Corporate Governance of State-Owned Enterprises in Europe and Central Asia

A SURVEY

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Abbreviations and Acronyms

AGM	Annual General Meeting
CFRR	World Bank's Centre for Financial Reporting Reform
ECA	Europe and Central Asia
EU	European Union
GDP	Gross domestic product
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
iSOEF	Integrated SOE Framework
MD&A	Management Discussion and Analysis
NAS	National accounting standards
OECD	Organisation for Economic Co-operation and Development
SAI	Supreme audit institution
SE	State enterprise (Unincorporated)
SMEs	Small and medium-sized enterprises
SOE	State-owned enterprise
STAREP	Strengthening Auditing and Reporting in the Eastern Partnership

About the Survey

Objectives

1. **The Corporate Governance of State-Owned Enterprises in Europe and Central Asia Survey (the Survey) analyzes the transparency and control environment governing state-owned enterprises (SOEs)** in selected countries of the Europe and Central Asia Region (ECA), with an emphasis on financial reporting, auditing, and transparency requirements. The Survey builds on and complements several studies on SOE governance that World Bank teams have carried out around the ECA Region.

2. **The primary audience for this Survey is the governments of participating countries.** It may also be useful for other stakeholders engaged in SOE governance and oversight, as well as for SOEs' boards, development institutions, civil society, and the general public.

3. **The purpose of this Survey is to provide the countries with an easy-to-follow benchmarking comparison of SOE practices in accountability requirements across the ECA Region.** The Survey will also inform ongoing and future World Bank assistance to partner countries in the areas of SOE financial accountability, controls, and transparency.

4. **The Survey aims to assist governments and SOE ownership entities in carrying out reforms and implementing effective SOE monitoring mechanisms and corporate governance practices.** It draws on global good practices and reform experiences from around the Region and presents the recent evolution of SOE frameworks and practices in selected ECA countries in five thematic areas: state ownership arrangements; legal and regulatory framework; corporate governance and the role of boards; financial reporting, transparency, and disclosure; and audit and control environment. Each part describes good international practices and identifies common challenges, while proposing a direction for further reforms. To put these findings into context, the team collected up-to-date landscape information on the SOE sector, as well as information on the overall governance frameworks supporting countries' accounting and financial reporting requirements. Experiences and observations drawn from World Bank in-country technical assistance engagements are cited in all parts of this Survey to complement the findings and offer options for supporting reforms to increase the capacities of the authorities and institutions that oversee SOEs.

5. **We must note that no one size fits all, and different legal traditions and backgrounds will require different approaches to SOE corporate governance reforms.** This Survey offers a snapshot of the progress of selected ECA countries that are implementing such reforms and provides a simple comparison of such reforms across several jurisdictions, leaving it to the governments to decide how to achieve the reform objectives they seek. The World Bank will continue working with client countries to assist them in advancing SOE governance reforms to improve the SOE ownership function, adopt and implement good international standards and practices, and increase SOEs' transparency and accountability to the public.

Scope and Methodology

6. **This Survey relies on the following publications as the benchmarks:** *Corporate Governance of State-Owned Enterprises Toolkit,* published by the World Bank in October 2014, and the OECD *Guidelines on Corporate Governance for State-owned Enterprises*, published in 2015 (summarized in Annex G). The Survey also captures the main assessment areas of the World Bank's new integrated SOE framework (iSOEF) and its module "Corporate Governance and Accountability Mechanisms." Approved in 2019, the iSOEF supports a holistic and balanced approach to SOE reforms, involving an assessment of SOE effects on markets, fiscal implications, distributional impact, corporate governance and accountability, and the financial sector and political economy. By addressing all key dimensions of SOE performance and the related policy and institutional framework, the iSOEF enables development partners and policymakers to consider the trade-offs associated with SOE reform. This Survey was based on only the "Corporate Governance and Accountability Mechanisms" module of the iSOEF and does not apply the multidisciplinary assessment of the full iSOEF.

7. **The underlying data were gathered through a survey of participating countries.** The Survey included six groups of questions that are reflected in the chapters of this publication: (i) the number of SOEs, their revenues, and employment (excluding financial sector); (ii) the legal and regulatory framework for SOEs; (iii) state ownership arrangements and model; (iv) corporate governance frameworks; (v) financial reporting and disclosure practices; and (vi) the audit and control environment.

8. **This survey focuses on the SOEs operating at the central or federal levels of the participating countries, hence, all matters discussed further in this report concern solely this group of entities.** In recent years, governments and international financial institutions have been shifting their attention to municipal level SOEs because of their fiscal risks and performance problems that negatively impact delivery of essential public services. The municipal and local level SOEs are beyond the scope of this survey. If such entities would be included, the analysis could potentially reveal other issues that are not be covered by this report. Nevertheless, governance measures and reform mechanisms discussed in this document could improve their performance as well, if implemented properly.

9. **Information was obtained on 15 ECA countries, including developing economies.** The countries initially surveyed were Albania, Georgia, Kosovo, Moldova, Romania, Serbia, Tajikistan, Ukraine, and Uzbekistan. Later, drawing on in-country analytical work performed by World Bank staff, the team added more countries: Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Kyrgyz Republic, and Poland. The team selected Germany, Lithuania, Norway, and Sweden as benchmarks because of their good practices in SOE ownership, oversight, and corporate governance.

10. **The SOE data obtained varied significantly in quality, coverage, and granularity.** The Survey analysis covers multiple periods between 2015 to 2018, and the data were processed and analyzed during 2019. Available public information for the participating countries was used to validate, reconcile, and update the results of the Survey. Every effort has been made to present the data in a consistent manner—that is, excluding all financial sector entities owned by the state and updating the financial information from open sources where possible. Annex A provides more details on the countries' responses and on data sources.

Executive Summary

1. **State-owned enterprises (SOEs)[1] are major economic actors across all regions of the world, and they rank among the world's largest companies.** They are active in a range of sectors, including energy, transport, mining, oil and gas, finance, telecommunications, and water. Almost a quarter of today's Fortune 500 companies are state-owned.[2] Collectively, SOEs generated an estimated US$8 trillion in revenues in 2014, equivalent to 10 percent of gross world product.[3] Recent estimates point to a combined net worth among SOEs of US$3.6 trillion.[4]

2. **SOEs remain significant in many ECA countries, even those that have gone through massive privatization over the past decades.** SOEs continue to deliver essential services in many sectors—utilities, health, transportation, finance, and natural resources—and often produce critical goods, such as medical supplies or basic food. With ECA's diverse pattern of historical and economic backgrounds, countries' support for and reliance on SOEs differ. But all countries see that SOEs continue to have an important role in their society. Hence, it is very important for governments to achieve efficient governance of these enterprises, considering the economic circumstances of each country and building on best present practices.

3. **Effective governance and management of SOEs pose a substantial challenge for many ECA countries.** In recent years problems have been associated with the corporate governance and management of SOEs, such as excess political interference in the operation of SOEs, passive and inefficiently performing SOE ownership entities and bodies in charge, insufficient transparency, and poor accountability. Therefore, authorities in many countries have begun assessing SOEs' impact on their economies and putting forward reform plans that aim to introduce corporate governance systems under which SOEs can contribute greater economic and social benefits.

4. **The Corporate Governance of State-Owned Enterprises in Europe and Central Asia Survey (the Survey) indicates that at various speeds and with different rates of success, the participating ECA countries are moving from having state-dominated mono-sector entities to having SOEs that must balance their commercial viability with socially important public policy objectives.** For example, in making the transition from a planned to a market economy, most surveyed countries have adopted the good practice of requiring SOEs to follow private sector laws, which is a stride towards good practices. The Survey confirms that the legislation evolution in the region reflects the common historical background and is on transition track from planned to market economy.

5. **One of the state's primary responsibilities toward SOEs is to act as an informed and active owner.** In this role the state needs to ensure that the governance of SOEs is carried out in an informed and accountable manner, with a high degree of professionalism and

[1] Commercial organizations fully or partially owned by the state, regardless of their legal form.
[2] SOEs. What role should they play according to CEOs? (PWC, 2017)
[3] Gross world product (or "global GDP") was estimated at US$80 trillion for 2017 (World Bank, 2018).
[4] Efficient Management of State-Owned Enterprises: Challenges and Opportunities (ADB, 2017)

effectiveness. To execute this important function, countries should be able to assess and evaluate their SOEs on a portfolio basis, considering all costs and benefits, including public policy objectives and security concerns. For this, governments need to have a system that allows real-time centralized collection, processing, and analysis of SOE information that enables informed decision-making.

6. Although, according to the Survey, the participating countries have made significant progress in strengthening SOE corporate governance frameworks, a lot remains to be done. Legislative changes and reform efforts need to be properly implemented at both the government and the SOE levels. If corporate governance frameworks are to be effective, the practical application needs to be consistent, providing for equal treatment for all SOEs that are subject to the high-standard requirements. For example, it is good practice to introduce professional directors and gradually reduce government representation at SOE board level.[5] At the same time, all surveyed countries have civil servants represented on SOE boards, a practice that affects SOE Board autonomy, accountability, and access to relevant industry and specialized skills.

7. Boards of directors play a central role in the corporate governance of SOEs and are an integral part of the SOE financial accountability, controls, and transparency framework. Many of the surveyed countries are taking steps to improve SOEs' board composition and qualification. Governments are increasingly seeking to establish a legislative framework and clear processes for board nominations and appointments. By doing so, the countries aim to depoliticize SOEs' boards, making them more professional and transparent, and ensuring that they have the competencies and objectivity needed to carry out their duties.

8. The Survey indicates that board-level committees are not yet common among the participating countries. Board committees support SOE boards in taking well-informed and considered decisions, and they manage much of the workload. For example, audit committees play a crucial role in informing a board's decisions about company financial performance and instilling quality financial reporting practices. Although the legislation in many surveyed countries requires the establishment of audit committees, in practice this requirement is challenging to implement.

9. Reliable and timely financial information is vital for making decisions and for holding SOEs accountable for their performance. SOEs should be subject to the same high-quality accounting, disclosure, compliance, and auditing standards as listed companies. Accordingly, all surveyed countries require, as part of their accounting legislation, that at least their largest SOEs adopt the International Financial Reporting Standards (IFRS). World Bank teams report, however, that in some countries the implementation and enforcement of the IFRS reporting requirements by SOEs appear weak.

10. The Survey indicates that SOE disclosure requirements are generally consistent among the participating countries, while SOE's disclosure practices vary significantly. All surveyed countries require their listed entities, including SOEs, to publish annual reports that contain audited financial statements. At the same time, the Survey results indicate that there are few or no requirements that would subject unincorporated state enterprises (SEs) to disclose their financial information publicly. Surveyed countries are striving to improve their SOEs' disclosure practices, yet this task remains challenging.

[5] Corporate Governance of State-Owned Enterprises: A Toolkit (World Bank, 2014)

11. **Financial transparency is enhanced through regular, open aggregate reporting on all SOEs**. The OECD recommends that the country's ownership entity publish aggregate reports via web-based communications to facilitate access by the public. Lithuania, Norway, and Sweden are often cited as global best practices in SOE oversight and disclosure; they provide comprehensive information on the entire SOE portfolio and individual SOE snapshots and also report on the public policy objectives costs carried out by SOEs and the related compensation provided by the state budget. Several countries in ECA aspire to international good practices and have built robust and informative SOE reports—for example, Croatia, Kosovo, Moldova, Romania, and Ukraine.

12. **The Survey indicates that most of the participating countries require their SOEs to have their financial statements audited annually by independent auditors**—accepted standard practice in the private sector. An independent external audit contributes to the credibility of the SOE's financial reporting and provides reasonable assurance to the owner, investors, and the general public that the financial statements fairly represent the company's financial position and performance. However, the quality of the external audits of the surveyed ECA countries is often suboptimal, at least partly because the auditor may be selected on the basis of the lowest price rather than qualitative requirements.

13. **The Survey also found that mechanisms for SOE boards and ownership entities to properly follow up on audit results are often missing or weak.** In most surveyed countries basic information on the number of unqualified and qualified audit reports does not exist, and there are no systematic reviews of SOEs' audit reports. Ownership entities and boards rarely receive management letters reporting on major internal controls weaknesses. Hence, they are unable to require SOE management to follow up on issues identified by audits.

14. **All surveyed countries empower their supreme audit institutions (SAIs) with the right to audit or inspect SOEs.** In most, the SAI primarily carries out specific thematic or performance audits of SOEs. In line with good practice, most surveyed countries do not substitute SAI audit for independent financial audits of SOEs.

15. **Internal audit helps an organization accomplish its objectives by bringing a systematic and disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes.** The Survey found that the internal control systems in the SOEs of the surveyed countries are often weak; internal audit functions rarely exist and are often not required by legislation. In some countries, the largest SOEs follow good practice and establish internal audit, but the practice is not widespread. SOE ownership entities would benefit from improving SOEs' internal audit framework and ensuring proper funding and appropriate capacity for it.

16. **The Survey analysis suggests there is scope for parliaments to increase their role in SOE oversight.** Parliaments, as representatives of their citizens, have the responsibility of protecting the interests of citizens through their oversight of SOEs' executives. They can hold the government accountable and ensure that policies are efficient and in keeping with the needs of the public. In doing this, parliaments may scrutinize SOEs' operations and the financial matters presented in SAI audit reports. Therefore, parliaments, or their specialized parliamentary committees, need to work with SAIs to ensure that the public receives quality service and value for money.

17. **COVID-19 truly exposed the need for SOEs to strengthen their corporate governance policies and increase their accountability.** The support governments provided to SOEs should ensure that they emerge as stronger public entities that serve their purpose of providing the essential services that citizens require, but also contribute to the post-crisis recovery with stronger fiscal and risk discipline and improved corporate governance.

18. **This publication acknowledges the significant steps the surveyed countries have made to strengthen their SOE ownership function and improve SOE governance, even if the practical implementation of these measures often remains a challenge.** Many countries face difficulties in securing political momentum for sensitive SOE reforms, sometimes including resistance to change from the entities themselves. Combined with limited financial resources and human capacity, this becomes a real obstacle for much needed change. In this respect, development institutions continue to have a significant role in helping countries to reform their SOE environment.

19. **The World Bank and its Governance Global Practice engages with client countries in SOE reforms on many levels.** This support includes policy advice to client governments on building or improving the SOE ownership function, adopting and implementing good international standards and practices, analyzing existing governance frameworks against established benchmarks and international good practices, strengthening SOEs' corporate governance, increasing their transparency and accountability, and developing the capacity of SOEs' supervisory staff to improve their ability to scrutinize/monitor SOEs' financial and other information. Our teams help countries around the world to strengthen their role in managing their SOEs, enabling them to carry out economic activities effectively and to fulfill their important public role.

Part I. State-Owned Enterprises: Regional Landscape

Evolving Role of State-Owned Enterprises

1. **SOEs play important and often dominant roles in economic development and people's lives across the ECA Region.** SOEs deliver essential services in many sectors, such as utilities, health, transportation, finance, and natural resources. Given ECA countries' diverse historical and economic backgrounds, their support for and reliance on SOEs differ. At the same time, the expectations of SOEs are similar across most of the countries participating in this Survey:

- Governments expect SOEs to perform well and to contribute to the economy through taxes and dividends; and
- The public expects SOEs to deliver reliable public services and quality goods.

2. **The performance and effectiveness of SOEs are among the most important concerns of governments, the private sector, and the general public.** When SOEs perform well, they can deliver on their mandates and contribute to the state budget. They can also lead by example in the private sector, modeling good corporate governance and transparency, promoting the development of incipient capital markets by listing shares, and serving as pioneers in reform and innovation. However, poor performance in SOEs can be very costly to the economy and its citizens, as scarce public resources are used to keep SOEs afloat rather than being directed to essential areas in which public spending may be needed. SOEs can be a source of fiscal burden and fiscal risk in some countries—for example, by being exempted from making payments to the government and other SOEs (including payments for taxes, inputs, raw materials, and so on) or being allowed to accumulate arrears; having loans provided or guaranteed by the state below market conditions; and receiving direct subsidies other than compensation for providing public services.

3. **SOEs' performance is influenced more by their governance practices than by sector-specific issues,** as several recent publications attest.[1] Countries that have been able to improve their corporate governance standards and practices have also been able to improve the business environment for and performance of both private and state-owned companies. However, countries with ineffective governance and low accountability continue to experience weak SOE performance, poor delivery of public services, stifled competitiveness and growth—including through the crowding-out of private companies—and increased opportunities for political patronage and corruption.

4. **The same recent publications suggest that the principal objective of SOE reforms should be to improve SOEs' accountability and efficiency** by establishing and enforcing adequate reporting of their performance while holding them accountable for reaching or their targets. Therefore, implementing a robust framework for accounting, reporting, and auditing of SOEs—

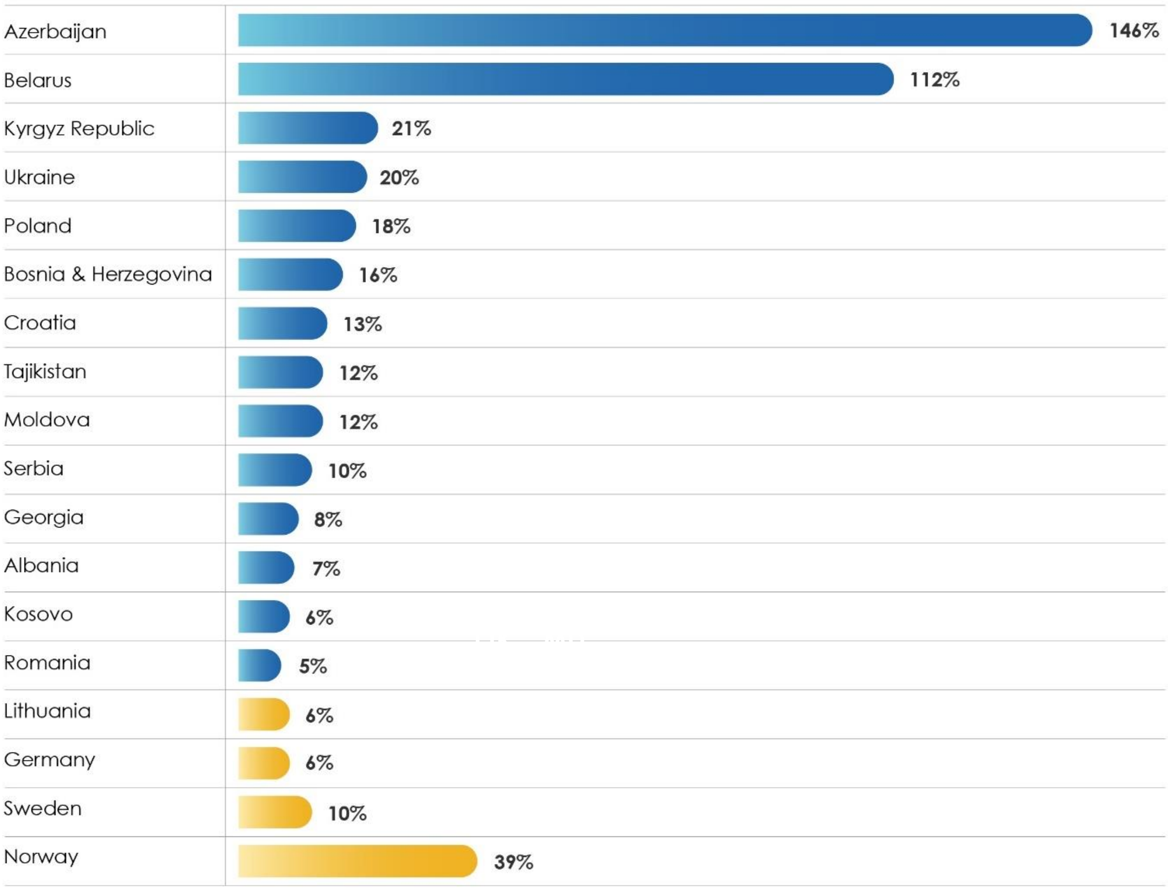
[1] *Corporate Governance of State-Owned Enterprises: A Toolkit* (World Bank, 2014); State-Owned Enterprises in the EU (European Commission, 2016); Reassessing the Role of State-Owned Enterprises in Central, Eastern, and Southeastern Europe (IMF, 2019).

as well as a rigorous oversight mechanism—would need to be an integral part of any government's strategy to ensure that SOEs are well governed, transparent, and accountable, and that they contribute in a positive way to the economy and society.

Size, Scope, and Contribution of SOEs

5. **While in the past decades most countries in ECA have implemented reforms to privatize SOEs, the SOE sector remains significant according to many metrics,** including revenues as a share of GDP, share of overall employment, and share of total investments. SOEs continue to deliver essential services in many sectors that are important to citizens—utilities, transportation, health, education, and others. Information on SOEs' value-added is not available in all countries; therefore, Figure 1 illustrates the size of countries' SOE sectors by comparing total revenues generated by SOEs to the country's GDP.

Figure 1. Revenue Generated by SOEs as Compared to GDP



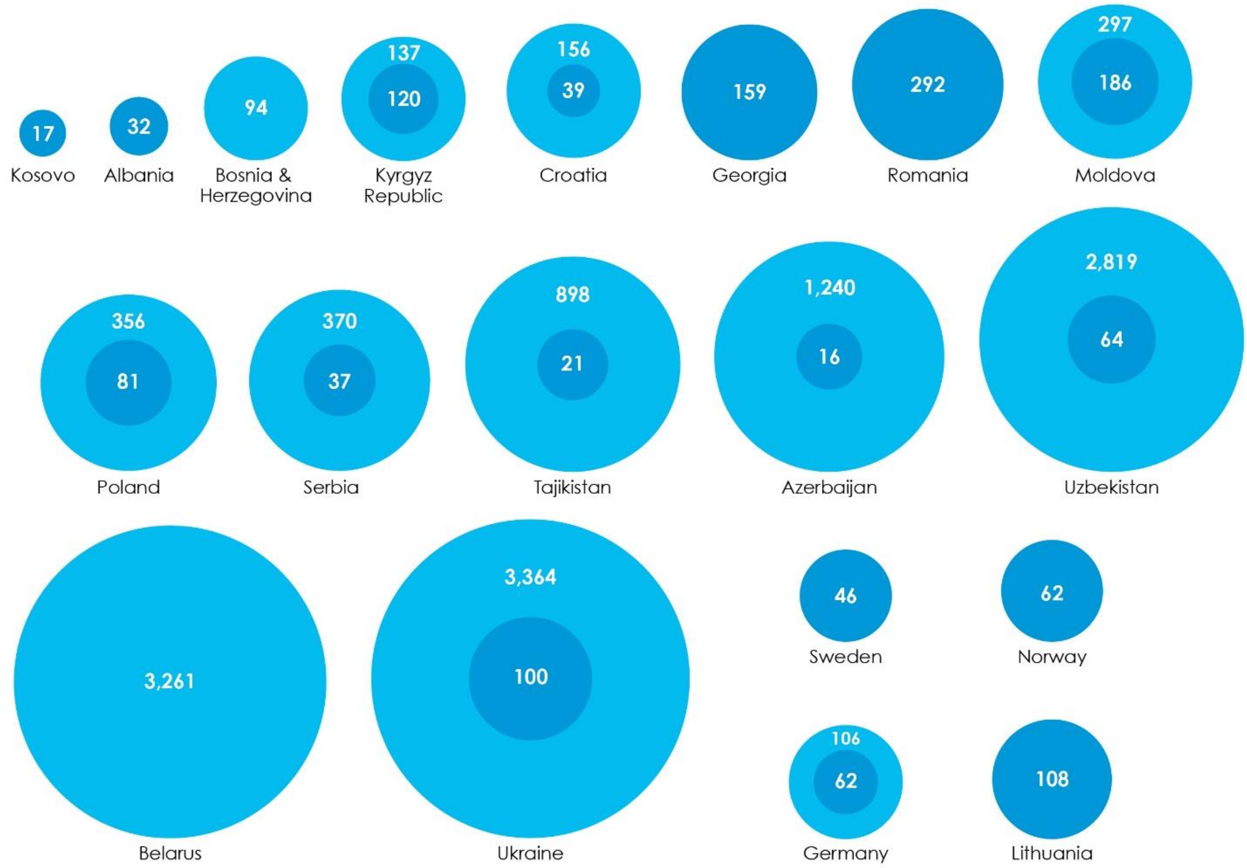
Source: Individual countries' SOE ownership reports, individual SOEs' financial statements (2016-2018).
Note: Revenues include all SOEs for Belarus, Moldova, and Romania; for the other countries presented, only the top SOEs are included, those defined by their governments as public interest entities and/ or included in the SOE ownership reports.

6. **The numbers of registered SOEs remain significant in the surveyed countries.** Starting in the early 1990s some economies—for example, Poland and Ukraine—carried out privatization, with massive sales of state property. Today these countries still have significant numbers of SOEs, which may not be operating in the most effective way or may simply be dormant without undergoing a formal liquidation procedure, inflating the numbers of SOEs and distracting

governments' resources. Nevertheless, the Survey data indicate a general path of downsizing state ownership in the Region.

7. Many governments around the Region focus their monitoring and oversight efforts on the most significant and publicly important SOEs. The Survey revealed that most countries define a list of SOEs that are classified as strategic, largest, or publicly important; definitions vary across the countries. Such enterprises are subjected to stricter reporting regimes and stronger corporate governance requirements, and they are typically included in any countrywide SOE ownership reports. Figure 2 illustrates the overall number of SOEs per country compared to the number of active SOEs that are included in ownership reports or subjected to higher accountability measures.

Figure 2. Total Number of Central Level SOEs vs. Monitored SOEs



Key: Total number of SOEs (centrally owned entities): majority- and minority-owned SOEs, dormant SOEs, and SOEs in transformation process. Numbers exclude financial sector SOEs (banks, insurance and leasing companies).

Number of actively monitored SOEs. If the numbers are the same, all active and majority-owned central-level SOEs are monitored by the SOE ownership entity.
* Belarus SOE monitoring is dispersed among the line ministries and the State Property Committee; no data are available on the number of SOEs under active monitoring.

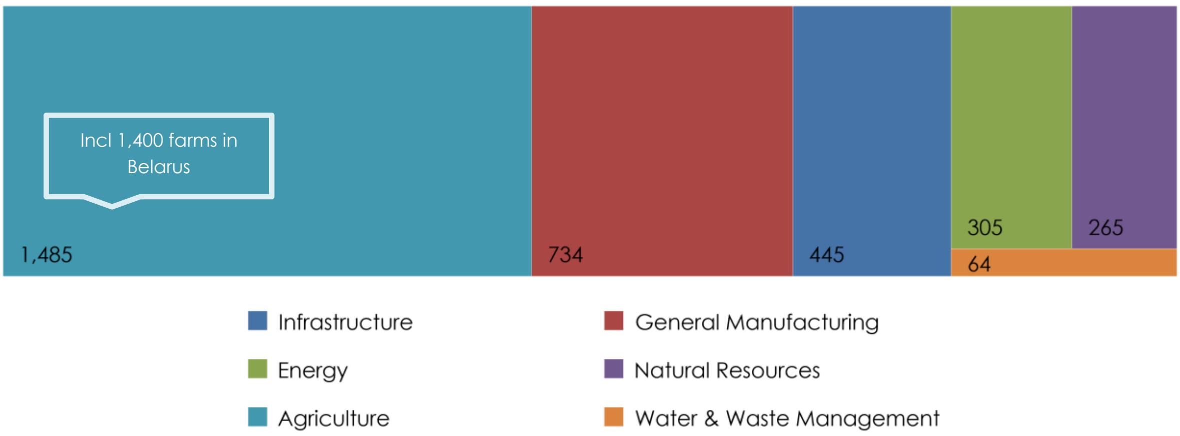
Source: Survey Responses (2015-2016), statistical information (2016-2018), individual countries SOE ownership reports (2016-2018).

8. **Governments keep control of enterprises for several reasons:** to maintain the operation of natural monopolies where market regulation is deemed infeasible or inefficient (e.g., alcohol distribution, energy generation); to support economic and strategic goals that are in the national interest, or raise security concerns—for example, keeping certain sectors under national ownership, or shoring up failing companies of systemic importance (nuclear energy, weapons productions, oil and gas); or to sustain employment in times of crisis. In many instances, however, companies remain in state control because of the public nature of their operations—for example, the forestry sector, road maintenance, or cultural ventures, theaters, sports facilities, and so on. In all cases, it is the government's priority to ensure that SOEs are generating profit and are self-sufficient in running their operations. Survey data suggest that when governments have a formalized ownership strategy and policy for strategic sectors and enterprises, SOEs tend to be more successful in achieving the operational and social targets defined by their mandate.

9. **Countries that have formally set SOE ownership priorities have been able to concentrate attention on priority sectors or individual enterprises, and to develop or strengthen their policies in "active" SOE ownership.**[2] These governments act as active and informed shareholders, providing strategic guidance and taking part in the major decisions made by an entity, including by (i) participating and voting in shareholder meetings; (ii) receiving and analyzing relevant and sufficient information on a timely and regular basis; (iii) electing and removing members of the board; (iv) approving extraordinary transactions; and (v) voting on dividend distribution and enterprise dissolution.

10. **SOEs play a particularly important role in the network industries**, as the recent European Union (EU) Institutional Paper[3] noted and the Survey data confirmed. The Survey suggests that energy companies—power generation, electricity distribution, transport, and oil and gas companies—account for the largest portion of SOE revenues. By the number of entities, infrastructure, natural resources, and energy SOEs are clear leaders in the benchmark countries, while the surveyed countries have many SOEs in the general manufacturing and agriculture sectors. Figure 3 illustrates the number of SOEs in each distinct sector as identified by the surveyed countries, and Figure 4 compares percentages of SOEs between benchmark countries (Germany, Lithuania, Norway, Sweden) and the surveyed countries.

Figure 3. Number of SOEs per Sector



Source: Individual countries' SOE ownership reports, statistical information, WB staff analysis.

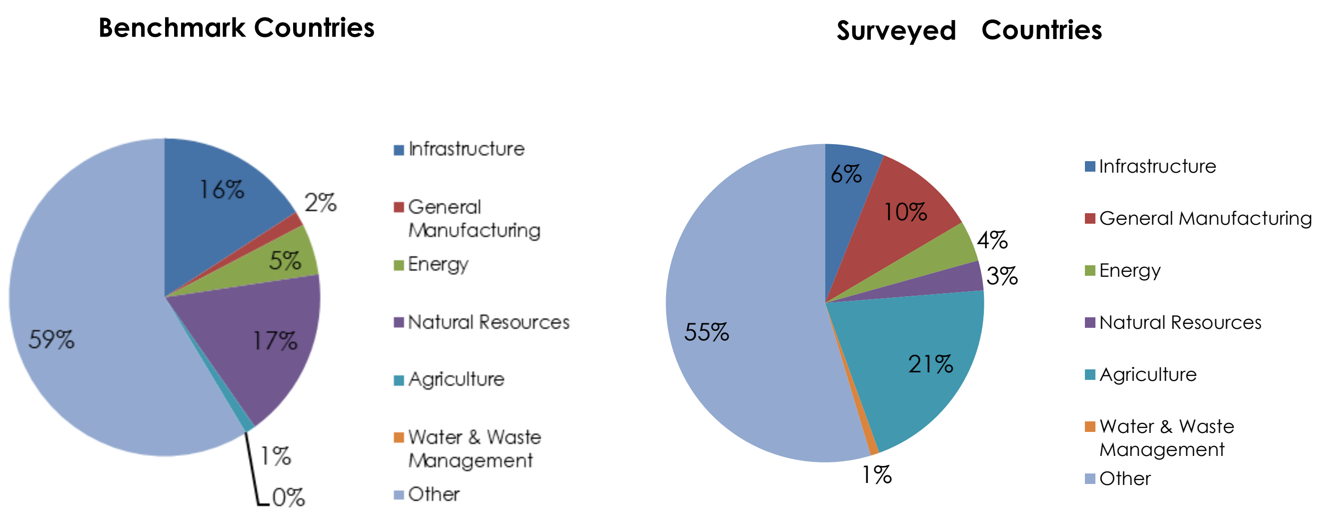
2 *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (OECD, 2015).

3 "State-owned enterprises in the EU: Lessons Learnt and Ways Forward in a Post-Crisis Context" (EC, 2016).

Note: The figure does not include SOEs that are categorized as Other Sectors. The graph is built on the publicly available information on SOEs per sector for the following countries: (i) benchmark countries Germany, Lithuania, Norway, and Sweden; and (ii) surveyed countries Albania, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kosovo, Kyrgyz Republic, Poland, Romania, Serbia, Tajikistan, Ukraine, and Uzbekistan. No sector information was available for Moldova.

11. **Many SOEs—about 4,000—are classified as Other Sectors by all countries analyzed in this Survey.** This is as many entities as in all other sectors combined, or 55 percent of all SOEs included in this Survey. The analysis suggests that the "other" category includes a variety of areas of activity: space technology, defense and weapons production, research, science, education, health, sports, arts, gambling, alcohol distribution, postal services, and more. The proportion of "other" SOEs is similar in benchmark countries and the surveyed developing economies, as Figure 4 shows.

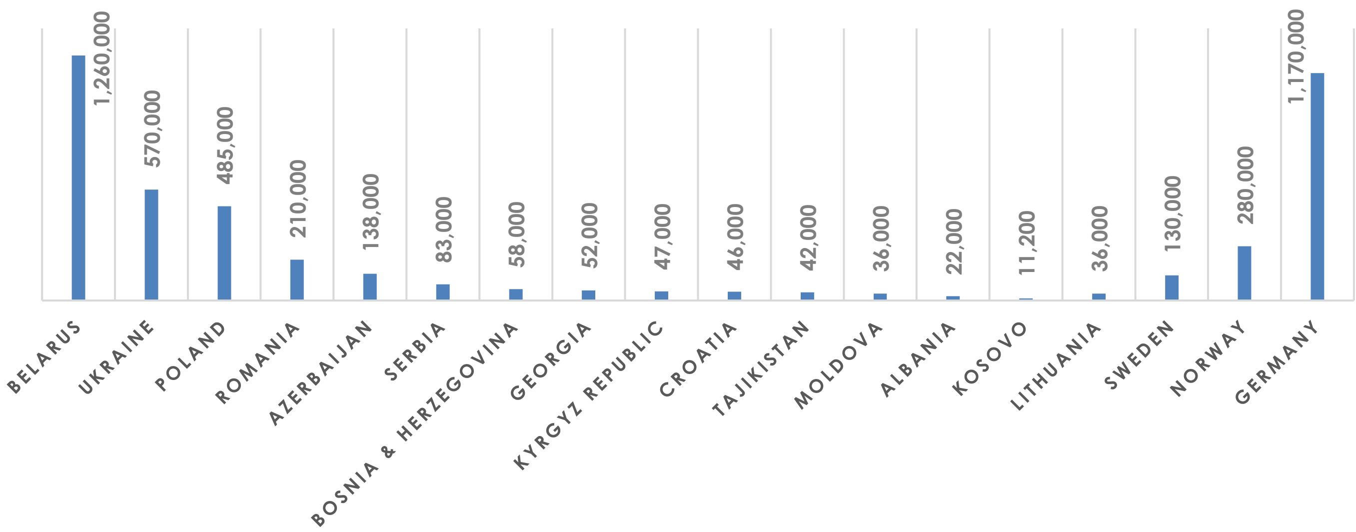
Figure 4. Number of SOEs per Sector (percentage)



Source: Individual countries' SOE ownership reports, statistical information, WB staff analysis.
Note: The figure is built on the publicly available information on SOEs per sector for the following countries: (i) benchmark countries Germany, Lithuania, Norway, and Sweden; and (ii) surveyed countries Albania, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kosovo, Kyrgyz Republic, Poland, Romania, Serbia, Tajikistan, Ukraine, and Uzbekistan. No sector information was available for Moldova.

12. **The Survey confirmed that SOEs remain important employers in all countries** included in this Survey (see Figure 5). The Survey identified Belarus as the country with the highest number of workers engaged in SOE operations – 1.26 million people. The Survey could not establish the SOE employment figure for Uzbekistan, but World Bank staff estimate that it may approximate the number for Belarus. Germany emerged as the benchmark country whose SOEs employ the most (1.17 million) people. More details on SOEs in selected surveyed countries may be found in the Annex D.

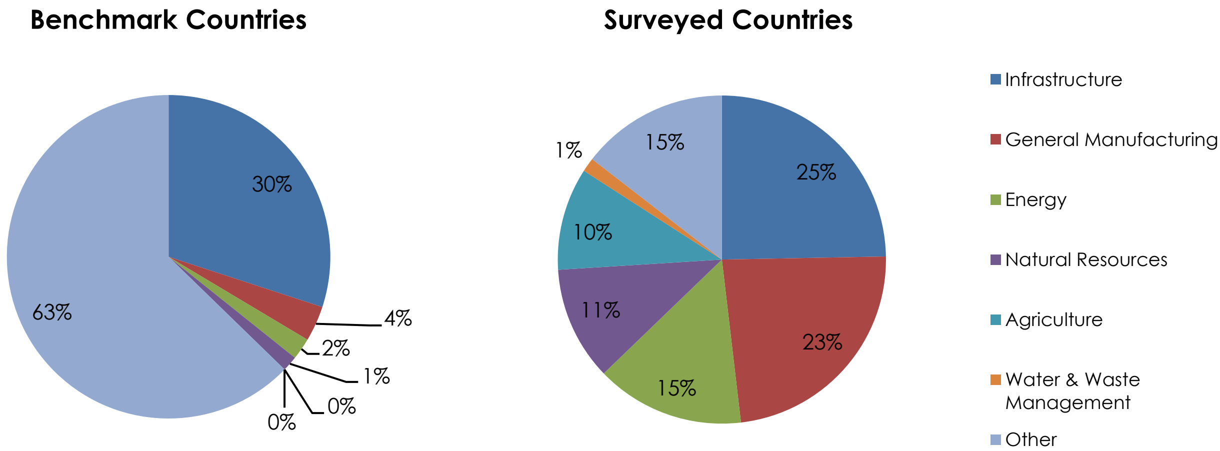
Figure 5. SOE Employment by Country



Source: Individual countries' SOE ownership reports, statistical information, World Bank staff analysis.

13. **SOE employment by sector varies between the benchmark countries and the surveyed countries; however, infrastructure is the leading employer sector for both groups of countries.** Figure 6 shows SOE employment by sector: infrastructure and transport enterprises are the largest employers among all SOEs for both benchmark and surveyed developing countries. Benchmark countries employ many more employees in the "other" category. Moreover, developed economies choose to invest and employ people in areas such as gambling and alcohol distribution, to retain control over these socially sensitive activities. Surveyed countries, however, retain significant labor forces in sectors that could perform well under private ownership, such as general manufacturing or agriculture. In surveyed developing countries, unlike in the benchmark countries, a significant part of the SOE labor force is in the energy and natural resources sectors. This may be due to low investment, leading to a significantly greater need for manual labor to service and provide upkeep for critical capital resources in these crucial sectors.

Figure 6. SOE Employment by Sector



Note: The graph uses publicly available information on SOEs per sector for the following countries: (i) benchmark countries Germany, Lithuania, Norway, and Sweden; and (ii) surveyed developing countries Albania, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kosovo, Kyrgyz Republic, Moldova, Poland, Romania, Serbia, Tajikistan, and Ukraine. No employment information was available for Uzbekistan.

14. In most countries postal services providers are among the largest employers and contributors to countries' GDP (see Figure 7). Their role is not purely commercial; in many countries, postal operators provide rural and low-income populations with basic financial services, such as access to benefits or pension payments, utilities payments, or basic savings instruments. Many ECA countries use the postal service for socially important functions, such as pension distribution and the sale of basic goods, but the postal services' operational performance remains far from exemplary. At the same time, the experience of several countries in the Region demonstrates that postal operators can operate at a profit if their activities are structured in a more commercial manner and they obtain proper reimbursement from the state budget for their social obligations (e.g., pension distributions).

Figure 7. Post Offices' Employment and Revenues

Country	Postal revenues (US$)	Postal employees
Albania	4,917,713	2,295
Azerbaijan	26,836,616	5,000
Bosnia & Herzegovina	17,248,039	2,546
Croatia	273,148,591	9,977
Georgia	34,191,792	2,662
Kosovo	12,740,358	2,753
Kyrgyz Republic	9,914,635	4,652
Moldova	25,426,845	5,116
Poland	1,692,100,804	80,000
Romania	298,731,608	24,900
Serbia	248,826,244	14,975
Ukraine	250,431,618	70,129
Uzbekistan	14,658,346	7,500
Norway	2,937,907,291	15,021
Lithuania	105,041,322	5,250
Sweden	4,333,256,643	29,962
Germany	72,668,240,850	547,459

Source: Individual SOEs' financial statements.

15. While state participation in various types of business may be beneficial for the economy, it could also lead to growing budgetary costs, particularly when companies are loss-making or are run inefficiently. Poor performance in SOEs can be very costly to the country and its citizens by suppressing competition, draining scarce public resources, or imposing a fiscal burden by issuing direct debt, accruing accounts payable, or accumulating losses. Proper monitoring and oversight of any enterprise, private or public, cannot be exercised without reliable financial information. Certain recently introduced changes to the corporate governance practices[4] and reporting obligations in the EU set the tone in enhancing transparency among enterprises, including those owned by the State. However, the availability of data on SOEs is still limited; indeed, such data are sometimes shrouded in secrecy. This Survey takes stock of how the surveyed countries apply their reporting and transparency frameworks and how this work contributes to better oversight, risk management, and performance of SOEs.

[4] *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (OECD, 2015).

Part II. Legal and Regulatory Framework of SOEs

16. Good practice suggests that countries should have a legal and regulatory framework for SOEs that sets out clear "rules of the game" under which they are to operate.[5] Such a legal and regulatory framework for SOEs is essential for communicating key expectations to all stakeholders, including shareholders, boards, management, and the general public. It can ensure that requirements are harmonized and meet a minimum standard, and that they are not incomplete, inconsistent, or conflicting.

17. A well-defined regulatory framework establishes the policy directions and defines the roles and responsibilities of the various government agencies engaged in SOE ownership and oversight. Such a framework thus strikes a balance between the state's oversight function and the need for SOEs to have operational autonomy. While approaches vary significantly among countries and contexts, the framework should strive to achieve the following:

- Set clear boundaries and define the relationship between the government as shareholder and SOE boards and management.
- Separate legitimate government control and oversight from the operational management for ensuring SOE accountability.

18. SOEs tend to operate at the intersection between public and private sector laws. SOE legal frameworks can range from a full-fledged application of public laws to a fully private law framework. Most countries fall somewhere in between: SOEs are subject to a blended legal framework or a combination of various laws—that is, general and sector legislation. Typically, the requirements for a company's formation and its operations are specified in company legislation: some countries establish general SOE framework laws that cover all SOEs, while others exclude such large strategic SOEs as energy, utilities, and natural resources companies, which have their own establishment laws. In addition, some countries also have sector-specific laws that govern one or several SOEs in a specific sector.

19. This Survey confirmed that a variety of legislative regimes are being applied to SOEs in ECA, and some SOEs are subject to more than one legal regime. The legislation evolution in the Region reflects the countries' common historical background and their transition from planned to market economies. At various speeds and with different rates of success, SOEs in the surveyed countries are moving from being state-dominated mono-sector entities to becoming enterprises that must balance their commercial viability with important social functions.

20. SOEs in most surveyed countries are subject—partially or entirely—to general company law. General company law typically applies to all corporate entities, regardless of their ownership – private or state. Some provisions applicable to other types of entities might also be legislated by countries' constitutions or civil codes. Georgia and the Kyrgyz Republic are the only two jurisdictions among the surveyed countries that apply only general company legislation to their SOEs. No other special legislation regulates the establishment and

[5] OECD, 2015, op. cit.

governance of SOEs in these two countries, so their SOEs are subject to the same requirements as their private sector peers.

21. **Many surveyed countries have additional laws on the establishment and governance of SOEs.** As Figure 8 shows, most surveyed countries have a general law that applies to all SOEs or to a specific subgroup of SOEs. Additionally, in some countries, some SOEs—typically those that operate in sectors that provide public services, such as utilities, energy, or infrastructure—must also follow specific laws governing their sector of operation. Moreover, several countries have individual establishment laws for selected, usually strategically important, SOEs.

Figure 8. Applicability of Legislation

	General SOE Law	Sector Specific Law	Individual Establishment Law	Company Law (Private Sector Law)
Albania	✓	✓	✓	✓
Azerbaijan			✓	✓
Belarus		✓	✓	✓
Bosnia & Herzegovina	✓	✓		✓
Croatia	✓		✓	✓
Georgia				✓
Kosovo	✓	✓		✓
Kyrgyz Republic				✓
Moldova	✓			✓
Poland	✓			✓
Romania		✓	✓	✓
Serbia	✓	✓		✓
Tajikistan	✓			✓
Ukraine	✓	✓	✓	✓
Uzbekistan	✓	✓	✓	✓

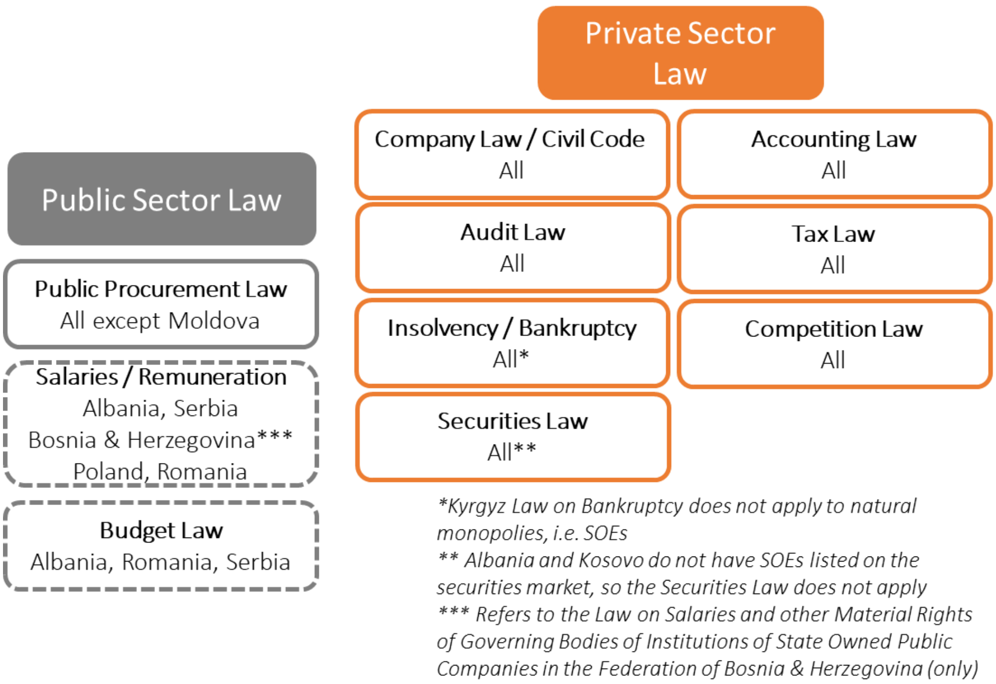
22. **To promote a level playing field and avoid discriminating between companies on the basis of their ownership, it is good practice for SOEs to follow the general legislation that is applicable to private sector companies.** For example, exempting SOEs from certain laws or regulations (e.g., tax holidays, sheltering from competition, or insolvency protection) could give them an unfair advantage over private companies. In fact, such distortionary measures are banned in the EU, where state aid provisions disallow member states from granting companies aid (e.g., direct and indirect subsidies) that may distort or threaten to distort competition.[6] At the same time, SOEs should not be placed at a disadvantage because of their ownership—for example, required to carry out public policy objectives that have not been clearly identified and/or duly compensated for.

[6] Art. 87 of the EU Treaty.

23. In addition to general legislation, other laws typically apply to SOEs' operations—for example, accounting law, audit law, securities law, public procurement law, competition law, insolvency law, tax law/code, and labor code. Most such legislation applies to both private and state-owned companies, although some applies only to the public sector.

24. Survey data indicate that in most countries SOEs are required to follow private sector laws, with some public sector laws applicable in selected jurisdictions (see Figure 9). SOEs are subject to certain private sector laws in all surveyed countries. In some countries, additional laws applying to the public sector also extend to SOEs; in Albania, Romania, and Serbia, for example, SOEs are required to follow budget-related laws. In Albania, Bosnia and Herzegovina, Poland (for majority-owned SOEs only), Romania and Serbia, SOEs must also abide by public sector remuneration rules. Public procurement law applies to all majority-owned SOEs, except those in Moldova.

Figure 9. Applicability of Legislation: Private vs. Public

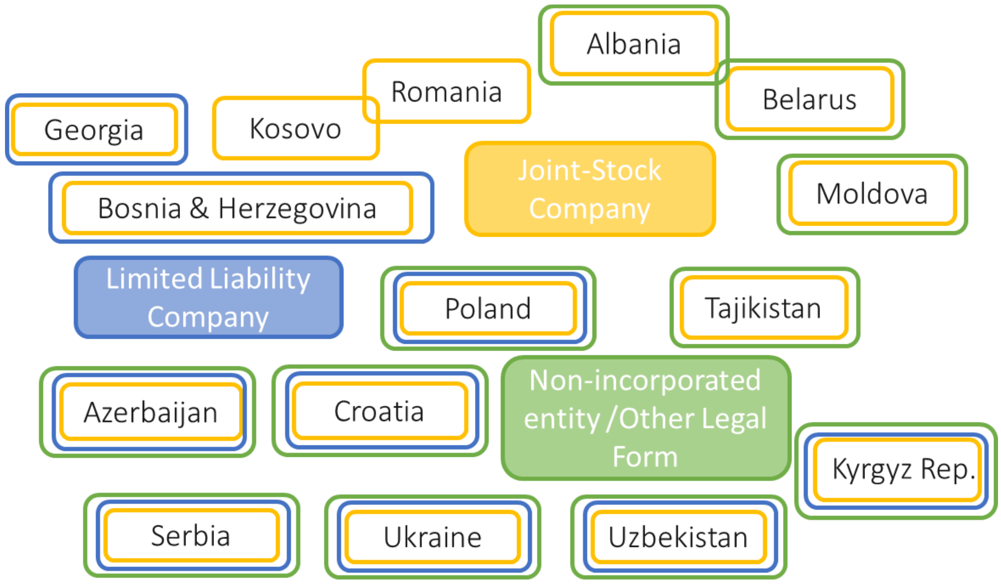


25. SOEs can be organized in legal forms that are typically used for private companies: joint stock companies or limited liability companies. However, when SOEs take legal forms different from those of general companies, they may face significantly divergent requirements, particularly as regards corporate governance, reporting, and transparency, not only as compared to general companies, but as compared to other SOEs. For example, in some countries, SOEs may have a unique legal form that is defined under their founding act or other type of specific legislation. The requirements under such acts may or may not be harmonized with each other, with the result that legal frameworks vary greatly across SOEs.

26. Among the surveyed countries, the joint stock company is the most popular organizational form for SOEs (see Figure 10). All surveyed countries confirmed that their SOEs may be incorporated as joint stock companies or corporations. In two countries, Kosovo and Romania, this is the sole legal form that SOEs may take. SOEs may also be incorporated as a limited liability company in nine countries: Azerbaijan, Bosnia and Herzegovina, Croatia, Georgia, Kyrgyz Republic, Poland, Serbia, Ukraine, and Uzbekistan.

27. **A legacy form of state ownership – unincorporated entity – still exists among surveyed countries.** Mainly for historic reasons, this distinct legal form (often called "public enterprise" or "state enterprise") is still used in 11 of the surveyed countries: Albania, Belarus, Croatia, Kyrgyz Republic, Moldova, Poland, Serbia, Tajikistan, Ukraine, and Uzbekistan. In Ukraine, SOEs may take several legal forms, but such "unitary" SOEs are still the most common, representing over 94 percent of all operational SOEs. In Azerbaijan, this legal form refers to a single state entity – the State Oil Company of Azerbaijan Republic, a quasi-governmental company that is wholly owned and governed by the state.

Figure 10. Variety of Legal Forms



28. **The unincorporated legal form of state enterprises carries significant fiscal, social, and reputational risks for governments, which are not addressed in the existing legislative environment.** This unique form implies that the assets—and the liabilities—of these entities do not belong to them, but rather to the state directly. Although some countries limit their governments' liability through regulations, they would still bear the secondary liability on the obligations of such entities, if the entities' property were insufficient to clear their debts. Therefore, potential bankruptcy or an interruption of the operations of any such enterprise represents potential risks and contingent liabilities for the government.

29. **Over the past two decades, many ECA countries have been corporatizing their unitary enterprises, but many remain.** The main goal of corporatization is to allow the government to retain ownership but still enable it to run SOEs efficiently and on a more commercial basis, like other companies. This process takes time, as it must follow the legal steps for establishing a corporate entity: from adopting an enterprise charter to setting up a proper corporate governance structure, realigning internal and external reporting lines, setting the accounting system, and adopting proper standards for financial reporting and disclosure. Corporatization implies that SOEs become subject to the same requirements that govern private joint stock companies. In practice, corporatization does not fully insulate SOEs from government noncommercial interventions, unless it is accompanied by the adoption of sound governance practices.

Part III. State Ownership Arrangements and Models

30. One of the state's primary responsibilities toward SOEs is to act as an informed and active owner. In this role, the state should ensure that the governance of SOEs is carried out in an informed and accountable manner, with a high degree of professionalism and effectiveness.[7] To carry out this important function, countries establish different models for exercising their ownership rights – similar to shareholder rights – over SOEs.

31. State ownership arrangements have evolved over time as SOEs have changed their legal form and as governments have sought to improve SOEs' productive capacity. While countries' legal frameworks vary substantially, ownership models today fall broadly into four models: decentralized, dual, advisory, or centralized. The decentralized and dual models are typical in the ECA Region, as many countries share a similar economic past. There are no bold lines separating ownership models; in fact, many countries may be categorized under one type of ownership model[8] but may also retain aspects of other models for some or all SOEs.[9]

- ***Decentralized model:*** SOE ownership responsibilities are dispersed among different line ministries
- ***Dual model:*** ownership responsibilities are shared by line ministries and a centralized ministry or agency—the ministry of finance or economy, or a state ownership agency.
- ***Advisory model:*** ownership remains dispersed, but an advisory or coordinating body provides high-level input into SOE governance and ownership matters.
- ***Centralized model:*** SOE ownership is centralized in a single ownership entity, which may be either independent or a part of the government.

32. The decentralized model emerged from the Region's historic tradition of organizing state ownership functions. Historically, governments organized their activities under the line ministries, which were responsible for all aspects of SOE management and oversight. The decentralized SOE ownership model, in which line ministries exercise ownership functions, creates a conflict between sectoral policy-setting and the state's ownership function: line ministries must pursue both public policy objectives and ownership objectives, while the SOEs are required to fulfill public obligations without proper reimbursement when such obligations adversely affect their operational performance. The decentralized model also dilutes accountability for SOE performance, as responsibility for SOEs' financial reporting and for overseeing them and enforcing legislation is spread among several ministries or agencies. The decentralized model still exists in several ECA countries, including Azerbaijan, Belarus, Bosnia and Herzegovina, Romania, Tajikistan, and Uzbekistan. But in many other countries, it has evolved to dual, advisory, or centralized models, as the OECD reports[10] (see Figure 11).

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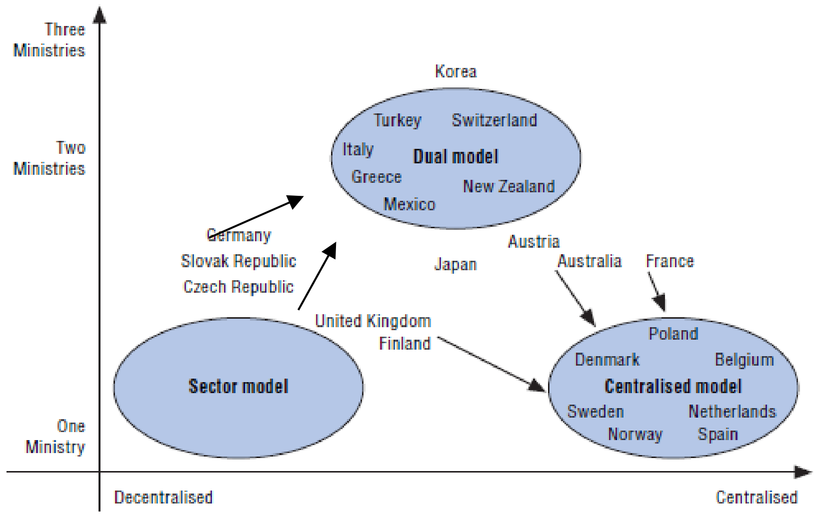
[7] OECD, 2015, op. cit.
[8] For the purposes of this Survey, the term "ownership model" does not refer to what entity is the legal owner of SOEs or their shares, but rather to the manner in which ownership rights are exercised.
[9] World Bank, 2014, op. cit.)
[10] *Ownership and Governance of State-Owned Enterprises A Compendium of National Practices* (OECD, 2018)

Figure 11. Evolution of SOE Ownership Models among OECD Countries



Source: OECD (2005, adapted 2015).

33. **The dual model evolved to introduce checks and balances and promote both technical and financial oversight over SOEs.** One advantage of the dual model over the decentralized model is that it enables both financial oversight of individual SOEs and aggregate analysis of SOEs. In this respect, the dual model balances the interests and objectives of line ministries – ensuring that the SOE is fulfilling its policy and service delivery roles, and that the government's financial performance objectives are being achieved at the aggregate level.

Box 1. Dual SOE Ownership Model: Czech Republic and Germany

In the Czech Republic, line ministries vote the state's shares, while the Ministry of Finance oversees the financial and operational performance of the SOEs.

In Germany, the Ministry of Finance sets out the framework for managing state holdings, oversees their performance, and publishes the annual performance report, while the line ministries are responsible for oversight of SOEs in their technical area of expertise.

Box 2. Advisory SOE Ownership Model: Lithuania

Lithuania's ownership model may be classified as advisory. The Governance Coordination Centre (GCC) is responsible for coordinating SOEs, collecting relevant information, and monitoring and analyzing the state's policy toward SOEs. The GCC is a stand-alone agency under the Ministry of the Economy and Innovation. The Ownership Guidelines define five functions for the GCC: (i) analysis of financial and nonfinancial information disclosed by SOEs and of the trends in the activities of these enterprises; (ii) preparation and publication of aggregate SOE reports; (iii) good practice advice on and coordination of strategic planning in SOEs; (iv) assessment of the strategic objectives set by SOEs; and (v) monitoring of strategy implementation indicators.

The GCC also takes part in the process of nominating board members by providing technical advice to the institutions representing the state in their search and selection of SOE board members. Finally, the GCC evaluates SOEs' compliance with the Ownership Guidelines and the Transparency Guidelines and submits its opinion and recommendations to the Lithuanian Government.

34. **Globally and in ECA, ownership arrangements have been steadily evolving from a decentralized or dual model toward greater centralization, to strengthen the focus on ownership issues and help resolve many of the problems associated with SOE governance.** In more and more countries, the state has become an active and professional owner of its assets, while giving SOEs operational independence. This approach envisages that SOEs are insulated from political influence and from day-to-day intervention in their operations, and are able to keep an arm's-length relationship with the state. Under centralized ownership arrangements, ownership entities may be housed in ministries or within ministerial departments, in dedicated ownership agencies, or in company-type structures.

Box 3. Centralized SOE Ownership Model: Sweden

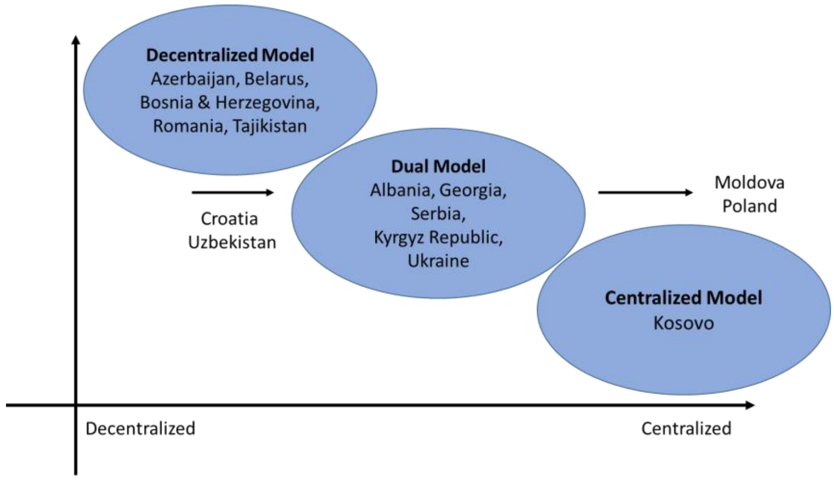
The Swedish Government has a mandate from the Parliament to actively manage SOEs to ensure optimal long-term value performance and, where applicable, to ensure that specifically adopted public policy assignments are duly performed.* Sweden's SOE ownership function is centralized with the Division for State-Owned Enterprises at the Ministry for Enterprise. The Government is responsible for (i) developing SOE ownership policy and other guidelines; (ii) setting SOEs' financial targets; (iii) setting the public policy targets for SOEs that have specific public policy objectives; (iv) appointing Boards of Directors; and (v) deciding on dividends.

There were 46 SOEs under the SOE Division's supervision in 2018. Seven more SOEs fall under line ministries, but they are subject to central coordination with the SOE Division.

* Sweden SOE Ownership Policy (2017): https://www.government.se/49f639/contentassets/c6382135343d45fe8685ab7fa53a2fa3/the-states-ownership-policy-and-guidelines-for-state-owned-enterprises-2017.pdf

35. As Figure 12 shows, most of the surveyed countries use either a dual model or a decentralized model, split relatively evenly between the two. The advisory model is not specifically used in any responding country, but some features of the model are attributable to Croatia and Ukraine. Only one country uses a centralized model.

Figure 12. SOE Ownership Models among Surveyed Countries



36. The variety of SOE ownership models is often complicated by additional clustering of SOEs into subgroups, such as commercial and noncommercial enterprises, or a sector-specific approach. Such a subgrouping often leads to different ownership models for various clusters within a single country. (Annexes B and C provide more details about the surveyed countries' ownership models.)

37. Several of the surveyed countries are undergoing substantial reforms to reduce the state's role in their economies, and thus, they are changing their SOE ownership models. Countries increasingly recognize the important role that good corporate governance and centralized oversight play in improving SOEs' performance and financial discipline.[11] Therefore, while some countries choose to keep their decentralized SOE oversight function, it is natural that others are considering more effective models for SOE ownership.

38. Among those surveyed, the following countries are changing their SOE ownership and oversight models:

- ***Kyrgyz Republic*.** Although legislatively the Kyrgyz Republic uses the dual model, in practice, many SOEs were de facto managed by their line ministries until recently. During 2017-2018, the State Property Management Fund strengthened its SOE ownership function by implementing the corporate governance code for SOEs, centralizing financial monitoring, and enforcing key performance indicators for all SOEs in the country. Line ministries retain policy and sector regulations. Thus, the SOE ownership model has changed from decentralized to dual.

[11] World Bank, 2014, op. cit.; IMF, 2019, op. cit.

- ***Moldova.*** The country is moving from a dual ownership model, under which SOE ownership rights were shared by line ministries and the central government (Ministry of Finance and the Public Property Agency, or PPA), to a centralized ownership model, empowering the PPA with SOE ownership rights. While many SOEs have already been transferred to the PPA, the process is ongoing and will take some time to complete.

- ***Poland*****.** The SOE ownership model has been evolving and shifting between centralized, dual, and mixed since the country's market transformation in the 1990s. The Ministry of Treasury, originally responsible for SOE privatization and oversight, was dissolved in 2016. From 2017, the centralized SOE ownership function was reassigned to the sectoral ministries, leaving general oversight with the Chancellery of the Prime Minister. Thus, Poland's SOE ownership model changed from centralized to dual. However, in December 2019, the new Ministry of State Assets was established and is once again taking over the centralized oversight of SOEs. As of the date of this Survey, it is too early to tell whether Poland has transitioned back to the centralized model, but it appears to be on track to do so.

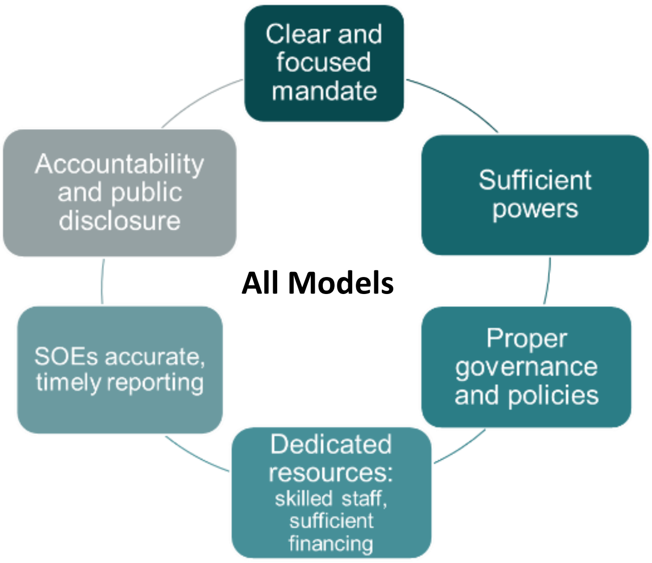
- ***Uzbekistan.*** Having initiated an ambitious SOE reform, Uzbekistan is gradually improving its SOE ownership model by establishing and empowering the State Assets Management Agency (SAMA). Since 2017, all SOEs must report to SAMA, which is mandated to act as SOEs' shareholder, develop and implement an SOE ownership policy, implement good corporate governance practices, appoint SOE board members, monitor financial performance, and develop and enforce key performance indicators, taking these functions from the line ministries. SAMA is also tasked with delivering a massive privatization program. Uzbekistan is moving gradually from a decentralized to a dual SOE ownership model.

39. Globally and in ECA, there is a trend for countries to gradually progress toward advisory and centralized models to bring focus and professionalism to the State's ownership role. This transition takes place gradually, typically progressing towards an advisory model from either de-centralized or dual ownership models. Only a few of the ECA countries have fully transitioned to the centralized model of SOE ownership, but this fact reflects the common history of many countries and the complexity of changes that the governments need to implement legislatively and practically. This evolution will take time and require significant resources from the developing countries' governments, as well as political will from their leaders.

40. Changing the SOE ownership model takes time. Not only does the process require changes to legal frameworks, but it also needs strong political will, significant investment in human resources, and capacity building at all levels. For example, creating a centralized ownership entity may involve a radical change that may not be feasible in the short term because of the political situation or lack of institutional capacity.

41. Regardless of the SOE ownership model used, the SOE ownership entity(ies) must have the capacity and competencies to effectively carry out their mandate, as illustrated in Figure 13. A pragmatic approach is required to improve SOE ownership arrangements and build a more effective oversight system. Sometimes, centralization of SOE oversight may not be feasible. In this case, decentralized and dual ownership arrangements can be improved by creating or strengthening an advisory or coordinating body, building its capacity, and empowering it with the authority to oversee the entire SOE portfolio or a group of the country's most significant SOEs. Such capacity and authority must be supported by formal regulations and procedures that are consistent with those applicable to the SOEs for which it exercises the state's ownership rights.

Figure 13. Features of Strong SOE Oversight System



Part IV. Corporate Governance and the Role of Boards

42. Evidence shows that a good corporate governance system is associated with benefits for all companies, whether private or state-owned.[12] These benefits include better access to external finance, which in turn can lead to larger investments, higher growth, lower costs of capital, and higher firm valuation, all of which work together to make investments more attractive and lead to growth and greater employment. Strong corporate governance also improves operational performance through better allocation of resources and more efficient management, reduces the risk of corporate crises and scandals, and can help reduce poverty and income inequality.

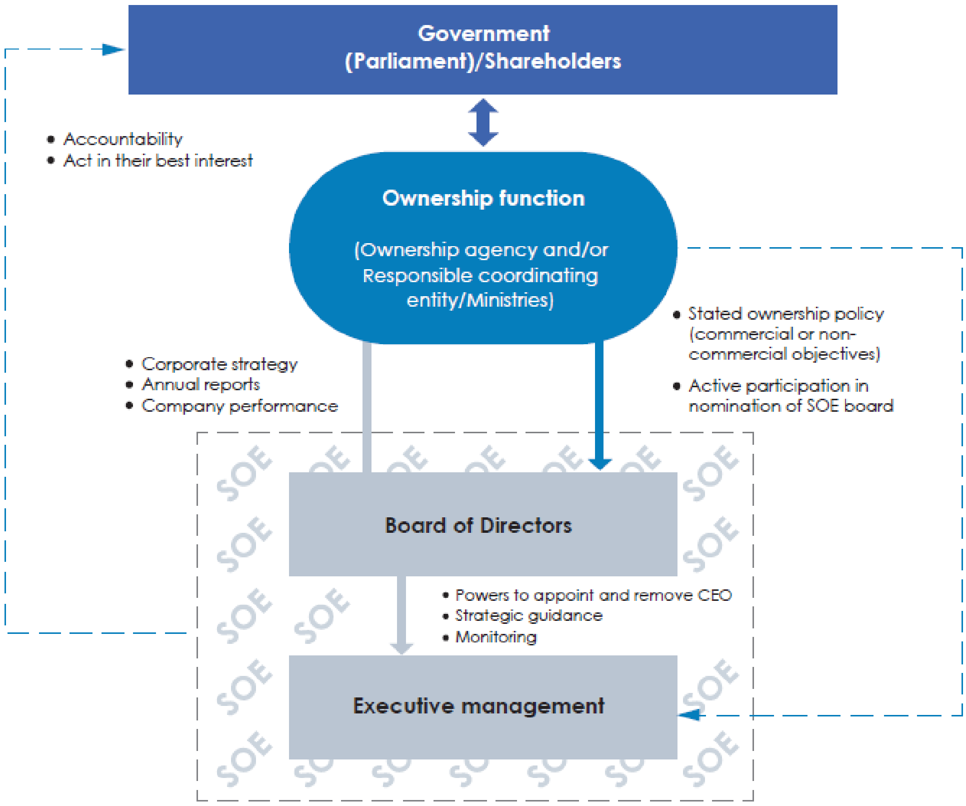
43. As an example, Lithuania was able to achieve enhancements in SOEs' efficiency following the sweeping corporate governance reforms it implemented during 2012-2013. A recent study[13] analyzing commercial Lithuanian SOEs' performance following the corporate governance reforms found evidence that such reforms enhance SOEs' efficiency. The quality of the board of directors and strategic planning also play important roles in overall organizational efficiency.

44. Proper corporate governance practices, as recommended by the OECD Guidelines,[14] distinguish clearly between the roles of the state's ownership entity, SOE boards, and SOE management (see Figure 14). The aim is to separate decision-making from ownership responsibilities to avoid conflicts of interest and disincentives. Clarifying these roles ensures that decisions are made on a rational and informed basis, and in line with stated objectives.

- The state, as the owner, should be responsible for defining and communicating SOE ownership policy and objectives, including any entity-specific objectives for individual SOEs.
- Boards should be formally charged by the state with setting the strategy to achieve the objectives and monitoring progress. Boards should be ultimately responsible to the shareholders (state or non-state) for the entity's performance.
- Executive management normally develops corporate strategy and proposes it to the board for approval (although in a minority of cases strategies may be imposed top-down). Once the corporate strategy is in place, however, the executive management is accountable to the board for implementing it.

[12] IMF, 2019, op. cit.
[13] Corporate Governance of SOEs and Performance in Transition Countries. Evidence from Lithuania (Curi, Gedvilas, Lozano-Viva, 2016).
[14] OECD, 2015, op. cit.

Figure 14. SOE Corporate Governance Arrangements and Distribution of Functions



Source: Adapted from *Boards of Directors of SOEs, an Overview of National Practices* (OECD, 2013)

Board of Directors

45. **Boards of directors play a central role in the corporate governance of SOEs and are an integral part of the SOE financial accountability, controls, and transparency framework.** The main role of the board is to act as a check on management, ensuring that the best interest of a company and its owners is upheld. SOE boards also have an important role in shielding management from political and government interference in SOE operations.

46. **SOE boards of directors should be empowered with the authority and autonomy to guide strategic direction, monitor performance, and hold management accountable.** Their autonomy and authority—including any necessary legislative authority—need to be clearly defined, along with the competence and objectivity requirements to facilitate strategic guidance and monitoring of SOE management. These necessary elements enable boards to fulfill their fiduciary duties as expected by the SOE and the general public, as the ultimate owners of SOEs.

47. **Boards perform a crucial stewardship and oversight function for SOEs.** Good practice demonstrates that boards of directors perform their functions most effectively when they are focused on guiding the implementation of SOE strategy, setting performance objectives, and monitoring financial and operational performance. To allow less frequent board meetings and more focus on strategic issues, decision-making on day-to-day implementation of the strategy, including procurement (except for major contracts), should be devolved to SOE

management, which is responsible for SOE operations. Effective SOE boards of directors should perform several key functions:

- Formulate or approve, monitor, and review corporate strategy;
- Establish appropriate performance indicators and identify key risks;
- Monitor disclosure and communication processes, ensuring that the financial statements fairly present the affairs of the SOE and reflect the risks incurred; and
- Assess and monitor management's performance.

48. In practice, in several of the surveyed countries, the role of SOE boards is often bypassed in a number of key areas. In many countries, SOE boards have limited decision-making power; instead, most strategic decisions are made by line ministries and/or by SOE senior management. This risks giving priority to the state's policy goals at the cost of efficiency and of commercial and financial viability.

49. SOE boards in some surveyed countries lack the authority to appoint and dismiss the CEO. This authority is fundamental to ensure executive management's accountability to the board. Without it, SOE boards cannot fully assume responsibility for SOEs' performance or exercise their monitoring function. Directly appointed CEOs tend to take instructions directly from political circles, circumventing the board, a practice that significantly weakens SOEs' corporate and public governance. To maintain the integrity of the board, good practice would at least require consulting with the board on the appointment of the CEO. Regardless of the procedure, appointments should be based on professional criteria and a competitive selection procedure.[15]

50. Globally, SOEs are increasingly required to establish boards—a requirement that is implemented to a good extent,[16] as this Survey found. Of the 15 surveyed countries, 9 require SOEs to establish boards of directors (see Figure 15). However, this requirement is generally applicable to SOEs that are incorporated as joint stock companies. Unincorporated entities are typically not required to establish boards of directors. Recognizing the need for good governance at SOEs, the remaining 6 of the 15 surveyed countries are gradually introducing legislative requirements for SOE boards. The requirements of these 6 countries are as follows:

- Belarus, Kyrgyz Republic, and Tajikistan require that SOEs incorporated as joint stock companies establish boards of directors. Unincorporated, unitary state enterprises are not required to do so, although the governments may direct them to form one.
- Georgia: boards of directors must be established in private and state-owned entities that are listed on the stock exchange, or when the number of shareholders exceeds 100. This requirement is applicable to the few SOEs that are significant for Georgia and is not mandatory for other SOEs. In practice, boards of directors are strongly encouraged and are established among the largest SOEs.
- Ukraine: corporatized SOEs are required to set up a board of directors only if they are listed. Since 2017, the largest unincorporated state enterprises, with state ownership

[15] OECD, 2015, op. cit.
[16] *Board of Directors of State-Owned Enterprises: An Overview of National Practices* (OECD, 2012)

exceeding 50 percent, are required by a special Government decree to establish boards of directors.[17]

- Uzbekistan: boards of directors are mandatory for SOEs corporatized as joint stock companies. However, if the SOE has fewer than 30 shareholders, its charter can vest its annual general meeting (AGM) with the board functions. In practice this means that very few SOEs have boards, as the state is the only, or a majority, shareholder.

Figure 15. Legal Requirement for SOEs to Establish a Board of Directors

51. SOE board members with professional qualifications and relevant industry experience contribute to stronger SOEs. In combination with independence and ethic requirements, board members' financial competencies and professional qualifications and skills are critical for the board to effectively carry out its mandate.

52. SOE boards in all surveyed countries include civil servants, although good practice suggests gradually reducing government representation at the SOE board level.[18] Boards composed mainly of government representatives can lack the necessary objectivity and relevant skills. Government representatives often lack the necessary qualifications, experience, and even time to be effective board members. Civil servants are typically appointed to pursue government policy goals. Therefore, when a government representative is appointed directly from the relevant line ministry, the board is more vulnerable to conflicts of interest as the appointee may pursue policy objectives rather than act in the best interests of the SOE. Together, these factors weaken an SOE board's autonomy, accountability, and access to relevant industry and specialized skills.

53. State representation on SOE boards is justified when SOEs are charged with important public policy objectives. At the same time, it is becoming a good practice, especially among the OECD member countries, to reduce undue state influence by limiting the number of public servants who may serving on an SOE board. There is growing consensus among OECD member countries that ministers, state secretaries, or other direct representatives of the executive power should not be represented on SOE boards. For example, Finland applies quotas for

[17] Decree #142 dated March 10, 2017. Largest SEs are defined as those with total assets exceeding UAH 2 billion (ca. US$80 million), and net revenue exceeding UAH 1.5 billion (ca. US$60 million). The MEDT estimates that the total number of such SOEs is 41.
[18] World Bank, 2014, op. cit.

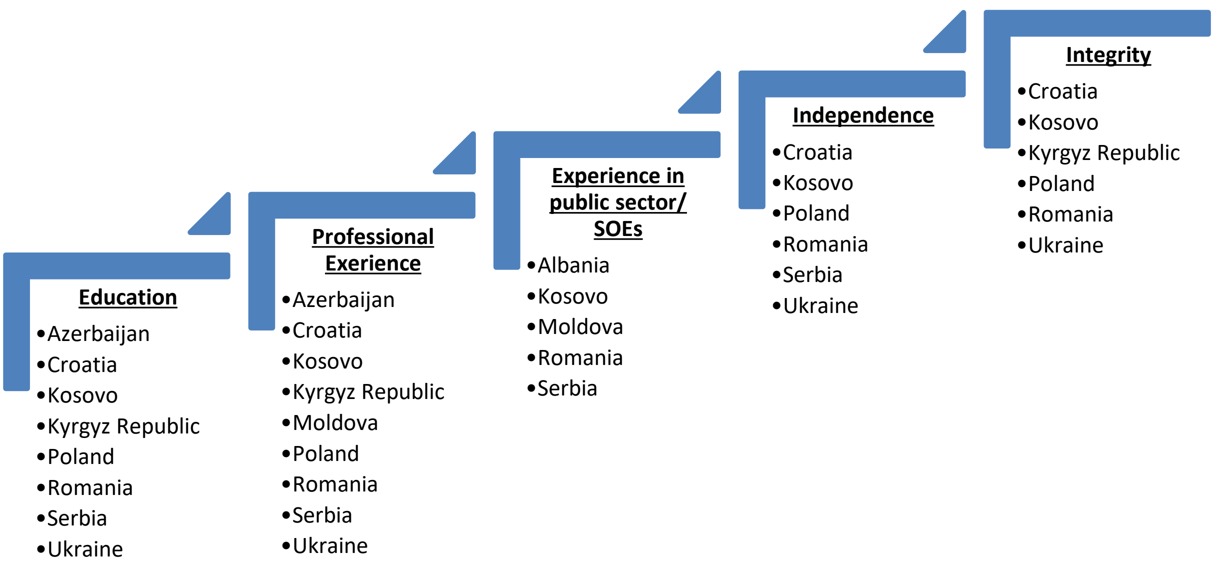
public servants, and Sweden appoints a majority of independent board members, using explicit exceptions for when representatives from the state ownership function can be appointed to SOE boards. Austria, Denmark, Germany, the Netherlands, and Norway all require by law that a majority of SOE boards must be independent directors.

54. Independent members help the board to exercise objective and independent judgment on the SOEs' strategic decisions and bring necessary experience to the board's skill mix. Independent board members are free of material interests or relationships with the enterprise, its management, other major shareholders, and the ownership entity that could jeopardize their exercise of objective judgment.

55. Many of the surveyed countries are taking steps to improve SOE boards' composition and qualifications. Governments are increasingly seeking to establish the legislative framework and clear processes for board nominations and appointments. Their aim is to depoliticize the process, make it more professional and transparent, and ensure that boards have the competencies and objectivity they need to carry out their duties.

56. Most of the surveyed countries have set requirements for potential SOE board members (see Figure 16)—requirements covering their education and professional experience, and sometimes their integrity. Clearly defined selection criteria for potential board members should lead to more professional and skilled SOEs boards. In setting the criteria, governments may give preference to candidates with relevant industry expertise; knowledge and understanding of financial statements, strategy-setting, risk management, and internal controls; and a proven ability to exercise independent and objective judgment. This Survey does not assess the extent of practical implementation of such requirements or address the difficulties and exceptions of meeting them in practice.

Figure 16. Requirements for Candidate for SOE Boards of Directors



57. Belarus, Georgia, Tajikistan, and Uzbekistan do not formally set criteria for potential SOE board members. In Georgia, though, the largest SOEs tend to emulate the best practices applied by private sector entities. Uzbekistan is implementing sweeping corporate governance reform, aiming to bring to Uzbekistan SOEs good corporate governance practices modeled on the OECD Corporate Governance Principles.

Box 4. Qualification Requirements for SOE Board Members among Selected Countries

Czech Republic: Requirements include experience in corporate governance and knowledge of economics, financial statements, and the commercial code.

Hungary: A degree in finance, economics, or law is required.

Lithuania: Additional proficiency and suitability requirements apply to candidate board members of large SOEs; the required expertise of each director position is specified to ensure that the board has an appropriate skills mix.

Romania: Most board members must have experience with profitable private sector companies.

Switzerland: Qualifications requirements are tiered into three categories: (1) for the board as a whole (team functions, strategic skills, relevant market and professional knowledge); (2) for single board members (integrity, independence, professional skills); and (3) for the chair (specific leadership skills).

Source: Adapted from World Bank, 2014, op. cit.

58. The Survey found that some participating countries subject potential SOE board candidates to a formal selection process—a written or oral examination. For example, in Belarus, Kyrgyz Republic, Poland, and Romania the ownership agency administers an exam. Candidates who pass the exam and meet the established qualification criteria are added to the pool of candidates available to the ownership agency, line ministries, or SOEs in that country. This practice is also used by many more developed economies, such as France, where the ownership agency – Agence des participations de l'État – manages a "directors' pool" of candidates, preselected through a formal evaluation.

59. Alternatively, some countries use third-party recruiting agencies to identify appropriate candidates for SOE boards. For example, Finland outsources to a recruitment consulting firm the development and maintenance of a database of prequalified candidates. In Portugal, board candidates are vetted according to specific criteria by the Committee on Recruitment and Selection for Public Administration. Among the surveyed countries, Ukraine uses third-party recruiting agencies to identify suitable candidates, who are then vetted by the special Appointment Committee composed of Government representatives and observers from the international financial organizations.

Audit Committee

60. Specialized committees play an important role in supporting the board—for example, in the areas of audit, risk management, remuneration, and appointments. The OECD Guidelines state that "SOE boards should consider setting up specialized 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. The establishment of specialized committees should improve boardroom efficiency and should not detract from the responsibility of the full board."[19]

61. Board committees enable boards to handle complex issues more efficiently; this is especially important for large and complex SOEs. Board committees support SOE boards in taking well-informed and considered decisions. As a rule, decisions are not made by the committees, but rather by the board as a whole; nonetheless, committees manage much of the workload in the decision-making process in relation to their specific mandates (analyzing specific problems, establishing facts, finding alternative solutions, etc.). Independent board members must be actively involved in the activities of the committees.

62. Audit committees play a crucial role in informing a board's decisions with respect to company financial performance and instilling quality financial reporting practices. The board sets up the audit committee to assist it in performing oversight of financial reporting, internal control and risk management systems, internal and external audits, and company compliance.

63. Although the use of audit committees is already a good practice in the private sector, it is not yet common in SOE boards among the surveyed countries (see Figure 17). Legislation in many of the surveyed countries requires the establishment of audit committees. In practice, this requirement is challenging to implement because of a lack of independent board members to chair the committee and/or of appropriate expertise among the existing board members. Moreover, certain countries use the term *audit committee* interchangeably with the term *revision committee*—a remnant from the Soviet planned economy structure, in which revision committees were primarily tasked with internal investigation aimed at finding legislative violations or misuse of funds. Revision committees typically report directly to the CEO, while an audit committee is part of the SOE's board. Figure 17 shows the countries that require the establishment of an audit committee and those that require a revision committee (grouped under the "No" response). For those that require one "in some cases," the practices are as follows:

- Albania's legislation requires all public interest entities (PIEs),[20] including SOEs, to establish an audit committee. However, this requirement is not enforced in practice, as there is no legislative guidance on the definition of an audit committee in the charter/ bylaws of SOEs, a prerequisite for their establishment.

[19] VII. "Responsibilities of the Boards of State-Owned Enterprises," OECD, 2015, op. cit.

[20] According to the EU's Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013, public interest entities include (i) entities traded on a regulated market, (ii) credit institutions, (iii) insurance undertakings, and (iv) undertakings that are of significant public relevance due to the nature of their business, their size, or the number of their employees.

- Ukraine: corporatized SOEs are required to set up a board of directors if they are listed. In addition, since 2017 a special Government decree[21] requires all SOEs with state ownership exceeding 50 percent, including the largest unincorporated state enterprises (SEs), to set up an audit committee, chaired by an independent board member. This practice is being gradually implemented.
- Belarus and Tajikistan: corporatized SOEs must establish a Control and Revision Committee. The duties of this committee build on the historic concept of a revision committee, as described above, but in Belarus and Tajikistan the committee is independent of SOE management as it reports directly to the AGM.

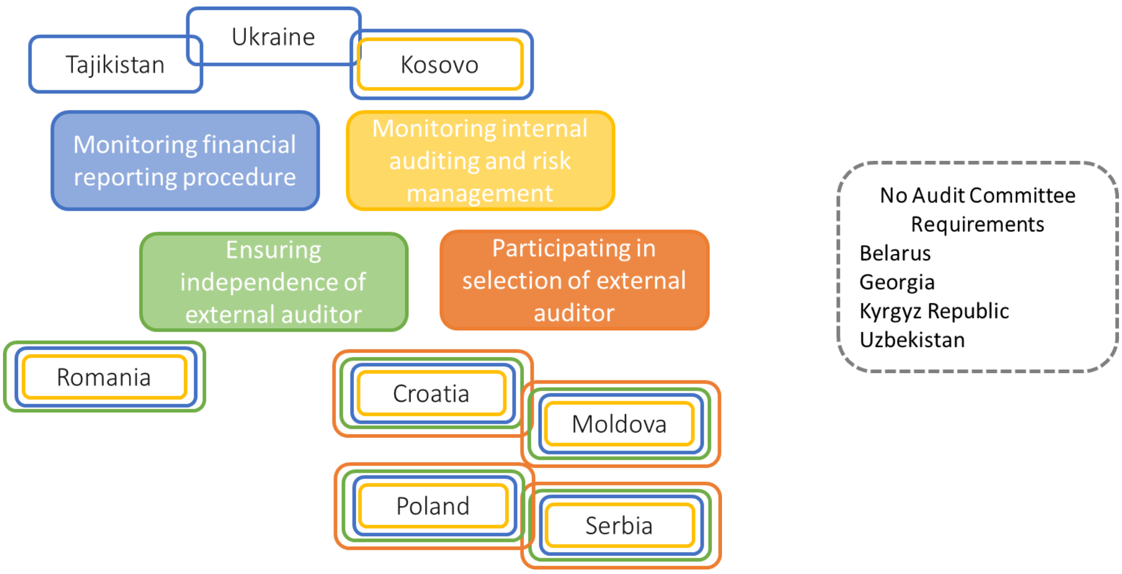
Figure 17. Are SOEs Required to Establish an Audit Committee?

64. **Functions of board-level audit committees differ among the countries that do legislate this requirement** (see Figure 18). However, certain core responsibilities are common, as is also suggested by good international practice:

- Financial reporting compliance, oversight of the preparation of quality financial statements.
- Appointment of and communication with external auditors.
- Internal audit oversight, ensuring adequate resources and independence.
- Oversight of the adequacy of internal controls.
- Overall responsibility for monitoring compliance, including legal and regulatory.

[21] Decree #142 dated March 10, 2017. Largest SEs are defined as those with total assets exceeding UAH 2 billion (ca. US$80 million), and net revenue exceeding UAH 1.5 billion (ca. US$60 million). The MEDT estimates the total number of such SEs to be 41.

Figure 18. Functions of Audit Committees



65. **The Survey data show that there is a clear tendency to increase the role of audit committees** among countries that have become members of the EU or are on their approximation path:

- **Croatia, Moldova, Poland, Serbia:** Audit committees are responsible for monitoring SOEs' financial reporting, the efficiency of their internal controls, and their internal audit and risk management systems; ensuring their independence; and recommending the selection and supervising the work of external auditors.

- **Romania:** Audit committees monitor financial reporting by SOEs; ensure the effectiveness of internal controls, internal audit and, where appropriate, risk management systems; monitor statutory audits; and ensure the independence of the statutory auditors of SOEs.

- **Kosovo:** Audit committees review key financial and strategic documents of SOEs before their adoption by the board of directors, including strategy, investment, and financial plans, annual business plan and budget, and financial statements and the annual report, providing observations or suggestions to the boards of directors. Audit committees are also responsible for ensuring adequate internal controls and compliance with regulations.

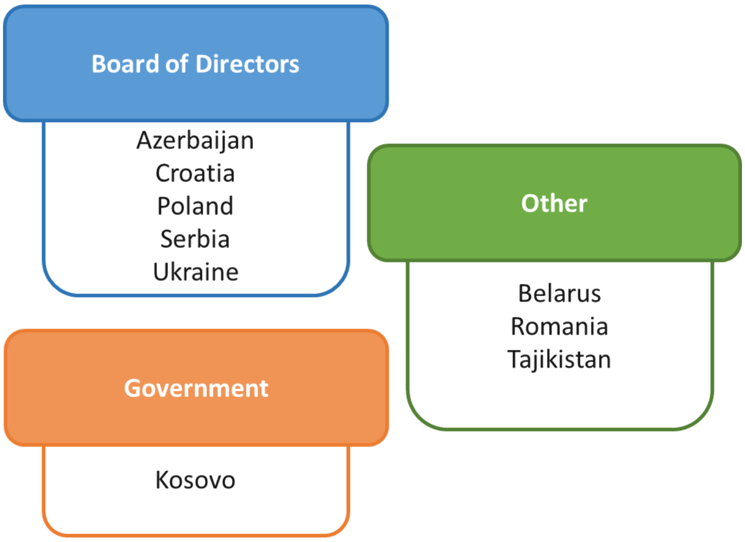
- **Ukraine, Tajikistan:** Audit committees are mainly responsible for monitoring SOEs' financial statements and annual reports. Since 2017, the role of audit committees among Ukrainian SOEs has expanded to cover all major functions suggested by good practices.

- **Albania, Azerbaijan:** SOEs are required by law to set up an audit committee. However, guidance on the responsibilities and duties of audit committees has not been developed, and SOEs have not yet established or are in progress of establishing audit committees.

66. **Audit committee members are usually selected from among members of the board of directors who have the required qualifications and experience in finance, accounting, and audit.** Ideally, a majority of audit committee members should be independent, but if this is not possible the committee should at least be chaired by an independent board member. Among surveyed countries that require SOEs to have an audit committee, the mechanism to appoint

committee members varies, largely depending on whether SOEs have boards of directors or are overseen by line ministries or directly by the central government (see Figure 19). In Romania, audit committee members for SEs are appointed by the line ministry, and for corporatized SOEs the AGM appoints the audit committee. In Belarus and Tajikistan, the AGM directly appoints the members of the Control and Revision Committee.

Figure 19. Appointment of Audit Committee Members



Part V. Financial Reporting, Transparency, and Disclosure

67. **Reliable and timely financial information is vital for effective decision-making and for holding SOEs accountable for their performance.** The OECD Guidelines recommend that SOEs observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance, and auditing standards as listed companies. While each country chooses its own way in selecting financial reporting standards and transparency and disclosure requirements, globally there is a growing trend toward convergence of standards and increased requirements for information disclosure.

Financial Reporting

68. **Adopting internationally accepted reporting standards both reduces adoption costs for individual countries and allows comparability of financial information across countries and sectors.** It also prevents lack of local capacity from leading to lower-quality national standards. The main international standards are shown in Table 1.

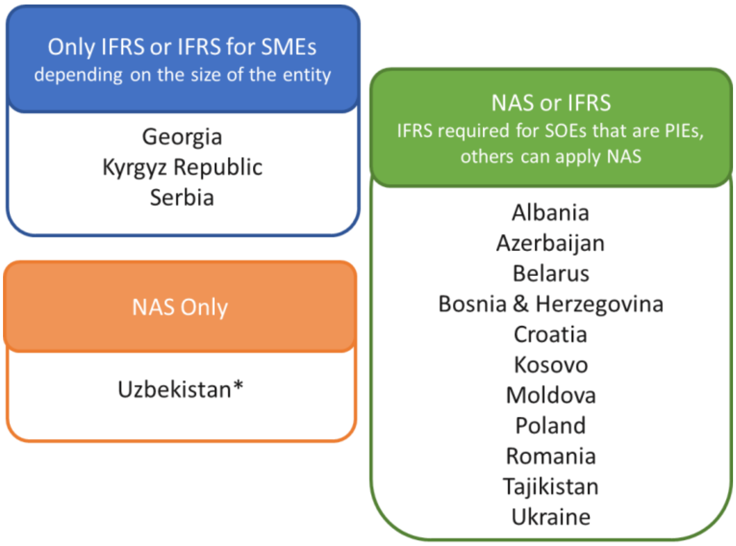
Table 1. Main International Standards on Transparency, Disclosure, and Controls

Topic	International standard	Standard-setter
Financial reporting	International Financial Reporting Standards (IFRS) and IFRS for Small and Medium-sized Enterprises (SMEs)	International Accounting Standards Board
Internal audit	International Standards for the Professional Practice of Internal Auditing	Institute of Internal Auditors
Internal control and risk management	COSO Internal Control–Integrated Framework	Committee of Sponsoring Organizations of the Treadway Commission
External audit	International Standards on Auditing (ISA) International Standards for Supreme Audit Institutions (INTOSAI)	International Auditing and Assurance Standards Board International Organization of Supreme Audit Institutions
Corporate governance	Principles of Corporate Governance SOE Corporate Governance Guidelines	OECD

Source: World Bank, 2014, op. cit.

69. **The surveyed countries overwhelmingly recognize the importance of adopting IFRS for their largest SOEs.** All surveyed countries require their largest SOEs to report using IFRS, although many still rely on their national accounting standards (NAS) (see Figure 20). All countries have established these requirements in their accounting legislation, in line with good practice.

Figure 20. Applicability of Various Accounting Standards



* Uzbekistan is in the process of adopting the IFRS at the time of this Survey.

- **IFRS only:** Georgia, Kyrgyz Republic, and Serbia have fully adopted IFRS and IFRS for SMEs in their local legislation. No parallel NAS exist in these countries, and all entities, private and state-owned, must follow either IFRS or IFRS for SMEs, depending on the entity size and other criteria set out in the accounting legislation.
- **Combination of IFRS and NAS:** most surveyed counties maintain their NAS. At the same time, they legislate the requirement for all PIEs – private or state-owned – to use the internationally recognized standards. The definition of PIEs varies,[22] but it typically includes listed entities, financial institutions, insurance companies, and the largest entities by volume, assets size, or employment. The largest SOEs normally come under the PIE definition.
- **NAS only:** Among the surveyed countries, only Uzbekistan does not currently require its SOEs to follow IFRS. One of the fundamental changes Uzbekistan is making as part of the significant transformation of its massive SOE sector is to introduce the IFRS reporting requirement for the largest SOEs from 2021.[23]

70. The quality of an entity's financial reporting is measured across different dimensions, including completeness, accuracy, timeliness, and relevance. As evidenced by in-country work by World Bank teams, SOEs have difficulties with producing IFRS-based financial reports. SOE reports are often incomplete, lacking key statements or notes that would normally be an integral part of the financial reporting package; or they may be inaccurate in the treatment of technical or sensitive areas; or they may be so delayed that they lose their timeliness and relevance.

71. It is good practice to subject SOEs, and especially publicly listed entities, to the same reporting requirements as their private sector peers—to produce an annual financial reporting package that must include four key statements: (i) a balance sheet; (ii) a profit and loss statement; (iii) a statement of changes to owners' equity; and (iv) a cash flow statement. The package must also include notes to the financial statements. These financial statements should

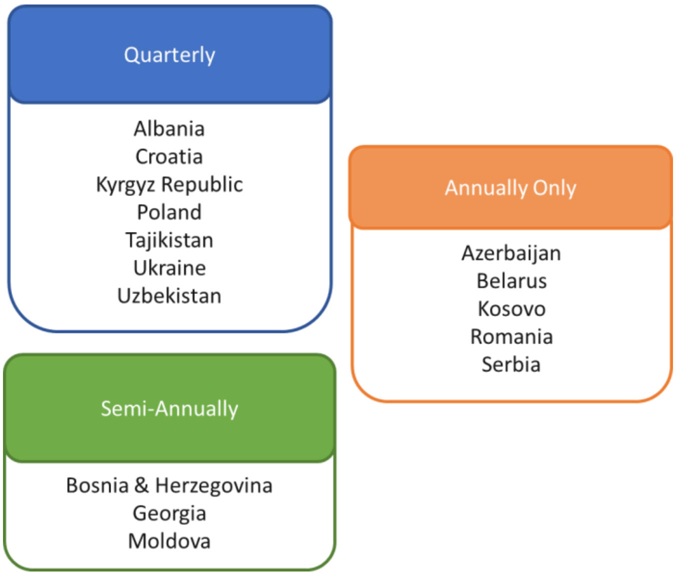
[22] Many surveyed countries follow the EU definition of PIEs, found in EU Accounting Directive 2013/34/EU.
[23] Decree of the President of Uzbekistan, #4611 dated February 24, 2020

generally be finalized three to six months after the end of the financial year to be relevant for decision-making and forecasting.

72. **The frequency with which SOEs must prepare the complete financial reporting package should be based on cost-benefit considerations.** Annual preparation of a complete financial reporting set is a must. Good practice[24] is to require semiannual reporting only for the largest and most economically significant SOEs. A quarterly reporting requirement may be excessive but could be considered on the basis of the government's need to analyze SOEs' financial situation. SOEs may also be requested to report on certain indicators or the material events affecting their financial position, even if those statements fall outside the usual reporting cycle.

73. **The Survey confirms that all participating countries require their SOEs to prepare annual financial statements,** and some require more frequent financial reporting (see Figure 21). In line with good practice, all countries have established their requirements in accounting legislation. Governments may request other types of reporting either regularly or ad hoc (these other types of reporting are not covered by this Survey).

Figure 21. SOEs' Reporting Frequency



- **Annual financial statements:** All surveyed countries require their SOEs, regardless of their legal form, to prepare annual financial statements. As IFRS is a required reporting standard for most SOEs corporatized as joint stock companies, the annual financial reporting requirement covers the full set of financial statements and notes. For SEs, the annual reporting requirements are more relaxed and may not include notes to the financial statements.
- **Semiannual reporting:** Georgia requires its listed SOEs to file semiannual financial reports in addition to their annual financial statements.[25] Listed Georgian companies, including SOEs, must also report on material events whenever they occur. Bosnia and Herzegovina and Moldova also require SOEs to report semiannually if they are defined as PIEs and admitted for trading on a regulated market.

[24] World Bank, 2014, op. cit.
[25] Per the Law of Georgia on Securities Market.

- **Quarterly reporting:** Quarterly reporting is required for listed SOEs in the Kyrgyz Republic and Poland, while non-listed SOEs can report annually. Albania, Croatia, Tajikistan, and Ukraine require their SOEs to prepare and submit quarterly financial statements to the central ministries for financial and fiscal risk monitoring. In Uzbekistan, all entities, except small and micro-entities, are required to prepare quarterly financial statements.

Annual Report

74. All surveyed countries require their corporatized SOEs to prepare an annual report that must be approved by the Shareholders Meeting (AGM). The annual report is one of the most informative ways for a company to communicate with stakeholders, investors, and the public. It is a useful tool for informing shareowners of a company's accomplishments and attracting potential investors, and it may also be useful for the company's own employees. Annual report requirements apply only to the PIEs; unincorporated SEs are not obliged to prepare annual reports and do not do so.

75. Information requirements for the annual report are often contained in two complementary sets of legislation: (i) company and securities laws, and (ii) accounting legislation. These reports typically include the Management Discussion and Analysis (MD&A), a full set of financial statements, the auditor's report, and other information that may be useful—a stock price history, financial ratios, significant events, and the like. The report should present a balanced and fair view, describing the company's success and explaining any setbacks during the reporting year. Table 2 summarizes the annual report requirements of the surveyed countries.

Table 2. Annual Report Information Requirement

	Full Set of Financial Statements and Notes	Auditors' Report	MD&A	Corporate Governance Statement/ Information	Report on Payments to Public Sector	Other
Albania	i	i	i	i	i	
Azerbaijan	i	i				
Belarus	i	i				i [1]
Bosnia & Herzegovina	i	i				
Croatia	i	i	i	i	i	
Georgia	i	i	i	i	i	i [1]
Kosovo	i	i	i	i		
Kyrgyz Republic	i	i	i	i		i [1]
Moldova	i	i	i	i	i	
Poland	i	i	i	i	i	
Romania	i	i	i	i	i	
Serbia	i	i	i	i		
Tajikistan	i	i		i		i [2]
Ukraine	i	i	i	i	i	
Uzbekistan	i	i				i [1]

1\ Material transactions, share information, changes at the board level.
2\ Statement of Contingent Liabilities by each SOE.

- **Annual financial statements and auditor's report:** All surveyed countries require their corporate SOEs to include annual financial statements, accompanied by the auditor's report, in the annual report package. This trend is in line with best practices.

- **MD&A and corporate governance statements**: The inclusion of these two types of reports in the annual report package is mainly required for listed SOEs. The MD&A allows a company's management to narrate the company's performance, its financial condition, and significant events during the reporting period, and to discuss compliance, risks, and plans for the future, such as goals and new projects. The corporate governance statement aims to inform users about the way the entity is governed, highlight any changes, and outline any significant deviations from the corporate governance codes or requirements.

- **Report on payments to governments:** This new reporting requirement became mandatory from 2016 for EU member states' PIEs and large entities that are engaged in exploration, development, and extraction of minerals, oil, and gas or logging of primary forests. This requirement has been legislated into the frameworks of the EU countries among those surveyed—Croatia, Poland, and Romania. In addition, Albania, Georgia, Moldova, and Ukraine, which are striving to approximate their legislation to the EU norms, are now also requiring their entities, including SOEs, to comply with this requirement for their annual reports.

- **Other information:** Other information that must be included in listed entities' annual reports varies among the surveyed countries. It includes data on shares issues, information about significant shareholders, disclosure of significant events (if the MD&A is not required), changes in the governance structure, and so on.

76. The MD&A and corporate governance statement are particularly challenging for SOEs to prepare. These two statements require judgment on the part of a company's management and maturity on the part of the corporate governance system. In the absence of detailed guidance from SOE ownership entities and of capacity in SOEs, this requirement remains challenging to implement properly.

77. Timelines for preparing annual reports vary among the surveyed countries (see Figure 22). Different regulators within one country, such as the securities regulator, business registries, or the accounting regulator, may request annual report filings at different points in the year.

Figure 22. Annual Report Filing Timelines

78. If annual reports are to be relevant for decision-making and forecasting, it is good practice to require that they be finalized within three to six months after the end of the financial year.

- **Early filing**: Uzbekistan and Bosnia and Herzegovina require all companies – private and state-owned – to file their annual reports much sooner than other surveyed countries. At the same time, the composition of the annual report in these countries is less comprehensive than in other surveyed countries (see Table 2). Such a condensed timeline for closing the year-end accounts and completing their audit may be too short to ensure their good quality.
- **Three- to four-month timeline:** Most of the surveyed countries require annual reports to be filed within 3-4 months after the end of the financial year. These annual reporting packages must be complete with all required information. Belarus requires listed entities (including listed SOEs) to file annual reports by March 31, and the consolidated IFRS and audited financial statements are to be filed with the Ministry of Finance by June 30.
- **Six- to seven-month timeline:** This is generally in line with good practice, since the financial and material information in the report remains relevant for those charged with governance and decision-making.
- **Other cases:** Georgia requires its listed entities, some of which are SOEs, to submit their annual reports by May 15 to the National Bank of Georgia, which also has the functions of

the securities market regulator. All other entities that are not regulated by the Securities Market Law, fall under the general requirement of the Accounting, Reporting and Auditing Law, which encourages all entities (including SOEs) to submit their annual reports as soon as practical, but not later than October 1. Azerbaijan does not have a timeline for filing annual reports; its timeline for submitting the annual financial statements is April 30, and June 30 for consolidated accounts.

79. The government needs to analyze SOE annual reports on a timely basis to inform its decision-making processes, risk assessment, and policy regulations. Like shareholders of any private entity, governments need to carefully review SOEs' annual reports, including financial statements, material events, profitability trends, operational performance, growth patterns, key performance indicators, and other key matters reported by the management. The auditor's opinion and footnotes to the financial statements contain important details about company assumptions that can be critical to a full understanding of an SOE's financial standing. Moreover, annual reports contain important information on material events, markets, products, and social functions of SOEs – all critical inputs for government policy decisions.

80. The review and analysis of SOEs' annual reports are made more complicated by the fact that the shareholder and oversight functions are often scattered among several government agencies. Many countries around ECA, including the surveyed countries, require SOEs to file their annual reports with multiple agencies (see Table 3), complicating the filing process for SOEs and diluting government oversight functions. The Survey also confirmed that the enforcement of these requirements and analysis of the filed reports remain weak.

Table 3. Annual Report Filing Requirement

	Securities Regulator (if listed)	Central Filing/ Financial Statements Registry	Central Ministry (MOF, MOE)/ Property Agency	Line Ministries	Statistics Agency
Albania		● [1]	●	●	
Azerbaijan			●	●	
Belarus			●	●	●
Bosnia & Herzegovina				●	
Croatia		● [2]		●	
Georgia	●	● [3]	●	●	
Kosovo			●		
Kyrgyz Republic	●		●		●
Moldova		● [4]		●	
Poland	●	● [5]		●	
Romania	●		●	●	
Serbia	●	● [6]	●		
Tajikistan			●	●	●
Ukraine	●		●	●	●
Uzbekistan			●	●	●

1\ National Business Center
2\ Register of Annual Financial Reports kept by the Financial Agency
3\ Service for Accounting, Reporting and Auditing Supervision
4\ Financial Statements Depository
5\ National Court Register
6\ Business Registers Agency

81. **Few of the surveyed countries are transitioning to a centralized reporting system; most continue to require their SOEs to report to multiple ministries and agencies.** It is good practice to have fewer reporting windows for all entities, regardless of their ownership. Generally, all listed entities (including SOEs) need to report to the securities regulator, as in Georgia, Kyrgyz Republic, Poland, Romania, Serbia, and Ukraine. Similarly, SOEs retain their reporting line to the agencies that exercise an ownership function, whether line ministries, central-level ministries, or property agencies. In addition, several jurisdictions require all entities, regardless of their ownership, to report to the Statistics Committee/ Agency/ Office, as in Belarus, Kyrgyz Republic, Tajikistan, Ukraine, and Uzbekistan.

82. **Central financial statement registries are a next step in raising financial transparency among private and state-owned companies.** Several of the surveyed countries have moved toward a centralized system for collecting financial statements, making it easier for regulators, owners, and the public to access and analyze financial statements. For example, Albania, Croatia, Georgia, Moldova, Poland, and Serbia require companies to file their financial

statements in a central registry. Typically, such centralized financial statements registries are a steppingstone on a disclosure improvement path.

Disclosure

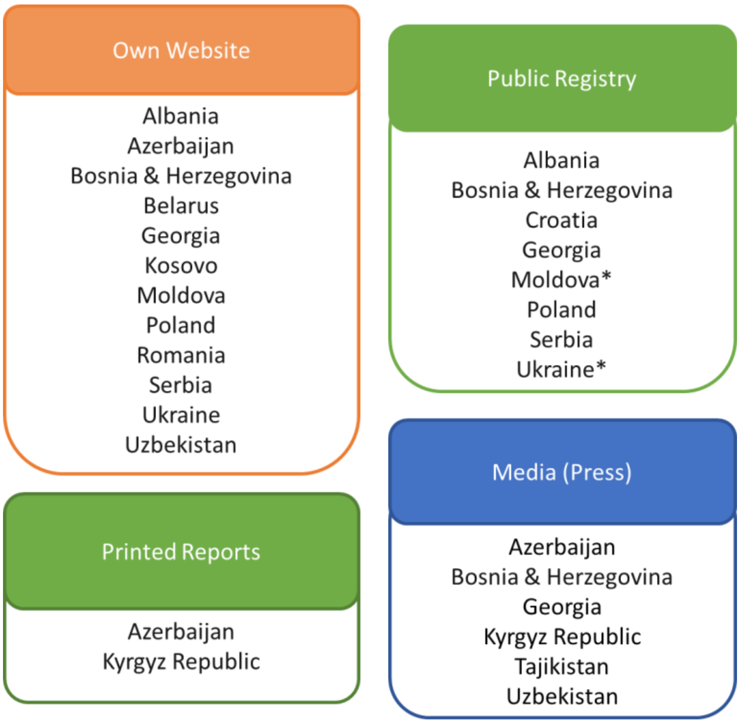
83. The Survey findings indicate that disclosure requirements for SOEs are generally consistent among the surveyed countries, but SOEs' actual disclosure practices vary significantly. All surveyed countries require their listed entities, including SOEs, to publish their annual reports, which contain audited financial statements. At the same time, there are no requirements that unincorporated SEs disclose their financial information. Given the size and importance of SEs in some of the surveyed countries, improved disclosure requirements for them would significantly raise the transparency of the SOE sector in these countries. The actual enforcement of disclosure practices among many countries in the ECA Region lags behind good practice. Multiple analytical studies undertaken by the World Bank[26] and the IMF[27] confirm that the implementation of disclosure requirements by SOEs is generally weak around the Region, partly because of the lack of enforcement by governments' ownership units.[28]

84. There is no consistency on SOEs' publication requirements among the surveyed countries. Some jurisdictions require publication of the complete annual report, while some require only that audited financial statements be publicly disclosed. The composition of the annual report to be published is driven by the content of the annual report package. The Survey confirmed that while the content requirements of the annual report differ, the general rule is that SOEs must publish their annual reports in their entirety.

85. The surveyed countries require SOEs to publicly disclose their annual reports in a range of ways. While some printed distribution channels are still in use (e.g., local press, printed versions available from companies or regulators), many countries are switching to electronic registries and online publication (see Figure 23). While more disclosure is always encouraged by good international practice, in reality, achieving even the minimum disclosure required by local legislation is challenging for SOEs.

[26] Country-based analytical notes on SOE ownership and governance practices; technical assistance projects.
[27] IMF, 2019, op. cit.
[28] Annex E is a useful resource to compare the existing national transparency, disclosure, and control practices for SOEs in any country with the IFC-World Bank Progression Matrix and help identify practical, progressive steps for improvement.

Figure 23. Legal Publication Requirements for SOE Annual Reports



- **SOEs' websites:** The great majority of surveyed countries require their SOEs to disclose annual report packages on their own websites. This requirement is aimed at improving transparency and is in line with good practice. However, it is extremely difficult to monitor and enforce. Therefore, many of the surveyed countries experience difficulties in improving the public profiles of their SOEs.
- **Central/public registry:** Countries that have established centralized reporting registries require that all companies file their annual reports at these registries. For example, Albania, Bosnia and Herzegovina, Croatia, Georgia, Poland, and Serbia collect SOE reports and make them publicly available to all users online. This is in line with good transparency practices. Moldova and Ukraine are in the process of building such public registries, and some limited functions are already available for public use.
    - Moldova's financial statements depository, housed in the Statistics Office, collects all annual reports and releases them by individual request. The legislative framework for a fully functioning depository is already in place, and the Government is presently developing the system.
    - Ukraine has launched an SOE reporting portal[29] that collects financial reports from the top-100 SOEs and makes them publicly available. The functionality of this portal is currently limited, as it is still under development. Once fully launched, the portal will provide all key information on SOEs in the country in live format.
- **Media publication and printed reports:** While online publication caters to the more advanced user categories, some countries still require SOEs to publish their annual reports through more traditional channels. For example, Azerbaijan requires SOEs to publish their information by all available channels: company internet pages, local press, and printed annual reports to be provided on demand to any stakeholder. Georgia also requires its companies to provide annual reporting through local media or individual Internet pages

[29] https://prozvit.com.ua/#/

in addition to the publicly available financial statements registry. The Kyrgyz Republic is the only jurisdiction in this Survey that requires companies to publish annual reports in the local media and printed form, with no mention of Internet options. Tajikistan and Uzbekistan require companies, including SOEs, to publish their annual reports on their individual websites. As very few companies in these jurisdictions have an Internet presence, both countries also require SOEs to publish annual reports in the local press.

Aggregate Reporting

86. Financial transparency is enhanced through regular, open aggregate reporting on all SOEs. The OECD Guidelines[30] provide several recommendations concerning transparency, including the publication of aggregate reports by the ownership entity through web-based communications to facilitate access by the public. Aggregate reporting should be the key disclosure tool directed to the public. As the OECD Guidelines recommend, the best way to foster public transparency and communicate aggregate reporting is by developing a robust website and ensuring continuous renewal of its content.[31] Aggregate reports should provide at least an indication of the total value of the state's portfolio and include a general statement on the state's ownership policy and its implementation methods. Aggregate reporting does not need to duplicate the SOEs' reports, but it could include individual reporting on the most significant SOEs.

87. Good practice places increasing emphasis on aggregate reporting on the SOE portfolio that provides an overall picture of SOEs' performance. Besides informing the public, the process of developing aggregate reports helps clarify policies and build consensus on sensitive issues. Developing aggregate reporting on SOEs requires that proper systems be in place and that the ownership entity have appropriate capacity. OECD recommends that the aggregate report should contain the following information: (i) financial performance and the value of the SOEs; (ii) information on performance-related nonfinancial indicators; (iii) an indication of the total value of the state's portfolio; (iv) a general statement on the state's ownership policy and information on how the state has implemented this policy; (v) information on the organization of the ownership function; (vi) overview of the evolution of SOEs, aggregate financial information, and reporting on changes in SOEs' boards; and (vii) key financial indicators, including turnover, profit, cash flow from operating activities, gross investment, return on equity, equity/asset ratio, and dividends. While all this information would be desirable, an aggregate report can contain less information and yet be very useful for the government and the public, as the ultimate owners of the SOEs.

88. Several countries in Europe have developed robust and informative reporting on their SOE portfolios. Lithuania, Norway, and Sweden are often cited as examples of global best practice in SOE oversight and disclosure. These countries provide comprehensive information on the entire SOE portfolio as well as individual SOE snapshots, and they also report on the costs related to public policy objectives carried out by SOEs and the commensurate compensation provided by the state budget. They disclose a list of all SOEs, and the amount of subsidies/appropriations provided to them during the reporting year. The Netherlands provides an interactive online report on the SOE portfolio and individual SOEs that allows users to analyze the portfolio in different ways.

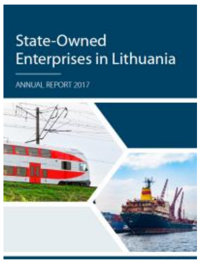
[30] *Transparency and Accountability, A Guide for State Ownership*, OECD, 2010.
[31] OECD, 2015, op. cit.

Box 5. Examples of Good Practices in Aggregate SOE Reporting

Lithuania

Annual Report: https://vkc.sipa.lt/wp-content/uploads/2018/09/SOE_Report_2018_EN_WEB.pdf

Periodic Reports: https://vkc.sipa.lt/apie-imones/vvi-portfelio-informacija/



Norway

Annual Reports: https://www.regjeringen.no/en/topics/business-and-industry/state-ownership/statens-eierberetning-2016/the-state-ownership-report/id2395364/

Sweden

Annual Reports: https://www.government.se/reports/2019/09/annual-report-for-state-owned-enterprises-2018/

The Netherlands

Annual Reports and Interactive Information:
https://www.rijksoverheid.nl/onderwerpen/staatsdeelnemingen/staatsdeelnemingen-in-2018

89. **The Survey notes that aggregate SOE reporting is only beginning to emerge among the surveyed countries** (see Figure 24). Some countries have rolled out regular reporting on their SOE portfolio, while others are not preparing aggregate reports or are in the process of designing proper systems to enable such reports in the future.

Figure 24. Aggregate SOE Reporting

Yes

- Croatia
- Kosovo
- Moldova
- Romania
- Ukraine (top 100 SOEs only)

No

- Albania
- Azerbaijan
- Belarus
- Bosnia & Herzegovina
- Georgia
- Kyrgyz Republic
- Poland
- Serbia
- Tajikistan
- Uzbekistan

90. **Overall, the Survey confirms that although financial reporting and disclosure requirements are in place in most of the surveyed countries, their implementation and enforcement could be stronger.** The operations and governance of SOEs in many countries are still shrouded in secrecy, and key information on profitability, subsidies, debt, and contingent liabilities is not always reliable and timely. This situation often results in significant fiscal risks and budget drain for governments. Reliable financial information is essential for well-informed decision-making on the part of SOEs' management, their boards of directors, government acting as a shareholder, potential and current investors and lenders, and civil society and citizens as the ultimate owners of SOEs.

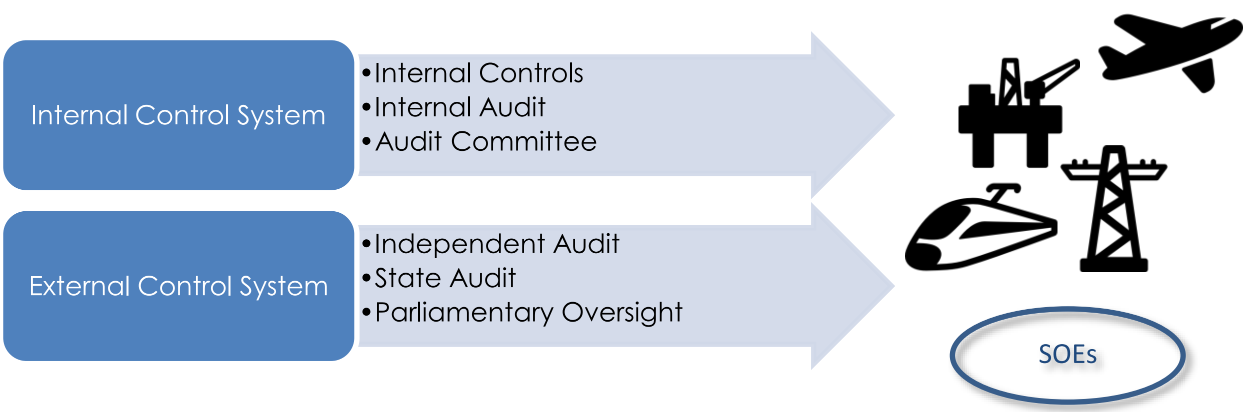
Part VI. Audit and Control Environment

91. **In the interest of the general public, SOEs should be as transparent as publicly traded private companies.** For this reason, the OECD Guidelines[32] recommend that all SOEs—regardless of their legal status, and whether or not they are listed—should report according to the internationally accepted accounting and auditing standards. This goal remains largely aspirational for most of the surveyed countries.

92. **SOEs basic control systems are often weak, and other vital parts of the control environment are not sufficiently developed to address the integrity of financial reporting and risk management systems.** As a result, the information disclosed by SOEs to the public may be inaccurate, and SOE boards and even top management may have an incomplete understanding of what is happening within the organization or of the risks it faces. In such a case, SOEs are exposed to the significant risk of misuse of funds, misrepresentation of facts, and fraud and negligence.

93. **A strong control environment consists of internal and external control mechanisms.** Internal controls are typically similar for both private and state-owned entities, while external controls for SOEs typically have an additional layer of controls as compared to private sector peers (see Figure 25).

Figure 25: SOE Control Environment



94. **Internal control lays out the foundation of checks and balances, which is a deterrence against possible unfair practices and fraud.** Internal control systems are designed to ensure the integrity and reliability of financial statements and nonfinancial reporting, as well as compliance with the law and with internal policies and procedures. The internal control system is designed to identify, evaluate, and manage (but not necessarily eliminate) significant risks associated with the achievement of the organization's objectives.

[32] *Transparency and Accountability, A Guide for State Ownership*, OECD, 2010.

95. **External controls are built to provide reassurance to external stakeholders, including the public.** External control mechanisms take the form of statutory audits, special audits, and oversight by the country's supreme audit institution (SAI), parliamentary committees, and other regulatory bodies. Adherence to the general legal framework concerning enterprises—that is, the commercial company code, the company law, or corporate governance codes—is defined as part of external control compliance. The accounting and audit standards that SOEs are expected to comply with are also part of the external control environment.

96. **One external control mechanism can be an SOE listing on a stock exchange.** Listing can be a way to sustain the commitment to good governance and financial reporting, establishing the SOE as a peer player with the private sector, raising private capital in an open and competitive manner.

Independent External Audit

97. **It is considered good practice for SOEs to be subject to independent audits by reputable professional audit firms.** An independent external audit contributes to the credibility of the SOE's financial reporting and provides reasonable assurance to the owner, investors, and the general public that the financial statements fairly represent the company's financial position and performance. In some countries, SOEs may be subject to regular audits by a state auditor, the SAI. However, the SAI's mandate differs from an independent auditor's, and the SAI does not generally provide an independent view on the fairness and completeness of the full set of financial statements. Many SOEs are audited by both the SAI and independent external auditors, in which case duplication of tasks and responsibilities should be avoided.

98. **An independent external audit of annual financial statements is an accepted standard practice in the private sector.** Many jurisdictions require independent audits for PIEs, which usually include listed companies, banks, and other financial institutions, while other jurisdictions may require an independent external audit for a much broader range of companies. For example, EU legislation requires audits of limited liability entities, although individual member states may exempt small companies[33] from a requirement to have their financial statements audited. The main reason for requiring such audits is the central role that financial information plays in informing a wide array of economic agents and public bodies and in helping investors and stakeholders hold the management of audited companies accountable for their actions and performance.

99. **Independent audit offers some level of additional protection to stakeholders who rely on the financial information**, although it does not provide a guarantee against erroneous or fraudulent reporting. An external audit can also be beneficial to management by providing useful insights into a company's main risk areas and by pointing to weaknesses in internal controls and the reporting process. For large companies with a broad geographical presence and multiple business units, external auditors normally cover those business areas that present the highest risks, providing useful information on risks of which the company's management may be unaware. Having an independent audit of an SOE is equally beneficial.

[33] As defined by the EU Accounting Directive.

100. Several key issues need to be considered to ensure that the state, minority shareholders, and other stakeholders derive the maximum benefits from SOE independent audits:

- **Equal requirement for private and state-owned entities:** In all aspects of financial reporting and external audit, economically significant SOEs should be governed by the same rules and procedures as equivalent PIEs in private ownership. For example, if private sector PIEs are required to have their financial statements audited in line with International Standards on Auditing (ISA), the same requirement should apply to economically significant SOEs.

- **Audit quality and regulations:** SOE auditors should fall under the same regulatory and professional framework as auditors of listed companies and banks. The framework should include requirements relating to external quality assurance, qualifications, ethics, and independence.

- **Reasonable assurance, not a complete verification:** External auditors cannot guarantee the accuracy of financial statements produced by SOE management. The role of external auditors is to provide "reasonable assurance" that the financial statements are free from material misstatement.

- **Publication and disclosure:** The independent auditor's report should be published together with the complete set of the SOE's financial statements and accompanying notes.

- **SOE boards' communication with external auditors:** Financial reporting and audits should be subject to continuous scrutiny by SOEs' boards and their audit committees, as well as by ownership agencies.

101. SOE boards and their audit committees play a key role in overseeing the selection and appointment of external auditors, and the audit process itself. Thus, SOE management is not directly involved in appointing an auditor—which would be a conflict of interest—and has limited opportunity to exercise undue influence over the auditors. This practice ensures clear lines of responsibility for managing the audit process within the SOE's own governance structure. The audit committee's key role is to maintain the auditor's independence from the SOE's management. To do this, the committee may have to set out guidelines on what non-audit services an audit firm may supply to the SOE. During the audit process, an audit committee should have direct communications with the external auditor and meet with the external auditor without the company management. Ideally, an audit committee should discuss the draft audit report with the auditors, and after the report is agreed, it can be finalized and presented to the SOE's board and ownership entity.

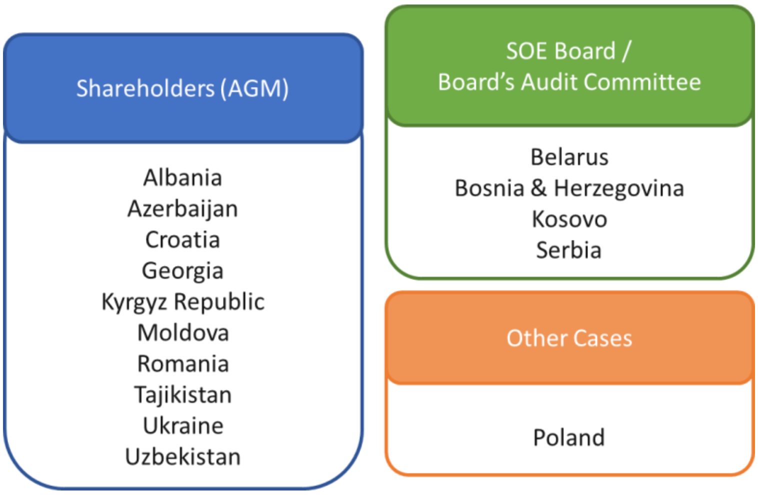
102. The Survey indicates that most of the participating countries have weaknesses in their audit and control environment for SOEs. While many responding countries mandate that their SOEs subject their financial statements to annual audits by independent auditors, the quality of these audits is often suboptimal. The selection of auditor is too often based on the lowest price rather than on qualitative requirements, leaving room for questions about the quality of the audit. An assessment of audit quality was not part of this Survey; however, multiple in-country technical assistance projects implemented by the World Bank indicate that audit quality remains an issue in many ECA countries. The Survey found that some countries develop quality and capacity criteria or even create special lists of eligible audit firms to audit SOEs. Such an approach can help ensure that only auditors with appropriate qualifications, experience, and capacity are admitted to audit SOEs. To strengthen the control environment further, surveyed countries could require their major SOEs to establish board-level audit committees that would scrutinize audit results and ensure measures to remove internal controls weaknesses.

103. The analysis confirms that all surveyed countries subject their SOEs to independent audits by corporate sector auditors, but this requirement is not universally applicable for unincorporated SEs. In Azerbaijan, Croatia, and Moldova, the legislation prescribes in detail which SOEs are subject to annual audits. Typically, they are the SOEs that fall under the PIE definition or are simply listed by name in the secondary legislation. Most of the other surveyed countries require annual independent audits for all corporatized SOEs, all listed SOEs, or all majority-owned SOEs.

104. Most of the surveyed countries have the same licensing and certification requirements for all auditors, including those that are admitted to audit SOEs. These eligibility requirements include requirements for individuals—for example, education, years of experience, and qualification or certification, and to be in good standing. There are also criteria for audit firms, such as licensing or listing in the registry. In addition to the general requirements applicable to all auditors, some countries (Moldova, Ukraine) set specific criteria for audit firms that are eligible to audit significant SOEs, including experience requirements and capacity in terms of staff. Since 2016, in line with the EU legislation change, several surveyed countries (Albania, Bosnia and Herzegovina, Georgia, Kosovo, Moldova, Poland, Romania, Serbia, and Ukraine) have amended their audit legislation to harmonize requirements for all audit firms and introduce a tiered approach: (i) clear criteria for auditors of private and state-owned PIEs, including audit quality requirements and regular audit inspections by the audit regulator; and (ii) more relaxed criteria for those auditing non-PIEs.

105. The final authority to appoint and dismiss auditors of SOEs varies among the surveyed countries. Good practice is for external auditors to be appointed by the shareholders, with the board making recommendations. A similar practice should be applied to the approval of the remuneration of the external auditors, as well as their reappointment or removal. Many of the surveyed countries have followed these good corporate governance practices and vested in the AGM the authority to approve external auditors' appointment and remuneration (see Figure 26). Some countries have vested this authority in the board or its audit committee. Two countries among those surveyed—Moldova and Romania—have assigned this responsibility to either the SOE board or the AGM, depending on the legal form of the individual SOE.

Figure 26. Authority to Approve External Auditors



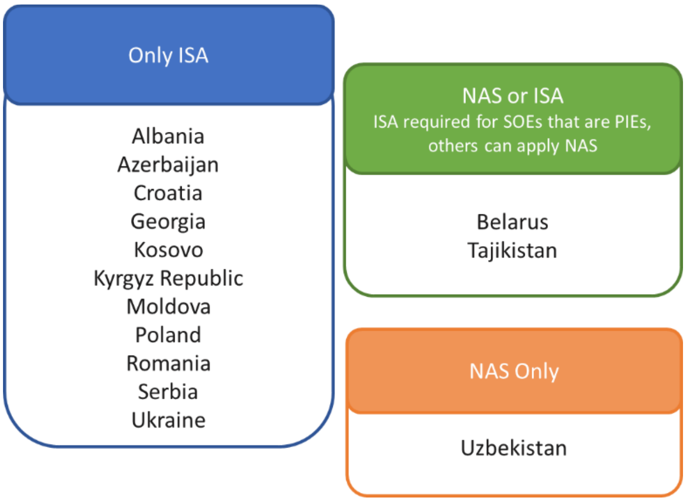
106. **Poland, among the surveyed countries, took a different approach to appointing the external auditors.** The Accounting Act provides that the external auditor should be appointed by the corporate governing body that approves the company's financial statements. The legislation does not spell out which governing body that is, and it allows an individual company charter to provide otherwise and establish this governing body. In practice, in many companies, including SOEs, external auditors are usually appointed by the board of directors. At the same time, the Accounting Act prohibits a company's management from selecting an external auditor.

107. **The selection of the external auditor should be a transparent process that relies on a combination of qualitative requirements and a price, and it should be free of undue management involvement.** Many surveyed countries confirmed that they use open public tender for selecting external auditors for SOEs: Bosnia and Herzegovina, Croatia, Georgia, Kyrgyz Republic, Moldova, Poland, Romania, Serbia, Tajikistan, Ukraine, and Uzbekistan. Several countries have established a list of criteria for audit firms that are admitted to audit SOEs, so that tendering is performed only among the preapproved auditors (Uzbekistan) or against established criteria (Moldova). The Survey finds that in many participating countries SOE management still has significant involvement in selecting an external auditor—an approach that is out of line with accepted good practice. Phasing out this practice would help to ensure auditors' independence and their unbiased view of SOEs' financial statements.

108. **SOEs in all surveyed countries, except Moldova, must comply with public procurement legislation in selecting an external auditor.** This legislation varies among countries. Some advanced frameworks allow a combination of qualitative and price components to inform their selection, but others rely on the least-cost method. Use of the least-cost method in selecting SOEs' external auditors is driven by (i) interpretation of public procurement laws and their application for selecting SOE external auditors; and (ii) limited understanding by those charged with governance about the value that external audit provides to SOEs. A consequence of using the lowest quote as the key selection criterion is that little consideration is given to the quality of bidders, including through a detailed review of audit teams' experience and capacity. This results in poor quality and low value of audits and thus weak accountability of SOEs.

109. SOEs should be subject to the same internationally accepted standards as their private peers—for external audits, the ISA. All surveyed countries recognize the importance of internationally recognized standards by adopting the ISA as their legislated auditing standards (see Figure 27). Some countries (Belarus and Tajikistan) allow the use of ISA along with their national standards on auditing. Uzbekistan is the only country among those surveyed that applies national auditing standards, developed on the basis of earlier versions of ISA. All respondents stated that auditing standards are the same for SOEs as for listed entities.

Figure 27. Auditing Standards Adoption



110. It should be noted that the surveyed countries have made or plan to introduce significant amendments and reforms of their audit legislation. For example, Romania and Ukraine amended their audit legislation in 2017, aligning it to the EU Audit Directive[34] and adopting ISA as the single set of auditing standards. Uzbekistan introduced ISA by President's Resolution in 2018, but it will take effect in 2020. Belarus adopted ISA in 2019, legislating the application of ISA for the audit of IFRS-based financial statements. As a result, Belarus now uses ISA alongside the national auditing standards.

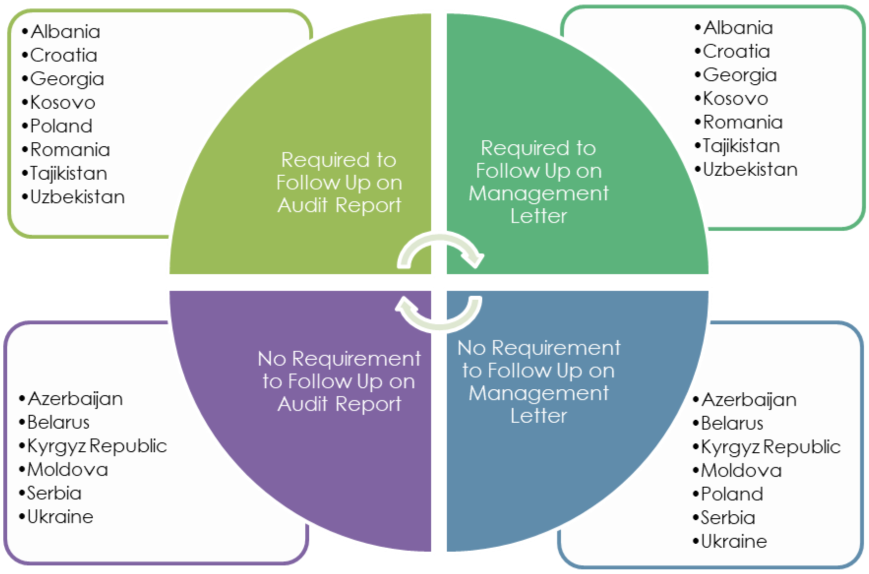
111. To maximize the benefit of external audit, it is important for any company, including SOEs, to analyze and act on the results of audits. When the external auditor's report uncovers deficiencies in an SOE's financial statements, internal controls, or risk management systems, these deficiencies should be remedied. The board's audit committee or the board itself needs to be aware of these deficiencies and the auditor's recommendations and to discuss remediation steps with the SOE's management. SOE ownership agencies also need to be aware of these deficiencies and ensure that SOE management takes appropriate action to correct such weaknesses.

112. The Survey found that mechanisms for proper follow-up on audit results by SOE boards and their ownership entities are often missing or weak. In many surveyed countries, there is no basic information on the number of unqualified and qualified audit reports, and there are no systematic reviews of SOEs' audit reports. Ownership entities and boards often do not receive management letters reporting on the weaknesses of major internal controls. Hence, SOE boards are not aware of, and do not require SOE management to follow up on, audit

[34] Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014.

qualifications from audit reports or issues raised by auditors in management letters. Figure 28 illustrates the legislative requirements for follow-up actions by SOE boards and ownership entities, though the actual implementation of these functions on the ground appears poor.

Figure 28. Audit Follow-up Requirements



113. **Information on audit findings, including the number of clean or unqualified opinions, is not widely available in surveyed countries.** The Survey found that only Croatia, Georgia, Kosovo, and Romania kept track of their SOEs' audit reports by category: unqualified, qualified, disclaimer, or adverse. Those countries that collect and analyze audit reports note a significant number of qualified reports and disclaimers of opinion. This fact should raise significant concerns over SOEs' accountability among policymakers and ownership entities. This Survey identified a scattered approach toward analyzing and responding to the audit findings: ownership entities in the surveyed countries undertake little scrutiny of audited financial information and do not have a rigorous monitoring and enforcement system, which would promptly flag and follow up on audit qualifications and on internal control issues raised in auditors' management letters. Addressing this area of financial oversight and control would help improve SOEs' accountability.

Internal Audit

114. Internal audit is an essential component of a company's internal control system that contributes to the company's success by enhancing the quality of corporate governance. Internal audit also improves the company's control and monitoring environment and mitigates the risk of fraud. Internal audit is an independent, objective assurance and consulting activity designed to add value to and improve a company's operations. It helps an organization accomplish its objectives by bringing a systematic and disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes.[35]

115. All significant SOEs should have internal auditors that report to the board-level audit committee or directly to the board, if there is no audit committee. This reporting line is very important in ensuring internal auditors' objectivity and ability to provide key information to the board. The internal auditors may have an implicit administrative link to management, but the board, with the support of the owners, is ultimately responsible for the independent operation of the internal auditor.

116. Internal auditors should organize their work using relevant standards—that is, standards issued by the Institute of Internal Auditors. These standards advise that internal auditors should place particular emphasis on monitoring the SOE's control systems. They should also evaluate risk exposures related to SOEs' governance, operations, and systems—for example, the reliability and integrity of financial and operational information, the effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws, regulations, procedures, and policies.

117. The internal auditor should evaluate the effectiveness of the SOE's risk management and assess how information on risk and controls travels through the SOE. These are wide-ranging responsibilities, and the internal auditor should work with the audit committee to set priorities and develop an audit plan. This plan should take into account the internal auditor's need to be responsive when a serious conflict of interest or a control failure occurs. In addition, internal auditors should typically be able to carry out ad hoc investigations at the request of the audit committee and board.

118. The Survey finds that the internal control systems in the SOEs of the surveyed countries are often weak, and internal audit functions rarely exist and are often not required by legislation. Only five of the surveyed countries have legislative requirements for SOEs to set up an internal audit function (see Figure 29). Some countries do not have a legislative requirement, but the largest SOEs follow good practice and establish internal audit in practice. In other countries a so called "censors" or "revision" committee is required, but the subordination, operations, and standards used by such committees are not clear; therefore, such committees offer limited value to safeguard controls in SOEs. Many countries noted a lack of guidance and weak implementation, which combined would have an adverse impact on the design and function of internal controls in SOEs.

[35] *About internal auditing*, Institute of Internal Auditors, Global, 2019, https://global.theiia.org/about/about-internal-auditing/Pages/About-Internal-Auditing.aspx.

Figure 29. Legislative Requirement to Establish Internal Audit

Yes	In Some Cases	No
• Albania • Azerbaijan • Croatia • Kosovo • Romania	• Kyrgyz Republic • Ukraine • Uzbekistan	• Belarus • Georgia • Moldova • Poland • Serbia • Tajikistan

119. The Survey indicates that among the participating countries the requirement and practice of establishing the internal audit function are mixed:

- **Required:** Some countries require SOEs to establish an Internal audit function.
- **No requirement**: Belarus, Moldova and Tajikistan do not have legislative requirements to establish internal audit. Georgia, Poland, and Serbia do not require the establishment of internal audit, but larger SOEs set up an internal audit function voluntarily.
- **Other cases:**
  - Kyrgyz Republic requires corporatized SOEs to establish revision committees, while unincorporated SEs must appoint an internal auditor reporting to the SE's general director or chief executive officer.
  - Ukraine requires its listed SOEs to establish a proper internal audit function that reports to the board. The internal audit function in non-listed SOEs is performed by dedicated audit teams that report to line ministries.
  - Uzbekistan mandates that SOEs that are joint stock or limited liability companies establish internal audit, but it has no requirement for unitary unincorporated SEs.

120. The subordination of the internal audit function is often vague and imprecise in the surveyed countries (see Figure 30). Modern corporate governance practice requires the board, either directly or through a board audit committee, to assume responsibility for reviewing the system of internal controls established by management. This oversight is important both for ensuring the effectiveness of the controls and for acting as a check on improper behavior by management.

Figure 30. Internal Audit Reporting Line

- **Board of Directors:** The subordination of internal audit to SOEs' boards or their audit committees was identified by Azerbaijan, Georgia (voluntary), Kosovo, Poland (voluntary), Romania, Serbia (voluntary), Ukraine, and Uzbekistan. Such subordination is in line with good corporate governance practices.
- **Management:** Albania is the only surveyed country that subordinates internal audit function to SOE management—a practice that impairs internal audit independence as it limits the ability to evaluate management's judgment and established internal controls.
- **Other cases:**
    - Kyrgyz Republic requires the establishment of revision committees that are accountable to the CEO rather than the SOE board.
    - Croatia subordinates the internal audit function to SOE management if companies have no board of directors. Where there is a board, internal auditors should report directly to the board.

121. **Because internal audit helps improve SOEs' governance, risk management, and management controls, it should be properly mandated and continuously strengthened.** A robust internal audit system is well connected in and informed about the organization. If properly structured and staffed with skilled professionals, it can provide insights and recommendations based on analysis and assessments of data and business processes. It can communicate relevant information and the latest developments to different stakeholders for informed decision-making and effect change by showing the management that action is necessary, appropriate, and urgently required. Therefore, SOE ownership entities would benefit from improving SOEs' internal audit framework, ensuring proper funding, and continuously building capacity.

State Audit

122. The mission and mandate of state auditors are usually very different from those of independent external auditors and vary from country to country. External auditors focus on the proper application of financial reporting standards and verify that reporting systems provide reasonable assurance that the financial statements are free from material misstatement. The state auditor typically seeks to verify the legality of SOEs' expenditures and make certain that SOEs comply with the budget—functions that are somewhat similar to those of the internal auditor or internal control.

123. Governments may introduce specific state control or inspection procedures, in addition to independent external audit of SOEs or, in some cases, as a substitute for external audit. An SAI often has extensive powers in terms of access to documents, premises, and the staff of SOEs to supervise the quality of financial management and accountability. This is the case for the Court of Audits in the Netherlands[36] and Federal Court of Auditors in Germany.[37] In some countries, the SAI performs the financial audit of the annual accounts of certain public sector entities—for example, the Comptroller and Auditor General in the United Kingdom and the Office of the Auditor General in Norway. More examples of the mandates and functions of state auditors towards SOEs are provided in Annex F.

124. All surveyed countries empower their SAI with the right to audit or inspect SOEs. In some countries these audits are required annually (Kosovo), in others only if SOEs receive or spend public funds (Georgia, Ukraine). In the majority of surveyed countries, SAIs primarily carry out specific thematic or performance audits of SOEs. In several countries—among them Albania, Poland, Romania, and Serbia—SAIs define their own work program, independently identify the SOEs they will audit, and determine the scope and timing of such audits. In Croatia the SAI can perform financial or performance audits, and it applies a risk assessment approach in selecting SOEs to audit. In line with good practice, in most surveyed countries the SAI has a right to perform SOE audits, but this is not a substitute for independent financial audits of SOEs. The only exception is Albania, which allows its SOEs to substitute the SAI's financial audit for an independent audit.

Parliamentary Oversight

125. As representatives of their citizens, parliaments have the responsibility to protect the interests of the public through oversight of SOE executives. Through this oversight function, parliaments can hold the government accountable and ensure that policies are efficient and in keeping with the needs of the public. To do this, parliaments need to scrutinize the functioning of SOEs, either directly or through specialized parliamentary committees.

126. Parliaments can exercise their oversight role by scrutinizing the financial performance of SOEs. Parliamentary oversight should include analyzing SOE reports and conducting site visits to verify whether projects discussed in the reports exist and whether those projects benefit the public. Parliaments' focus should be mainly on financial matters presented in the SAIs' audit reports, which should be included in the annual report to the parliament. Parliaments and their specialized parliamentary committees must work with SAIs to enhance effective oversight of and accountability for SOEs, ensuring that the public receives quality service and value for money.

[36] The Government Accounts Act 2001.
[37] The Federal Budget Code 1969 and the Budgetary Principles Act 1969.

Part VII. Survey Conclusions and Reflections

127. To conclude, many countries in the ECA Region are working to reduce SOEs' footprint in their economies by improving the legislative frameworks and strengthening SOE ownership and oversight functions. However, they face difficulties in balancing the roles of a state as an owner and as a regulator of SOEs, and in improving accountability systems and ensuring transparency.

128. This Survey confirms and acknowledges the significant progress that participating countries have achieved in strengthening SOE corporate governance frameworks. Going forward, the governments may wish to give closer attention to improving the existing SOE frameworks in the following areas:

- Building centralized mechanisms for SOEs reporting, monitoring, and oversight;
- Corporatizing state entities that remain in unincorporated status (state enterprises), subjecting them to similar corporate requirements as other legal forms of SOEs;
- Instilling corporate governance requirements to all corporate SOEs;
- Legislating proper authority and mandate to SOEs' boards of directors;
- Supporting the process to professionalize and increase the independence of SOE boards;
- Establishing stronger accountability for SOE management by subordinating their appointment and dismissal to SOE boards;
- Strengthening the oversight over financial performance and discipline of SOEs via skilled audit committees, while also
- Increasing SOEs accountability via rigorous financial reporting and disclosure requirements.

129. Taken together, stronger corporate governance measures will over time contribute to a range of benefits: increased efficiency of SOEs; a more efficient allocation of resources by reducing the fiscal burden and fiscal risk of SOEs; greater public and private investment in critical sectors such as infrastructure that contribute to competitiveness and growth; reduced vulnerabilities in the financial system; and increased resilience to crisis.

130. As this Survey was being finalized, the world entered into the COVID-19 pandemic, the effects of which are only beginning to emerge. It is clear that the outbreak has put the entire public sector under extraordinary stress; public institutions are on the front lines of managing the crisis, providing health care, and ensuring public security. Moreover, the public purse comes under particular strain because of emergency expenditures, decreasing tax revenues, and the introduction of fiscal stimulus and social programs. Governments need to deliver more, with less, under unusually high public expectations and scrutiny. The evolving crisis suggests that SOE ownership may be significantly affected by SOEs' ability to withstand the pandemic: some SOEs might be closed or restructured, and it is also possible that governments may need to nationalize certain entities that are critical for countries' economies, thus increasing the state's share in their economies.

131. Many SOEs were called to respond to the crisis following governments' decisions to provide essential services with significant waivers or by channeling substantial subsidies. SOEs operating in public services sectors were requested to continue providing services even if users accumulate debts or fail to pay basic service fees during the emergency, causing significant financial distress to the SOEs. SOEs that are engaged in manufacturing medical supplies and medications were called to significantly increase their production. Many countries opted to provide substantial financial support to critical SOEs in essential sectors to ensure uninterrupted service. This support requires conditionality and careful monitoring to measure the impact. This increased scrutiny can only be possible if SOEs are held accountable for the use of funds, including through improved corporate governance practices, financial and service delivery performance, and fiscal risk management.

132. COVID-19 truly exposed the need for SOEs to strengthen their corporate governance policies and increase their accountability. The support governments provided to SOEs should ensure that they emerge as stronger public entities that serve their purpose of providing the essential services that citizens require, but also contribute to the post-crisis recovery with stronger fiscal and risk discipline and improved corporate governance.

Annex A. Survey Data Sources

1. **This report is based on data collected through a survey of the responding countries.** The Survey was conducted during 2015-2017 and included six groups of questions, reflected in the chapters of this publication: (i) number of SOEs, their revenues, and employment (excluding financial sector); (ii) legal and regulatory framework questions; (iii) state ownership arrangements and model; (iv) corporate governance frameworks; (v) financial reporting and disclosure practices; and (vi) audit and control environment details.

2. **The first surveyed countries were developing economies from the ECA region:** Albania, Georgia, Kosovo, Moldova, Romania, Serbia, Tajikistan, Ukraine, and Uzbekistan. Later, the team added more countries based on in-country analytical work performed by World Bank teams: Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Kyrgyz Republic, and Poland. As benchmarks the team used several countries that were selected for their good practices in SOE ownership, oversight, and corporate governance: Germany, Lithuania, Norway, and Sweden. The team used publicly available information for the participating countries to validate, reconcile, and update the results of this Survey. The presented dataset covers multiple periods between 2015 to 2018, processed and analyzed by the team during 2019.

Country	Survey (2015-2017)	Public resources (2016-2018)	World Bank analytical work and analysis
Albania	✓		✓
Azerbaijan		✓	✓
Belarus		✓	✓
Bosnia & Herzegovina		✓	✓
Croatia		✓	✓
Georgia	✓	✓	✓
Kosovo	✓	✓	
Kyrgyz Republic		✓	✓
Moldova	✓	✓	✓
Poland		✓	✓
Romania	✓	✓	
Serbia	✓	✓	✓
Tajikistan	✓		✓
Ukraine	✓	✓	✓
Uzbekistan	✓	✓	✓
Germany		✓	
Lithuania		✓	
Norway		✓	
Sweden		✓	

Extensive use was made of the aggregate SOE Ownership Reports that are publicly available for Croatia, Germany, Lithuania, Moldova, Norway, Poland, Sweden, and Ukraine.

Annex B. Role of Ownership Entities in Key SOE Functions: Who Does What?

	Setting SOE governance policies	Appointing boards of directors	Appointing senior management	Approving major SOE decisions	Setting SOE objectives	Legal owner of SOE shares	SOE performance monitoring
Primarily Decentralized Model							
Azerbaijan	President's Office Cabinet of Ministers Line ministries State Service[43]	Cabinet of Ministers Line ministries	Line ministries	Line ministries SOEs	President's Office Cabinet of Ministers Line ministries	State Service	Line ministries
Belarus	President's Office Line ministries State Property Committee	SOE: Annual General Meeting (AGM): Line ministries State Property Committee SE: Line ministries	SOE: Annual General Meeting (AGM): Line ministries State Property Committee SE: Line ministries	Line ministries State Property Committee	Line ministries State Property Committee	State Property Committee	Line ministries State Property Committee
Bosnia and Herzegovina	Government Line ministries	Government Line ministries	Board of Directors	Government Line ministries	Government Line ministries	Government Line ministries	Government Line ministries
Romania	Parliament Cabinet of Ministers Line ministries	Annual General Meeting (AGM) Line ministries	Board of Directors Line ministries	AGM Board of Directors Cabinet of Ministers Line ministries	AGM Line Ministries Ministry of Finance	Government via Line ministries	AGM Cabinet of Ministers Line ministries Ministry of Finance
Tajikistan	Line ministries	No info	Line ministries	Line ministries	Line ministries	State Committee on Investments and Management of State Property	Line ministries Ministry of Finance

[43] From October 2019 Azerbaijan Committee on Property Issues became State Service on Property Issues, part of the Ministry of Economy.

	Setting SOE governance policies	Appointing boards of directors	Appointing senior management	Approving major SOE decisions	Setting SOE objectives	Legal owner of SOE shares	SOE performance monitoring
Uzbekistan	State Assets Management Agency (SAMA) Line ministries	Annual General Meeting (AGM): Government Line ministries SAMA	Board of Directors Line ministries SAMA	Board of Directors Line ministries SAMA	AGM: Government Line ministries SAMA	SAMA Line ministries	SAMA SOE management
Primarily Dual Model							
Albania	Ministry of Finance and Economy (MOFE) or Line ministry	MOFE or Line ministry	MOFE or Line ministry	MOFE or Line ministry	SOE Line ministry	MOFE or Line ministry	MOFE or Line ministry
Croatia	7-yr strategy: Ministry of Physical Planning, Construction and State Assets drafts, Government proposes, Parliament approves	Ministry of Physical Planning, Construction and State Assets proposes, Commission appoints	Commission	Ministry of Physical Planning, Construction and State Assets, Line ministries provide opinion, Commission approves	Ministry of Physical Planning, Construction and State Assets Commission Line ministries	Ministry of Physical Planning, Construction and State Assets on behalf of Government	Ministry of Physical Planning, Construction and State Assets
Georgia	National Agency for State Property (NASP) Line ministries Partnership Fund (PF)	NASP Line ministries PF	Board of Directors (if exists) Line ministries	Board of Directors (if exists) Line ministries	Line ministries PF	NASP Line ministries PF	NASP Line ministries PF
Kyrgyz Republic	Ministry of Economy State Property Management Fund (SPMF)	SOE: Government Committee SE: N/A	SOE: Government Committee SE: Line ministries	SOE: AGM SE: Line ministries	SOE: Board of Directors SE: Line ministries	SPFM	Line ministries SPFM
Moldova	Public Property Agency (PPA) Ministry of Economy	SOE: Annual General Meeting (AGM) SE: PPA	SOE: AGM SE: PPA	SOE: AGM or Board of Directors SE: PPA	AGM or Board of Directors	PPA	PPA Ministry of Finance

	Setting SOE governance policies	Appointing boards of directors	Appointing senior management	Approving major SOE decisions	Setting SOE objectives	Legal owner of SOE shares	SOE performance monitoring
Poland	Prime Minister[44]	Ministry of State Assets Line ministries	Ministry of State Assets Line ministries	Annual General Meeting Board of Directors	Board of Directors	Ministry of State Assets Line ministries	Board of Directors Ministry of State Assets Line ministries Prime Minister
Serbia	Ministry of Economy	Government	Government via public competition process	Board of Directors	Board of Directors	Government	Line ministries
Ukraine	Cabinet of Ministers Line ministries, Ministry of Economic Development and Trade, Parliament (sometimes)	Annual General Meeting (AGM) Line ministries	Line Ministries via Board of Directors Cabinet of Ministers via competition process for largest SOEs	AGM or Board of Directors	Line ministries via AGM representation Ministry of Finance	State Property Fund of Ukraine Line ministries	Line ministries via AGM Ministry of Economic Development and Trade Ministry of Finance
				Primarily Centralized Model			
Kosovo	Government, via Ministry of Economic Development (MoED)	Government (via MoED)	Board of Directors	Board of Directors	Board of Directors	Government (via MoED)	Government (via MoED)

[44] SOE ownership arrangements in Poland changed from 2017. The Ministry of Treasury of Poland was liquidated, and the SOE ownership model changed, as SOE oversight was assigned to appropriate sectoral ministries under the general oversight of the Prime Minister. Starting December 2019, the new Ministry of State Assets was established and is taking over the centralized oversight function over the largest SOEs. As of the date of this survey, it is too early to tell if Poland has transitioned back to the centralized system.

Annex C. SOE Ownership Models among Surveyed Countries

Decentralized Model Countries

Azerbaijan

SOE management and ownership functions in Azerbaijan are dispersed among the Cabinet of Ministers, line ministries, and the Ministry of Economy via the State Service on Property Issues. This decentralized model gives most ownership functions to the line ministries, including setting policies and objectives and the appointment of board members and CEOs. With respect to the largest SOEs in the country, line ministries receive recommendations and advice from the President's office and the Cabinet of Ministers.

The State Service on Property Issues is the legal owner of the SOEs on behalf of the state. Its powers include mainly changes to the SOEs charter documents, approval of changes to SOEs' capital structure, representation at SOE boards, processing of SOEs' privatization, restructuring, and post-privatization monitoring. The Ministry of Finance and Ministry of Economy are involved in and provide their input to the approval of major decisions and performance monitoring of SOEs.

The Azerbaijan Committee on Property Issues ceased to exist in October 2019, when it became part of the Ministry of Economy, changing its status to an Agency. As of the date of this Survey, the structure and charter of the State Service on Property Issues are not approved; therefore, it is too early to say if this will lead to a change in Azerbaijan's SOE ownership model.

Belarus

Belarus continues to rely on a decentralized SOE ownership model, under which shareholders' functions are spread among the line ministries and the State Property Committee. The legal owner of SOE shares and the founder of SEs is the State Property Committee or, for municipal SOEs and SEs, the local authorities.

The operational control and oversight of these shares is delegated to the line ministries, which control key ownership functions over SOEs in Belarus and have the greatest responsibility for exercising the Government's ownership rights. In addition, several SOE "concerns" (associations of SOEs in a few key sectors) are operating similarly to the line ministries without ministry status.

Boards of Directors are required only for corporate SOEs and are appointed by the AGM based on nominations from the Council of Ministers, line ministries and the State Property Committee. The Ministry of Finance and Ministry of Economy can also nominate board members. SOE managements are appointed either by the AGM or by the Board of Directors, which in practice disconnects the board from this critical decision. In theory, the approval of SOE objectives and major decisions also rest with the board; in practice, however, these functions are performed by the line ministries. SOE performance monitoring is dispersed among the line ministries and the State Property Committee, with no single agency analyzing the entire SOE portfolio. Belarus lacks coordination channels that would allow the Government to streamline the agencies' supervision mandate.

Bosnia and Herzegovina

SOE ownership and oversight functions are carried out by multiple government agencies in both the Federation of Bosnia and Herzegovina and the Republika Srpska—by the Ministries of Finance and several line ministries. The same ministries are also responsible for setting governance policies and objectives for the centrally owned SOEs.

Members of the Boards of Director are nominated by responsible line ministries and approved respectively by the cabinets of the Federation of Bosnia and Herzegovina and the Republika Srpska. Boards are responsible for SOE management appointments.

SOE performance is monitored by the line ministries, creating dual reporting lines. This system dilutes SOE accountability and hinders the Governments' ability to evaluate SOE portfolio-level risks and performance red flags.

Romania

In Romania, the state ownership function is distributed among a number of government entities:

- Setting SOE governance policies is driven and influenced by the Cabinet of Ministers, line ministries, and the Parliament.
- Appointment of Board directors is the responsibility of line ministries; however, this is expected to change.
- Monitoring of SOE performance is technically assigned to the Ministry of Public Finance; in practice, however, line ministries play an important role through their representatives at the AGM.

Tajikistan

Tajikistan follows the decentralized ownership model, with line ministries playing the leading role in SOE functioning.

- Most ownership functions are assigned to the State Committee on Investment and Management of State Property. In practice, however, its role is rather limited.
- Line ministries continue playing the main role in most of the ownership functions, including setting up SOE objectives, appointing senior management, and approving major decisions.
- SOE performance monitoring was centralized under the Ministry of Finance's Department for SOE Monitoring, which analyzes SOEs performance and assesses the fiscal risks of the 24 largest SOEs in Tajikistan.

Uzbekistan

In Uzbekistan, a number of Government entities exercise shareholder rights on behalf of the state. The main functions are performed by line ministries and the State Assets Management Agency (SAMA):

- Setting of SOE governance policies is the responsibility of the SOE founder, but mainly of SAMA and line ministries. There seems to be no overarching governance policy that applies to all or some SOEs.

- Most of the SOE ownership functions are performed by the ownership agency, either through the AGM or by the Board of Directors. The AGM appoints the Board and sets SOE objectives, while the Board is responsible for appointing senior management and approving major SOE decisions.
- SAMA is responsible for coordinating with other Government bodies the voting instructions for Government representatives who sit on supervisory boards and the AGM. Such coordination is required only for larger SOEs, for which the Government holds a significant percentage of shares, or for major decisions.

Uzbekistan is transitioning from a decentralized to a dual model, while undertaking an ambitious reform of its massive SOE sector. In this transition, operational management and oversight over SOEs is still performed by the line ministries. At the same time, the ownership function is gradually being transferred to SAMA, which is working on building a proper corporate governance architecture and introducing a system of centralized financial oversight over SOEs' performance.

Dual Model Countries

Albania

In Albania, the SOE ownership is spread between the Ministry of Finance and Economy and the Ministry of Infrastructure and Energy and, for municipally owned SOEs, local governments. Starting in 2017, several SOEs have been transferred to line ministries to ensure sector expertise. These ministers are the legal owners of SOEs and are responsible for a majority of ownership-related functions, such as appointing the Board of Directors, approving major SOE decisions, and monitoring performance.

SOE Boards of Directors are responsible for setting objectives, and the line ministries contribute to this task during the strategic planning process. Boards are also responsible for appointing SOE management.

The Government collects financial information from all SOEs but does not aggregate the data. It also does not perform centralized oversight; monitoring is done at the company level.

Croatia

The Croatian Parliament is responsible for approving SOEs' four-year strategy documents, which are proposed by the Government and drafted by the Ministry of Physical Planning, Construction and State Assets.

Croatia's Ministry of Physical Planning, Construction and State Assets and line ministries share ownership and oversight of Croatian SOEs:

- The Ministry of Physical Planning, Construction and State Assets has a coordination role for SOE-related issues: it proposes measures and actions, such as appointments of Board members, and conducts performance monitoring of SOEs.
- Line ministries are responsible for providing opinions, together with the Ministry of Physical Planning, Construction and State Assets, on major SOE decisions and on proposed objectives of SOEs. Line ministries also take part in nominating representatives to the AGM and recommending Board of Directors members and SOE management.

- The Ministry of Physical Planning, Construction and State Assets undertakes centralized performance monitoring of special interest legal entities – the 39 largest and most strategically important SOEs in Croatia.

Georgia

The management and governance of SOEs in Georgia can be classified as dual. SOEs are owned and supervised by several Government agencies: (i) the National Agency of State Property under the Ministry of Economics and Sustainable Development; (ii) the extra-budgetary Partnership Fund; and (iii) several line ministries.

For the major groups of SOEs, the current system of SOE ownership in Georgia depends on their subordination to Government agencies according to the delegated authority of the ownership functions. The model can be classified as dual:

- The National Agency of State Property is the legal owner of SOEs for the Government of Georgia. With respect to the SOEs under its authority, the National Agency of State Property coordinates with the line ministries and contributes to SOEs' policies, appoints their Boards of Directors, approves capital increases and changes to their charters, and monitors and evaluates their financial performance.
- The Partnership Fund performs a similar function with respect to SOEs under its authority: dividend decisions, appointment of Boards of Directors, approval of changes to shares; and approval of sales of shares.
- Line ministries carry out the other monitoring and coordination functions with respect to SOEs that belong to the Partnership Fund, and to the SOEs under the direct mandate of the line ministries.

There is no centralized monitoring of SOE performance. The Ministry of Finance has a mandate to monitor fiscal risks stemming from SOEs, but no other Government agency has a comprehensive view of SOEs' financial standing and performance.

Kyrgyz Republic

The current ownership model in the Kyrgyz Republic is dual: oversight and governance functions are split between the State Property Management Fund and line ministries. The State Property Management Fund acts as SOEs' shareholder on behalf of the state and exercises its shareholder rights in SOEs' corporate governance, performance monitoring, and financial oversight. The line ministries handle industry policies. The Ministry of Economy sets the Government's policy toward SOE ownership and objectives.

SOEs' Boards of Directors are appointed by the special Government Committee, consisting of 17 representatives from different state bodies. Candidates for the SOE Boards of Directors should come from the pool of preselected candidates kept by the State Property Management Fund. The Boards are tasked with approving major SOE decisions and setting SOE objectives. There are no Boards for unincorporated SEs, for which all ownership and oversight functions are carried out by the line ministries. SOEs' managements are appointed by the Board, and SEs' management – by respective line ministries.

Although legislatively Kyrgyz Republic uses a dual model, in practice, many SOEs were de facto managed by their line ministries until recently. During 2017-2018, the State Property

Management Fund strengthened its SOE ownership function by implementing the corporate governance code at SOEs, centralizing financial monitoring and key performance indicator enforcement for all SOEs in the country. Line ministries kept policy and sector regulations.

Moldova

In Moldova, several bodies are engaged in different ownership-related functions with respect to SOEs: Ministry of Economy, Public Property Agency, Ministry of Finance, and line ministries. Currently, the ownership function is being centralized in the Public Property Agency, which is gradually taking over the ownership function from the line ministries. The present segregation of authority is structured as follows:

- The Ministry of Economy is responsible for setting SOE governance policies.
- The Public Property Agency is the legal owner of SOE shares and carries out the shareholders' functions of the SOEs under its mandate. As of the date of this Survey, ownership rights are being gradually transferred from the line ministries to the Public Property Agency.
- Board members are appointed by the AGM. For majority-owned SOEs, the Board must include representatives of the Ministry of Finance and Ministry of Economy.
- The executive body is appointed by the founding institution (Public Property Agency or line ministries), based on the Board's proposal.
- For SEs, the Board of Directors is appointed by the founder (Public Property Agency, once all ownership rights are fully transferred).
- Boards of Directors and the AGM are tasked with setting individual SOE objectives and approving major SOE decisions.
- The Public Property Agency and Ministry of Finance exercise monitoring functions over SOEs performance: (i) the Ministry of Finance's Financial Monitoring Department monitors the financial performance of non-corporatized state enterprises and majority-owned SOEs (exceeding 50 percent of shares); (ii) the Public Property Agency conducts financial monitoring of corporatized SOEs with 30 percent or more owned by the state.

Poland

Poland's SOE ownership model has been evolving and shifting between centralized, dual, and mixed since its market transformation in the 1990s. Starting in 2017, the centralized SOE ownership function was reassigned to the sectoral ministries, leaving general oversight with the Chancellery of the Prime Minister. Thus, Poland's SOE ownership model changed from centralized to dual.

Starting in December 2019, the new Ministry of State Assets was established to execute the shareholders' functions in SOEs on behalf of the State Treasury. The Ministry of State Assets is gradually consolidating the ownership function and introducing centralized oversight over the largest SOEs in Poland. The Ministry is now responsible for the ownership function, including setting SOE governance policy and practices, for most of the largest Polish SOEs. As of the date of this Survey, it is too early to tell whether Poland has transitioned back to the centralized system, but the indications are that the country is on track to centralize the SOE ownership function.

Boards of Directors, appointed by the Ministry of State Assets or the line ministries, continue playing a dominant role in SOE governance, including approval of major SOE decisions, setting SOE objectives, and monitoring and evaluating SOE performance.

Serbia

In Serbia the Government is ultimately responsible for most ownership-related functions: appointing Boards of Directors, managing the public competition process for appointing the chief executive officer, approving major SOE decisions, and being the legal owner of SOE shares.

Key responsibilities of SOE Boards include setting SOEs' strategic objectives, which must align with national and sectoral development plans. The Boards are responsible for major decisions related to SOE strategy and operations.

The Ministry of Economy is responsible for setting legislation and governance policies for SOEs and for monitor the development and execution of SOEs' annual business plans.

The Ministry of Finance monitors SOEs' performance and assesses fiscal risks stemming from their operations.

Line ministries are responsible for monitoring SOEs' sector-specific performance of SOEs, rarely focusing on their financial performance.

Ukraine

Ukraine is progressing from a decentralized toward a dual system, with the main ownership functions shared by the different branches of the Government:

- Setting of SOEs' governance policies is shared between the Cabinet of Ministers and line ministries, sometimes with recommendations from the Parliament.
- Setting SOE objectives and monitoring SOEs' performance is shared among the Ministry of Economic Development and Trade, Ministry of Finance, and line ministries directly or via the AGM.
- Starting in 2016 the Government applies competitive procedures to hire independent Board of Directors members and senior managers for the largest SOEs. The process is coordinated by the Cabinet of Ministers and the Ministry of Economic Development and Trade. For SOEs that are not among the largest, appointments to Boards of Directors and SOE management continue to be made by the line ministries.
- The State Property Fund of Ukraine is the legal owner of SOEs, along with line ministries.

Ukraine has launched centralized monitoring for the top 100 SOEs via publication of the annual TOP-100 report and also by launching the SOE reporting portal.[45] The portal is now in the development phase. Once fully launched, the portal will provide all key information on SOEs in the country in live format.

[45] https://prozvit.com.ua/#/

Centralized Model Countries

Kosovo

Kosovo uses a centralized model of SOE ownership. The Ministry of Economic Development is responsible for setting governance policies for and monitoring the performance of SOEs. The main functions of the state as an owner also rest with the Government of Kosovo, which is the legal owner of SOEs and exercises its rights by appointing Boards of Directors.

SOEs' Boards of Directors are in turn responsible for the rest of the ownership functions, including appointment of senior management, approval of major SOE decisions, and setting SOE objectives and monitoring their performance.

Annex D. Additional Charts on SOE Landscape in Selected Countries

Azerbaijan

The below data is prepared based on the top-15 SOEs summary and individual SOE financial reports.

Figure A. SOE Revenues per Sector (USD billion)

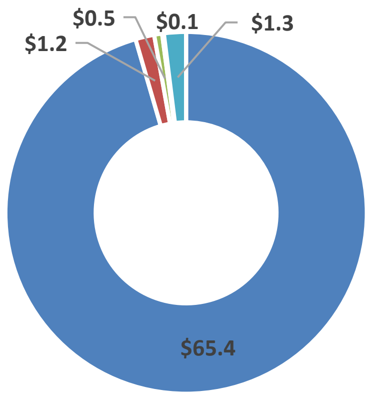


Figure B. SOE Employment per Sector (thousand)

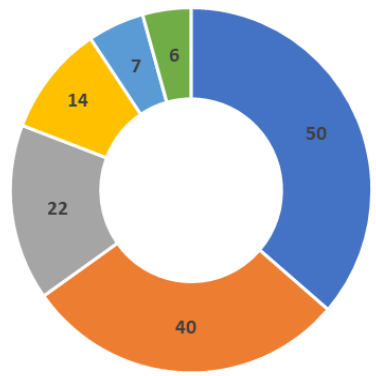


Figure C. Top Five SOEs per Revenues, 2018

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
The State Oil Company of the Azerbaijan Republic (SOCAR)	Natural Resources	$65.4	$36.6	51.1
Azerishig	Energy	$0.7	$1.3	no data
Azerenergy	Energy	$0.6	$2.2	6.0
Azeravtoyol	Infrastructure	$0.6	no data	13.4
Azerbaijan Irrigation and Water Operations	Agriculture	$0.5	$1.6	21.6

Belarus

The below data is prepared based on the annual statistical bulletin (2018) and top SOEs' individual financial statements.

Figure A. SOE Revenues per Sector (USD billion)

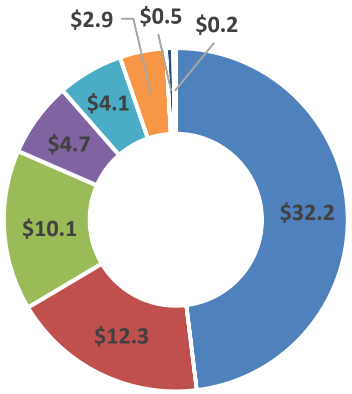


Figure B. SOE Employment per Sector (thousand)

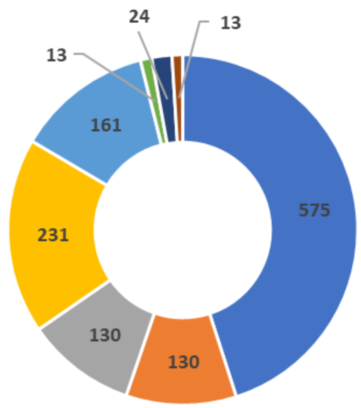


Figure C. Top Five SOEs per Revenues, 2018

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
Mozyr Oil Refinery	General Manufacturing	$4.0	$2.0	5.0
Naftan Oil Refinery	General Manufacturing	$3.7	$2.2	10.0
Gazprom Transgaz Belarus	Energy	$3.3	$1.5	6.4
Belaruskaliy (Belarus Potash)	General Manufacturing	$2.1	no data	16.3
Belarus Metallurgical Plant BMZ	General Manufacturing	$1.8	$2.2	10.9

Croatia

The below data is prepared based on the SOE annual report prepared by the Ministry of State Assets[46] (2018).

Figure A. SOE Revenues per Sector (USD billion)

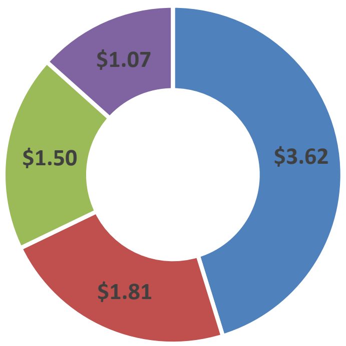


Figure B. SOE Employment per Sector (thousand)

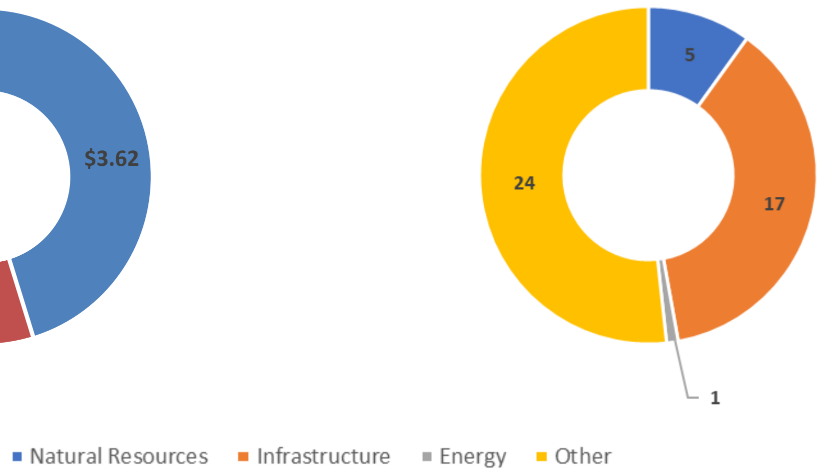


Figure C. Top Five SOEs per Revenues, 2018

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
INA – Industrija nafte d.d.	Natural Resources	$3.5	$3.3	4.2
Hrvatska elektroprivreda d.d.	Energy	$1.5	$5.5	0.5
Hrvatske autoceste d.o.o.	Infrastructure	$0.4	$6.3	2.8
Hrvatske šume d.o.o.	Other (Forestry)	$0.4	$0.4	8.1
Croatia Airlines d.d.	Infrastructure	$0.3	$0.1	1.0

[46] Succeeded by the Ministry of Physical Planning, Construction and State Assets.

Germany

The below data is prepared based on the SOE annual report prepared by the Ministry of Finance (2017).

Figure A. SOE Revenues per Sector (USD billion)

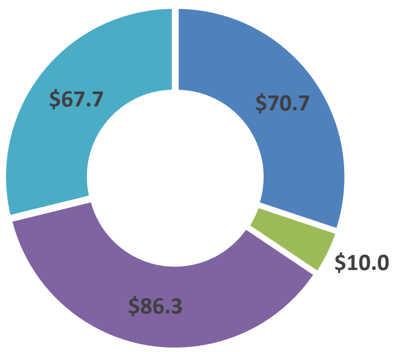


Figure B. SOE Employment per Sector (thousand)

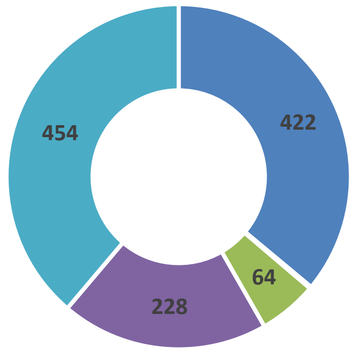


Figure C. Top Five SOEs per Revenues, 2016

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
Deutsche Telekom AG*	Other (Communications)	$86.3	$175.3	228.1
German Post AG*	Other (Communications)	$67.7	$45.2	454.0
Deutsche Bahn AG	Infrastructure	$47.9	$66.9	312.3
DB Regio AG	Infrastructure	$7.4	$8.1	21.7
DB Netz AG	Infrastructure	$6.5	$24.0	42.4

* The company is minority owned by the German State, with majority stake floating at the stock exchange.

Kyrgyz Republic

The below data is prepared based on the data published by the State Property Management Fund and SOEs' individual financial statements (2018).

Figure A. SOE Revenues per Sector (USD billion)

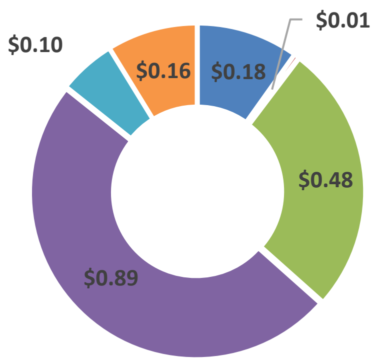


Figure B. SOE Employment per Sector (thousand)

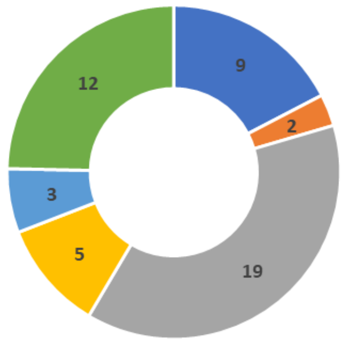


Figure C. Top Five SOEs per Revenues, 2018

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
OJSC Kyrgyzaltyn (Gold Mine)	Natural Resources	$0.8	$0.4	1.8
OJSC Electric Power Plants	Energy	$0.2	$0.8	4.6
OJSC Severelectro	Energy	$0.1	$0.2	3.0
CJSC Alfa Telecom	Other	$0.1	$0.1	1.2
SE Kyrgyz Temir Zholu (Railways)	Infrastructure	$0.1	$0.1	4.8

Lithuania

The below data is prepared based on the SOE ownership report prepared by the Governance Coordination Centre at the Government of the Republic of Lithuania (2017).

Figure A. SOE Revenues per Sector (USD billion) **Figure B. SOE Employment per Sector (thousand)**

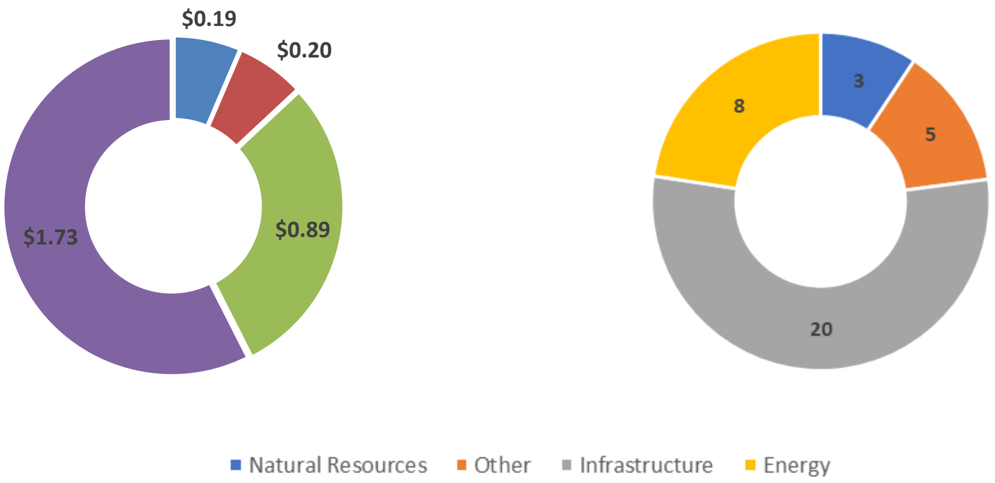


Figure C. Top Five SOEs per Revenues, 2017

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
Lietuvos energija, UAB, Group	Energy	$1.3	$3.0	4.5
AB Lietuvos Geležinkeliai Group	Infrastructure	$0.5	$2.4	10.0
UAB EPSO-G Group	Energy	$0.3	$0.9	1.0
AB Klaipėdos nafta	Energy	$0.1	$0.4	0.4
VĮ Kelių priežiūra	Infrastructure	$0.1	$0.2	2.6

Norway

The below data is prepared based on the SOE ownership report prepared by the Ministry of Trade, Industry and Fisheries of Norway (2018).

Figure A. SOE Revenues per Sector (USD billion)

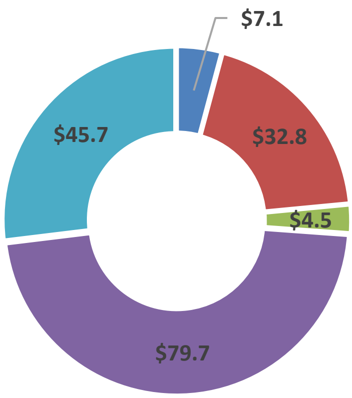
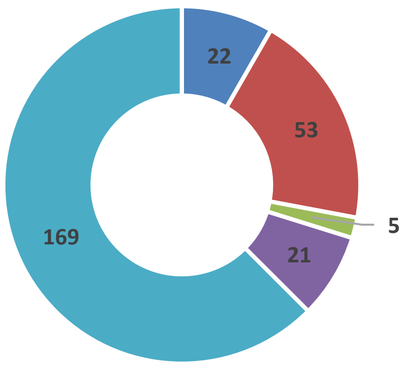


Figure B. SOE Employment per Sector (thousand)



Infrastructure General Manufacturing Energy Natural Resources Other

Figure C. Top Five SOEs per Revenues, 2018

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
Equinor ASA	Natural Resources	$79.6	$112.5	20.5
Norsk Hydro ASA	General Manufacturing	$19.7	$19.9	36.2
Telenor ASA	Other (Communications)	$13.6	$23.5	20.0
Yara International ASA	General Manufacturing	$13.1	$17.8	16.8
Helse Sor-Ost RHF	Other (Health)	$10.1	$8.4	61.1

Ukraine

The below data is prepared based on the top-100 SOE report prepared by the Ministry of Economic Development and Trade (2018).

Figure A. SOE Revenues per Sector (USD billion)

Figure B. SOE Employment per Sector (thousand)

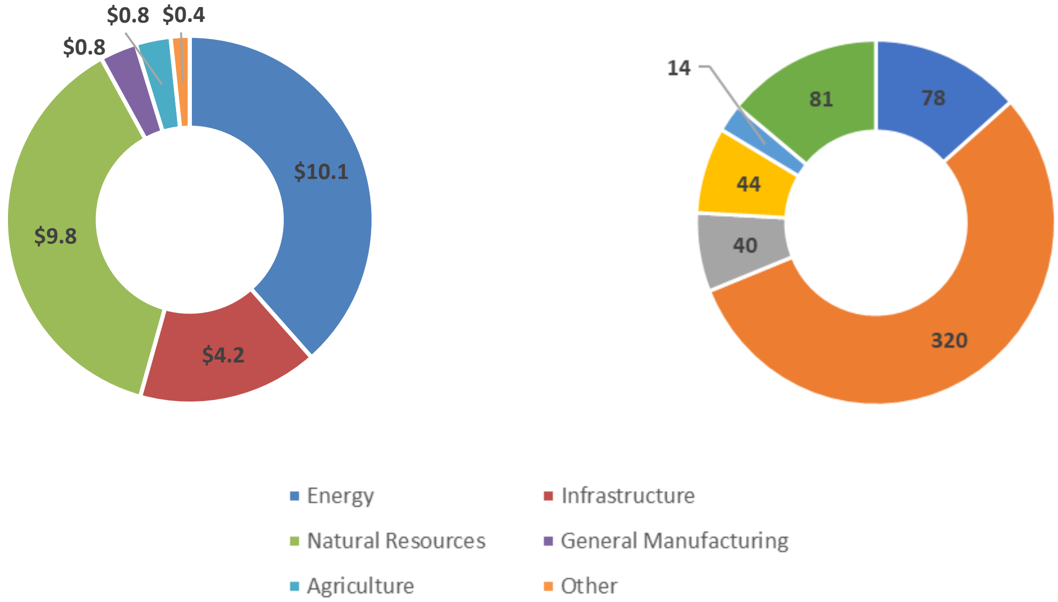


Figure C. Top Five SOEs per Revenues, 2018

Name	Sector	Total Revenues (USD, billion)	Total Assets (USD, billion)	Employees (thousand)
National Joint-Stock Company "Naftogaz of Ukraine"	Natural Resources	$9.4	$22.2	0.7
State Enterprise Energorynok	Energy	$6.3	$1.6	0.2
Public Joint-Stock Company "Ukrzaliznytsya"	Infrastructure	$3.1	$9.8	264.6
National Atomic Generating Company 'Energoatom'	Energy	$1.6	$7.9	33.7
Public Joint-Stock Company "Centrenergo"	Energy	$0.5	$0.3	6.8

Annex E. IFC–World Bank Progression Matrix for SOEs: Transparency, Disclosure, Control Environment[47]

Level 1: Basic Corporate Governance Practices	Level 2: Extra Steps to Ensure Good Corporate Governance	Level 3: Major Contribution to Improving Corporate Governance Nationally	Level 4: Leadership
Transparency and disclosure			
✓ SOE prepares timely annual financial statements according to domestic financial reporting standards. ✓ SOE prepares an annual report.	✓ SOE prepares half-yearly financial statements in accordance with domestic financial reporting standards. ✓ Annual reports include management commentary, SOE objectives, ownership and control, risks, related-party transactions, and basic details on board members. ✓ Reporting is publicly available.	✓ Financial statements are prepared in accordance with IFRS. ✓ Annual reports include indirect ownership and control, special state voting rights, code of ethics, key performance indicators, compliance with corporate governance code, and management and board remuneration. ✓ The SOE or government reports on public service or policy obligations. ✓ Criteria are established for disclosing related-party transactions with other SOEs and with the government.	✓ Reports include remuneration, risk management, performance against key performance indicators, environmental and social reporting, board attendance, training, and evaluations. ✓ Cost and funding of public service or policy obligations are fully disclosed. ✓ All public disclosure is available on the SOE and relevant government website.
Control environment			
✓ The SOE has a system of internal controls in place. ✓ Internal audit function in place. ✓ Annual financial statements are subject to an independent audit.	✓ Internal controls and internal audit units are staffed and in place. ✓ Risk management is part of the internal control framework. ✓ Internal audit is accountable to board.	✓ The independent external audit is subject to the oversight of an audit committee or equivalent body. ✓ Independent external auditor's opinion on the financial statements does not contain any qualification.	✓ The design of internal control systems complies with the 2013 COSO Framework. ✓ Internal audit unit meets standards of Institute of Internal Auditors, and its recommendations

[47] Corporate Governance of State-Owned Enterprises: A Toolkit (World Bank: 2014)

✓ The state audit institution's work is clearly defined.	✓ Independent external audit is carried out in accordance with ISA. ✓ SOE acts on issues raised by the independent auditor.	✓ The state audit institution audits use of public funds and implementation of public service objectives.	are taken into account. ✓ Oversight is exercised by a fully independent audit committee and, when appropriate, risk committee.

Annex F. Role of the State Audit in Specific State Control or Inspection Procedures of SOEs

The United Kingdom: All executive non-departmental public bodies produce annual reports and accounts, which are made available to Parliament. The Comptroller and Auditor General, supported by the National Audit Office, is either the external auditor of, or has inspection rights to, all executive non-departmental public bodies. The Comptroller and Auditor General is also the auditor of the financial statements of trading funds. The specific powers and duties of the Comptroller and Auditor General and the National Audit Office are laid down in acts of Parliament. The main acts of Parliament are the National Audit Act 1983 and the Government Resources and Accounts Act 2000.

The Netherlands: The Court of Audit's tasks, powers, and legal status are laid out in the Constitution and the Government Accounts Act 2001. The Court of Audit audits whether central Government revenues are received and spent correctly (regulatory audit) and whether central Government policy is implemented as intended (performance audit). It has a mandate to audit institutions that carry important statutory tasks at arm's length from the Government.

The Government Accounts Act 2001 states that the Court of Audit may institute an audit in respect to:

a. public companies and private companies with limited liability, all or virtually all of whose issued share capital is owned by the state;

b. public companies and private companies with limited liability other than those referred to under a, for which the state owns at least 5% of the issued share capital and a financial interest is involved that is greater than a sum to be fixed by the Minister of Finance;[48]

c. legal persons, limited partnerships, and general partnerships to which the state, or a third party acting for the account and risk of the state, has given, directly or indirectly, a grant, loan, or guarantee;

d. legal persons performing a function regulated by or pursuant to an Act of Parliament and to that end funded wholly or in part by receipts from levies instituted by or pursuant to an Act of Parliament.

The Court of Audit supplements control over the agents of the state that is performed by the internal audit division or by external accountants by order of the responsible minister. For example, in general, the act establishing independent administrative bodies (ZBO) stipulates that their annual accounts need to be checked by an independent auditor and presented to the parent ministry. At the same time the Netherlands Court of Audit supervises the quality of financial management and accountability.

Source: prepared on the basis of applicable legislation.

[48] Certain limitations on the audit powers and procedures toward this type of entity are detailed in the Act.

In **Finland**, an independent body affiliated with the Parliament, the National Audit Office,[49] exists to audit the financial management of the state and compliance with the budget. The National Audit Office audits all government budget entities yearly, including state authorities, government agencies, and business enterprises. Based on sampling, the National Audit Office also audits SOEs and nongovernmental organizations that receive government financing and are under its auditing powers.

In addition, all entities incorporated under the private law as limited liability companies are subject to mandatory audit.[50] However, there is no obligation to appoint an auditor for a company that did not meet more than one of the following conditions in both the past completed financial year and the financial year immediately preceding it: (1) the balance sheet total exceeds €100,000; (2) net sales or comparable revenue exceeds €200,000; or (3) the average number of employees exceeds three. The auditor is appointed by the shareholders.[51]

Source: prepared on the basis of applicable legislation.

Norway: The Office of the Auditor General is the Parliament's[52] auditing and monitoring body. The Auditor General Act of 2004 provides detailed provisions for its work. The Office of the Auditor General performs its duties in an autonomous and independent manner and determines itself how the work shall be arranged and organized. The Parliament may nonetheless instruct the Office of the Auditor General, through plenary decisions, to initiate an investigation into individual matters.

The Office of the Auditor General has a broad mandate, covering all the activities of central Government, including the GPF-G,[53] public hospitals and universities, public corporations, and state grant recipients. One of the mandates is the audit responsibility for all central Government financial statements, defined as financial statements rendered by central Government agencies and other authorities that are accountable to the central Government. The Office of the Auditor General also has audit responsibility for Government corporations, Government agencies with special powers, and Government funds. It also has audit responsibility for other agencies or entities, when such responsibility is stipulated in the act regulating the activities of such agency or entity.

The Office of the Auditor General also monitors and controls the administration of the state's proprietary interests in companies, etc. (corporate control). Corporate control encompasses state-owned limited liability companies, state-owned enterprises, companies organized through separate legislation, and certain other separate legal entities that are wholly owned by the state, such as the student welfare organizations and the Norwegian Risk Capital Development Fund for Developing Countries. This control also encompasses companies in which the state owns so many shares that it represents 50 percent or more of the votes, or in which the state has a controlling interest through its shareholdings or by virtue of state control of the company's interests. The Office of the Auditor General does not normally conduct a financial audit of companies in which the state has ownership

[49] The Act on the National Audit Office 2000.
[50] The Auditing Act 2007.
[51] The Limited Liability Companies Act 2006.
[52] The Storting.
[53] Government Pension Fund—Global.

interests, as the financial statements of these companies must be audited annually by an independent external auditor.

The Office of the Auditor General does not cover the local government sector. It has about 500 staff and is generally perceived to be highly competent. The main activities include financial audit (70 percent), performance audit (26 percent), and corporate control of state interests in companies with full or partial state ownership (4 percent).[54] These companies also have private auditors, and the corporate control is generally much less comprehensive than the regular audits.

Source: prepared on the basis of applicable legislation[55]; also, IMF, 2009.

Spain: Parastatals are controlled by the Financial Controller at the Ministry of Finance, reporting to the Council of Ministers. Financial controls on autonomous bodies are carried out in the same manner as general government ones and using similar procedures. *Ex ante* control on all spending decisions is executed by the Financial Controller representative in each autonomous body. Public entities are subject only to *ex post* audit of their financial management and accounts. They may also be audited by external independent auditors. Annual information and accounts of these entities are subject to the external control of the Court of Accounts, reporting to the Parliament.

Source: OECD, 2002.

[54] The term corporate control refers to OAG's assessment of whether the parent ministry has fulfilled its role as the administrator of the Government's interest in companies in line with the decisions and intentions of the Storting.

[55] Act No 21 of 7 May 2004 relating to the Office of the Auditor General; Instructions No 700 of 11 March 2004 concerning the activities of the Office of the Auditor General.

Annex G. Summary of the OECD Guidelines on Corporate Governance of State-Owned Enterprises

The OECD Guidelines on Corporate Governance of State-Owned Enterprises were updated in 2015 and include recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. Detailed Guidelines can be accessed on the OECD website[56].

I: RATIONALES FOR STATE OWNERSHIP

The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

A. The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources.
B. The government should develop an ownership policy. The policy should *inter alia* define the overall rationales for state ownership, the state's role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.
C. The ownership policy should be subject to appropriate procedures of political accountability and disclosed to the general public. The government should review at regular intervals its ownership policy.
D. The state should define the rationales for owning individual SOEs and subject these to recurrent review. Any public policy objectives that individual SOEs, or groups of SOEs, are required to achieve should be clearly mandated by the relevant authorities and disclosed.

II: THE STATE'S ROLE AS AN OWNER

The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

A. Governments should simplify and standardise the legal forms under which SOEs operate. Their operational practices should follow commonly accepted corporate norms.
B. The government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management. The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner.
C. The state should let SOE boards exercise their responsibilities and should respect their independence.
D. The exercise of ownership rights should be clearly identified within the state administration. The exercise of ownership rights should be centralised in a single ownership entity, or, if this is

[56] https://www.oecd.org/corporate/guidelines-corporate-governance-soes.htm

not possible, carried out by a coordinating body. This "ownership entity" should have the capacity and competencies to effectively carry out its duties.

E. The ownership entity should be held accountable to the relevant representative bodies and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

F. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Its prime responsibilities include:

1. Being represented at the general shareholders meetings and effectively exercising voting rights;
2. Establishing well-structured, merit-based and transparent board nomination processes in fully- or majority-owned SOEs, actively participating in the nomination of all SOEs' boards and contributing to board diversity;
3. Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;
4. Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;
5. Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;
6. When appropriate and permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;
7. Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

III: STATE-OWNED ENTERPRISES IN THE MARKETPLACE

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

B. Stakeholders and other interested parties, including creditors and competitors, should have access to efficient redress through unbiased legal or arbitration processes when they consider that their rights have been violated.

C. Where SOEs combine economic activities and public policy objectives, high standards of transparency and disclosure regarding their cost and revenue structures must be maintained, allowing for an attribution to main activity areas.

D. Costs related to public policy objectives should be funded by the state and disclosed.

E. As a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations. Laws and regulations should not unduly discriminate between SOEs and their market competitors. SOEs' legal form should allow creditors to press their claims and to initiate insolvency procedures.

F. SOEs' economic activities should face market consistent conditions regarding access to debt and equity finance. In particular:

1. SOEs' relations with all financial institutions, as well as non-financial SOEs, should be based on purely commercial grounds.
2. SOEs' economic activities should not benefit from any indirect financial support that confers an advantage over private competitors, such as preferential financing, tax arrears or preferential trade credits from other SOEs. SOEs' economic activities should not receive inputs (such as energy, water or land) at prices or conditions more favorable than those available to private competitors.
3. SOEs' economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

G. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

IV: EQUITABLE TREATMENT OF SHAREHOLDERS AND OTHER INVESTORS

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

A. The state should strive toward full implementation of the *OECD Principles of Corporate Governance* when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:

1. The state and SOEs should ensure that all shareholders are treated equitably.
2. SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.
3. SOEs should develop an active policy of communication and consultation with all shareholders.
4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.
5. Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.

B. National corporate governance codes should be adhered to by all listed and, where practical, unlisted SOEs.

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

D. When SOEs engage in co-operative projects such as joint ventures and public-private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner.

V: STAKEHOLDER RELATIONS AND RESPONSIBLE BUSINESS

The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

A. Governments, the state ownership entities and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements.

B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labor, creditors and affected communities.
C. The boards of SOEs should develop, implement, monitor and communicate internal controls, ethics and compliance programmes or measures, including those which contribute to preventing fraud and corruption. They should be based on country norms, in conformity with international commitments and apply to the SOE and its subsidiaries.
D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.
E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions.

VI: DISCLOSURE AND TRANSPARENCY

State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

A. SOEs should report material financial and non-financial information on the enterprise in line with high quality internationally recognised standards of corporate disclosure and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. With due regard to enterprise capacity and size, examples of such information include:

1. A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity);
2. Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives;
3. The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes;
4. The remuneration of board members and key executives;
5. Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board;
6. Any material foreseeable risk factors and measures taken to manage such risks;
7. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships;
8. Any material transactions with the state and other related entities;
9. Any relevant issues relating to employees and other stakeholders.

B. 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.
C. 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.

VII: THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of SOEs should 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.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably.
B. SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government. They should have the power to appoint and remove the CEO. They should set executive remuneration levels that are in the long term interest of the enterprise.
C. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.
D. Independent board members, where applicable, should be free of any material interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardise their exercise of objective judgement.
E. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.
F. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.
G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.
H. 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. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.
I. SOE boards should, under the Chair's oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.
J. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

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