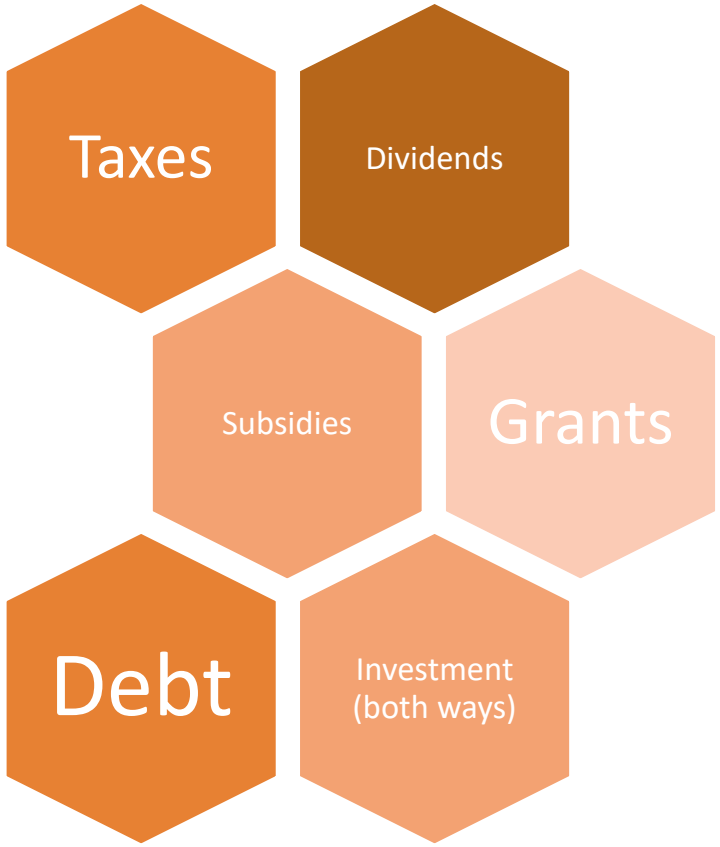
iv. Other, i.e. of significant public relevance because of the nature of business, size or the number of employees

*** - as defined by the EU Accounting Directive*

Quality and reliability of SOEs financial information

Why is SOEs financial information so important???

» SOEs are large tax payers
» Dividend revenue for the budget
» Subsidy | grants allocation from the budget
» Investment by SOEs into public good
» Investments attracted by SOEs from 3rd parties
» Large issuers of debt



Serves as a basis for effective management and decision making

Quality and reliability of SOEs financial information

How to instill financial discipline and ensure SOEs report good quality numbers

- » SOEs = PIEs
- » Reporting under IFRS
- » Annual audits
- » Mandatory publication of audited financial statements
- » Corporate governance as at private sector peers, public companies
- » Functioning boards with proper expertise & independent directors

Quality and reliability of SOEs financial information

» Good practice in leading economies and OECD member countries to apply same rules to SOEs as to listed companies (and/ or PIEs)

» In fact, in many countries, SOEs are indeed listed (to varying degree)

Best practices

» Sets the level playing field for private and state owned entities

» Instills corporate governance requirements in SOEs = private

Quality and reliability of SOEs financial information

- Accounting and Audit frameworks should be updated to reflect stronger requirements for SOEs = PIEs (large SOEs)
- Enforcement of requirements and monitoring should be embedded into the legislation
- Achievable either by general accounting legislation OR by special dedicated decision of the Government:
  - Belarus: IFRS required starting January 1 2017
  - Ukraine: IFRS required for public stock companies (listed) + special list published by MOE
  - Georgia: special decree by the Ministry of Economy (expected in 2017)
  - Most EU countries: IFRS mandatory*

* based on size, listing status or specifically designated by the governments

Quality and reliability of SOEs financial information

- Regular audits (annual, quarterly or 6-M reviews)
- ISA based
- Quality assurance system
- Public oversight

+

- Publication Publication Publication

Quality and reliability of SOEs financial information

- Audits to be performed by credible/ reputable audit firms (POB quality assurance, other ways to assure quality of audits if POB is not existent)
- Selection and appointment of independent auditors: thought through, based on qualification and ability of an auditor to properly perform an audit. NOT lowest cost method**
- Communication between independent auditor and the board (via audit committee) is crucial for building credible and reliable financial statements
- Publication of audit financial statements is a must for SOEs = PIEs

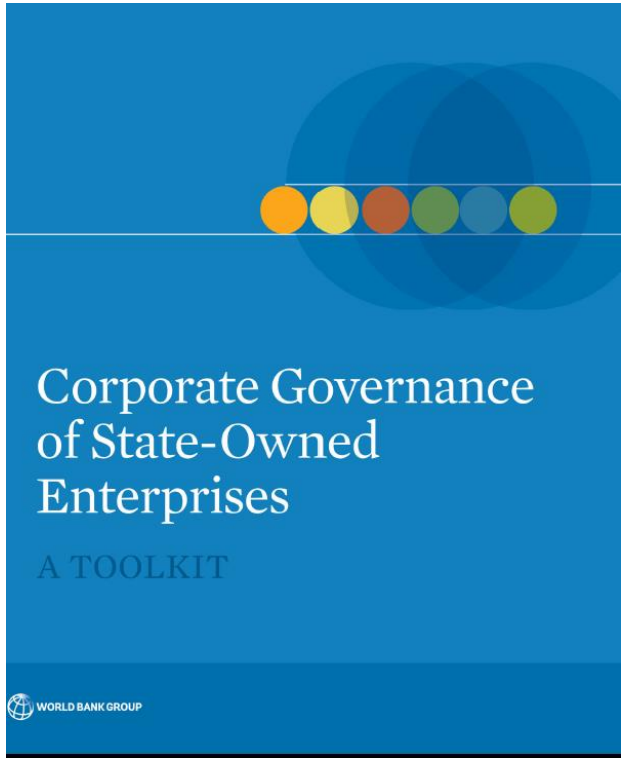
** - price should be considered, but not become the only decision factor

Good governance practices at SOEs

- »What is the standard setter for SOE accountability?
- »Where are the good practices?
- »Where to look for more answers

Good governance practices at SOEs

»OECD: Guidelines on Corporate Governance of State-Owned Enterprises (2015)



»The World Bank: Corporate Governance of State-Owned Enterprises: Toolkit (2014)

Good governance practices at SOEs

I. Rationale for state ownership

The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources

II. State role as an owner

The state should act as an informed and active owner and should exercise its ownership rights as a shareholder

Good governance practices at SOEs

III. SOEs in the marketplace

Legal and regulatory framework for SOEs to ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

IV. Equitable treatment of shareholders and other investors (minority)

The state and SOEs should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information

V. Stakeholders relations and responsible business

State ownership policy should fully recognise SOEs' responsibilities towards all stakeholders and request that SOEs report on their relations with stakeholders.

Good governance practices at SOEs

VI. Disclosure and transparency

SOEs to observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

SOEs' annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit.

The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

Good governance practices at SOEs

VII. Responsibilities of the boards of SOEs

SOE boards to have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

SOE board composition should allow the exercise of objective and independent judgement.

SOE boards should consider setting up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.

Good governance practices at SOEs

Main priorities of OECD Guidelines:

A rules-based environment. SOEs should be subject to the same rules and regulations as other enterprises. They should compete on a level playing field with private enterprises and not distort competition.

Reinforcing the ownership function. The state administration should exercise SOE ownership on a whole-of-government basis. The state ownership function should be separate from the regulatory function to avoid conflicts of interest.

Equitable treatment of shareholders. The state should not have any undue advantages over other investors in SOEs.

Transparency and disclosure. SOEs' objectives and performance should be disclosed and reviewed.

Stakeholder relationship. SOEs and their owners should treat employees, creditors and affected communities fairly and equitably.

Boards of directors. The boards are the SOEs' highest decision-making bodies. They should exercise their powers free of political interference.

Where to find good practices in SOE corporate governance?

- OECD web-site: http://www.oecd.org/
- OECD: Guidelines on Corporate Governance of SOEs (2015): RUS: http://www.oecd-ilibrary.org/docserver/download/2615068e.pdf?expires=1475525236&id=id&accname=guest&checksum=F4EE436A996B1F23E1333D6F62770D8D
- ENG: http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en

Where to find good practices in SOE corporate governance?

- Leading economies in Europe:
- Sweden: http://www.government.se/government-policy/state-owned-enterprises/
- Norway: https://www.regjeringen.no/en/topics/business-and-industry/state-ownership/statens-eierberetning-2013/the-state-ownership-report/id2395364/
- Lithuania: http://vkc.turtas.lt/en

Conclusions

Evidence shows that a good corporate governance system is associated with a number of benefits for all companies, whether private or state owned:

- » better access to external finance
- » larger investments and lower costs of capital
- » higher growth
- » higher valuation
- » greater employment creation and growth
- » improved operational performance and more efficient management
- » reduced risk of corporate crises and scandals
- » further reduce poverty and income inequality.

Taken together, these benefits can boost the efficiency of SOEs and economy as a whole, make transactions among companies more competitive and transparent; result in more efficient allocation of resources; reduce fiscal burden and fiscal risk of SOEs; lead to greater public and private investment in critical sectors, contribute to competitiveness and growth; reduce vulnerabilities in the financial system and promote financial sector development.

Questions

Discussion

Thank you.