SOE Corporate Governance Country Assessment
Peru

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Corporate Governance Policy Practice
Private Sector Vice Presidency
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SOE Corporate Governance Assessment

Acronyms and Abbreviations

AFP   Peru private pension system
AGM   Annual General Shareholders Meeting
BVL   Bolsa de Valores de Lima (Peru stock exchange)
CAP   Cuadro de Asignación de Personal (document stating the staffing limits and allowances of each SOE)
CEO   Gerente General
CGR   Contraloría General de la República (Peru State Audit Body)
CONASEV   Comisión Nacional Supervisora de Empresas y Valores (Peru Securities Comisión)
CONSUCODE   Consejo Superior de Contrataciones y Adquisiciones del Estado (Peru state procurement regulatory agency)
DGAA   Dirección General de Asuntos Ambientes
FONAFE   Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (Peru state companies ownership entity)
IFRS/IAS   International Financial Reporting Standards (preceded International Accounting Standards)
INDECOPI   Peru antitrust regulatory agency
ISA   International Standards on Auditing
LGS   Ley General de Sociedades (Peru Corporate Law)
MEF   Ministry of Economy and Finance
OSIPTEL   Peru telecommunications regulatory agency
OSINERG   Peru electricity regulatory agency
OSITRAN   Peru transportation regulatory agency
ROSC   Report on Observance of Standards and Codes
RPT   related party transaction
SA   Sociedad Anónima
SAA   Sociedad Anónima Abierta
SBS   Superintendencia de Banca y Seguros (Peru banking regulator)
SNC   Sistema Nacional de Control
SNIP   Sistema Nacional de Inversión Pública (Peru state investment projects regulatory agency)
SOE   state-owned enterprise
SUNASS   Peru water and sanitation regulatory agency
Introduction

Corporate governance refers to the structures and processes that direct and control companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders, and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The Organization of Economic Co-operation and Development (OECD) Principles of Corporate Governance provide the framework for the work of the World Bank Group in this area. These principles identify the key practical issues: rights and equitable treatment of shareholders and other financial stakeholders, role of nonfinancial stakeholders, disclosure and transparency, and responsibilities of the board of directors. The international financial community has adopted these principles as 1 of 12 core best practice standards. The World Bank is the assessor in the application of the OECD Principles of Corporate Governance to country regulatory frameworks and business practices. The Bank and the International Monetary Fund (IMF) carry out these assessments as part of their program on Reports on the Observance of Standards and Codes (ROSC). The goal of the ROSC initiative is to identify weaknesses that may contribute to a country’s economic and financial vulnerability. Each Corporate Governance ROSC assessment reviews the country’s legal and regulatory framework, as well as practices and compliance of listed firms, and assesses the framework relative to an internationally accepted benchmark.

In state-owned enterprises (SOEs), state ownership and government control present inherent governance challenges that contribute to poor performance. However, efforts to improve corporate governance in SOEs have lagged behind those of the private sector. SOE reform has focused on privatization, which remains the most direct solution to the challenges of state ownership. Nevertheless, for both political and economic reasons, states clearly will remain major owners of productive assets in a number of economies for years to come. Extensive experience with privatization also has confirmed the important role that corporate governance can play before, during, and after the state divests its assets.

Current thinking on SOE corporate governance reform incorporates lessons on how to improve corporate governance in the private sector and the international consensus that has developed regarding corporate governance reform. Current thinking also builds on reforms to SOE administration and management in the 1970s and 1980s and later efforts to prepare SOEs for privatization. Overall, corporate governance provides a coherent and tested framework for addressing key weaknesses of SOEs that is consistent with indefinite state ownership or continuing privatization. The OECD Guidelines on the Corporate Governance of State Owned-Enterprises outlines this framework and what SOEs and governments need to do to ensure good corporate governance.

This report directly addresses SOE governance in Peru by focusing on improving the corporate governance of state-owned companies. Better corporate governance should result in more transparency of revenue flows and in more accountable boards and management. Improved corporate governance also will contribute directly to develop sustainable job strategies, as better managed enterprises expand their operations and improve their profitability.

This report should be read in concert with two highly related studies: the Accounting and Auditing ROSC for Peru (World Bank, 2004) and the Corporate Governance ROSC for Peru (World Bank, 2004). These reports raise a number of relevant issues for SOE governance, many of which are not included here.

Following the OECD Guidelines, this report defines a state-owned enterprise as any enterprise with state ownership, a distinct legal form (separate from the public administration), and commercial sales and revenues. This definition includes banks and financial institutions as well as industrial companies and utilities. Given the large number of privatized companies with minority state ownership in Peru, the definition also includes all companies with minority state ownership.

This report reviews Peru’s:
- SOE portfolio
- Legal and Institutional framework for SOEs
- Ownership entity, FONAFE
- Equitable treatment of shareholders and stakeholders
- Transparency and disclosure
- Responsibilities of SOE boards.

The report also:
- Summarizes issues surrounding SOE governance
- Develops policy recommendations.

The final section is a detailed review of SOE governance in Peru relative to the OECD Guidelines on SOE Governance.
SOE Corporate Governance Assessment Peru

SOE Corporate Governance in Peru

Even compared to countries at much higher levels of development, Peru’s SOE governance framework is relatively advanced:

- The state’s ownership and regulatory functions are separated by law.
- SOEs are under commercial laws and structured as corporate entities.
- SOE transparency and reporting are well evolved.
- All majority-owned SOEs have a single state ownership entity on the national level, the Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE). FONAFE is a public enterprise that holds the central government’s SOE shares and wields administrative powers.

On the positive side, since its creation and the centralization of the ownership function, FONAFE has had a significantly positive effect on SOEs. FONAFE has been building the SOE regulatory framework as well. FONAFE also made a major step forward recently by issuing a Code of Corporate Governance and a Code of Ethics. A recent concern has surged with the adoption of the Law to Strengthen and Modernize PETROPERÚ, which took PETROPERÚ out of the FONAFE framework, undermining the good work carried out so far on the SOE framework in Peru.

However, to cement Peru’s SOE framework and make it effective, much remains to be done. The SOE governance arrangements are still subject to political influence, mainly via the power of FONAFE’s board (composed of ministers) over the nomination of SOE directors. The State Audit Body, Contraloría General de la República (CGR), elects external and appoints internal auditors, infringing basic shareholder rights. SOE performance can be improved not least by streamlining the numerous procedures to which SOEs are subject (and to which private companies are not) involving procurement, investment, budgeting, and staffing. Most SOE directors exhibit weak qualifications, passive behavior beholden to the respective line ministry, and the absence of effective accountability to the FONAFE executive. Finally, hundreds of local/municipal SOEs appear to go without any governance or oversight.

Public Sector Portfolio

In the second half of the 1990s and early 2000s, Peru experienced a privatization wave that was carried out as far as politically feasible at the time. Peru’s current public sector comprises (1) 78 SOEs at the central government level (of which 24 are in liquidation or not operational, 36 are majority state-owned, and 18 are minority state-owned; (2) 87 municipal enterprises under Dirección Nacional del Presupuesto Público; (3) an unknown number of SOEs at the local government level (the total number of local entities, including government agencies and state enterprises, is 1826); and (4) 101 public beneficiary societies. The 36 majority-owned SOEs at the Central Government level are overseen by FONAFE. Per the Company Law, FONAFE also has a minority shareholder role with the 18 minority-owned SOEs at the central government level.

Oversight or governance of public enterprises at the regional and municipality levels is deficient. Registration decisions on new municipal enterprises are not tightly controlled so are subject to easy capture at the local level. Municipalities are incapable of local SOE oversight, because they are characterized by inadequate financial management systems and do not comply with the financial administration legislation. Stakeholders have expressed serious concerns about insufficient control over the creation and functioning of municipal corporate entities empowered to encroach on private sector activities. Regional and municipal SOEs are not required to publicly disclose their statements. There is very little information or official statistics on the regional/municipal SOEs. In part for this reason, this report will focus exclusively on SOEs at the national level. The report also will exclude the Peru Central Bank, Banco de la Nación, which has a special public entity
statute.3

**Degree of state ownership.** There are 28 wholly owned SOEs, and another 8 owned at the 85 percent level or above. Four are controlled at the 35 percent–50 percent level, and the state participates with 15 percent or less of the capital in another 14 enterprises.

**Listed SOEs.** Eight SOEs are listed on the Lima Stock Exchange (Bolsa de Valores de Lima, or BVL), with from 10 percent to 0.54 percent of their shares. Nine more are will be listed in 2006. Total market capitalization of the listed SOEs is US$135 million, or less than 0.5 percent of overall stock market capitalization on BVL, which stands at US$34 billion.

**Performance.** SOEs’ performance is largely, positive, due not least to the economic upturn of the past several years.4 Approximately 10 SOEs that are dedicated predominantly to performing unprofitable public/social functions have annual losses. No systematic benchmarking analysis has been carried out to understand the performance of SOEs relative to their potential or existing best practice.

**Economic importance.** The SOEs operating at the national level under FONAFE employ a total of approximately 17,000 employees.

### Key Issues

#### SOE Legal and Institutional Frameworks

The SOE legal framework in Peru goes a long way toward providing an operational environment for SOEs comparable in structure to the SOE framework in leading countries.

*A single ownership entity oversees all SOEs. SOEs are organized as commercial companies, although they experience additional operational restrictions not imposed on private firms.* The Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE) was created in 1999 under Ley de FONAFE No. 27170, and the associated Reglamento, as a single ownership entity for all majority-owned SOEs on the national level.

SOEs are organized as commercial companies and subject to company, tax, debt enforcement, and bankruptcy laws, much as private firms are. Also as are private companies, SOEs are subject to industrial and market regulation. However, in addition, SOEs fall under the jurisdiction of several regulations specific to SOEs, such as the State Procurement Law, State Investment (SNIP) Law, Regulation on Short-term Investments, State Debt Financing Law, Law on Access to Public Information, Public Employment Law, and State Audit Law and regulations. SOEs also must align their strategic and operational plans with the sectoral policies outlined by the respective line ministries. Occasionally (and unpredictably), SOEs can be subject to state austerity measures, whereby their operational expenses are cut without notice. These additional regulations make for a complex set of operational and procedural requirements that position SOEs on a nonlevel playing field vis-à-vis their private sector counterparts. Thus, the flexibility and efficiency of SOE operations are significantly limited.

SOEs also are subject to FONAFE’s regulations as the ownership entity, including the Directives on Performance Management, Budgeting, and Staffing; on SOE borrowing from FONAFE; on Dispute Resolution; on Strategic and Operational Planning; on Disclosure; on Directors; as well as the Codes of Corporate Governance and of Ethics.

*The institutional framework creates a separation between the state’s ownership and regulatory functions. Nevertheless, certain government entities such as ministries and the State Audit Body encroach on SOE governance functions.* The institutional framework for the ownership and control of SOEs is presented in
FONAFE, regulates and approves SOE activities, including budget/investment, nomination and election of directors, SOE financing by FONAFE, dispute resolution among SOEs, strategic and operational management goals, and regulations on limits of staff increases.

- SOEs in certain sectors are subject to control by regulatory bodies, such as OSIPTEL (telecommunications), OSINERG (electricity), OSITRAN (transport), SUNASS (water and sanitation), INDECOPI (antitrust, free competition), and DGAA (environment).
- Listed SOEs are overseen by CONASEV and BVL rules and regulations. All SOEs are registered with the company registrar and owe disclosure obligations to it.

The above regulators are the norm for SOEs and private firms alike. However, SOEs have three additional regulators:

- SOEs must conform to CONSUCODE (under the Ministry of Economy and Finance, or MEF) in their procurement practices.
- The State Audit Oversight Body, Contraloría General de la República (CGR), exercises supervisory functions on the reporting and compliance of SOEs, imposes sanctions, appoints SOE internal auditors, and controls the selection of SOE external auditors.
- MEF approves major SOE investments (via SNIP) and financing. The line ministries engage in industrial policy decisions, and in clearing SOE sectoral objectives. Ministries also play a governance role via FONAFE’s board.

Figure 1. Institutional framework for the ownership and control of SOEs

Due to the lack of a clear definition of the limits of the ministry/regulator/CGR functions, these entities find themselves encroaching on ownership/governance functions. To illustrate, FONAFE’s board is composed of major ministers. This structure in effect introduces political influence over SOE functioning. Stakeholders have noted that such powers have resulted in SOE boards (selected by the board, not by the executive, of FONAFE) being beholden to the ministries, not to their shareholders.

FONAFE has focused on solving this problem mainly by operationalizing its powers to effectively remove nonperforming directors (section VI). As another illustration, SUNASS, the water regulator, has undertaken SOE performance management actions with its regulated SOEs.
CGR monitoring of SOE compliance may not be very effective and focuses more on process than substance. SOE compliance is monitored by the State Audit Body (CGR), which places little emphasis on performance management and other areas of SOE operation and functioning. CGR may not be the most appropriate monitor for these areas. In private firms, shareholders and boards perform this role. Rather, the Supreme Audit Body focuses on subsidized or noncommercial areas of SOE operation which use public resources, provide a “public good,” and are carried out on a nonprofit basis.

SOEs not only are not exempt from general corporate laws but also are subject to additional state-related regulations that limit SOE flexibility and efficiency. Article 60 of the Peru Constitution states that public and private enterprises should be treated equally. SOEs are organized as commercial companies and are subject to the same laws as private companies, including Company Law (Ley General de Sociedades, or LGS). However, in addition to general commercial laws, SOEs are subject to rules on procurement, investment, budgeting, staffing and remuneration, audit control, as well as FONAFE regulations. These provisions and rules take responsibility from the SOE and from FONAFE, in the areas of (1) dividend payments (regulated by Ley de FONAFE), (2) external auditor selection (CGR), (3) procurement (CONSUCODE), (4) investment (SNIP/MEF), and (5) external financing (MEF). Of day-to-day management decisions, it would seem that very few are truly within the SOE domain: operational contracts in the course of business, short-term borrowing, and trade credit.

Noncommercial goals of SOEs are not clearly mandated and separately priced in a transparent manner. SOE goals also are not clearly prioritized or devoid of conflicting directions. However, general SOE objectives are publicly disclosed and defined in line with sectoral objectives outlined by the line ministries (the 5-year strategic plan), and in line with FONAFE objectives on the operational level (the annual operational goals and commitments to management objectives).

Ownership Entity (FONAFE)

FONAFE has had a significantly positive effect on SOEs since its creation in 1999 and the centralization of ownership functions of SOEs. It has been actively building the SOE regulatory framework as well, although it has not taken up the practice of prior public online consultation on newly proposed regulations. FONAFE has improved SOEs’ efficiency, for example, by introducing aggregate SOE procurement for some typical items to reduce costs. However, political resistance to change is considerable, and SOE boards/management are entrenched and beholden to the ministries.

The state has a clear and consistent ownership policy, but this policy is limited to majority-owned SOEs at the national level. In FONAFE the exercise of ownership rights is clearly identified within the state administration. The law outlines the scope of jurisdiction of FONAFE (for example, municipal companies are not under its powers), as well as the functions of FONAFE’s board and management, and its resources. FONAFE oversees SOE activities, issues related norms, administers SOE dividends, maintains share registers, and directs SOE budgets and management processes. For majority-owned SOEs, FONAFE exercises several key functions in addition to ownership rights, such as approval of budget and staffing. For SOEs of which the state is a minority shareholder, FONAFE exercises ownership rights in accordance with Company Law. FONAFE’s board, composed of major ministers, has concentrated most of FONAFE’s power.

The ownership policy defines the state’s role in the corporate governance of SOEs but has gaps. The government ownership policy toward SOEs is outlined in Ley FONAFE and Reglamento, as well as several Directives of the FONAFE board (on SOE directors, SOE disclosure, dispute resolution, related lending by FONAFE to SOEs, CAP, strategic plans, operational plans/budget, management contracts), and the Codes of Corporate Governance and Ethics for SOEs. FONAFE lacks policies for dividend/retained earnings determination, capital increases, and other major corporate decisions. FONAFE is responsible for only 36 central-government-level SOEs that are majority-owned by the state, leaving a considerable number of municipal SOEs uncontrolled and unmanaged. For majority-owned SOEs, FONAFE exercises several key functions in addition to ownership rights, such as approval of budget.

SOEs lack full operational autonomy vis-à-vis the state, to achieve their defined objectives. FONAFE
controls some areas of day-to-day SOE operations and various other regulatory/state organs, specifically budget, staffing, investments, and borrowing. The situation described above leaves SOEs very little operational, managerial, and supervision leeway so may preclude their effective functioning.

**SOE boards are not able to independently exercise their responsibilities.** SOE boards are nominated by the FONAFE board, which is composed of five ministers. In June 2006, regulations were reformed to decrease the influence on SOE board nominations of the respective line minister sitting on the FONAFE board. However, in practice, SOE boards do not play an independent role. Given the ministries’ influence on director nominations, boards tend to consult frequently with line ministries on decision-making.

**The ownership entity is not held exclusively accountable to Parliament.** The law does not clearly specify to whom FONAFE reports. However, by its structure, FONAFE clearly seems beholden to the five ministries that are represented on its board. This structure allows considerable influence on FONAFE by line ministries and MEF. Furthermore, in practice, FONAFE is not as powerful or weighty a player as the more economically important SOEs. Other factors undermining FONAFE’s fully successful functioning are the weak powers and autonomy of the executive function vis-à-vis its board.

**The state exercises its ownership rights according to the legal structure of SOEs.** FONAFE votes regularly at Annual General Shareholders Meetings (AGMs), following case-by-case instructions by the FONAFE board. FONAFE has no written AGM voting policy. FONAFE has no internal rules governing major shareholder decisions such as capital increases and dividend amounts. Because SOE directors are nominated by the FONAFE board, decisions are heavily ministry driven.

For SOEs with minority participation, the minority representative directors are chosen by cumulative voting as provided by company law. FONAFE has experimented with setting up reporting systems on SOE performance management contracts, but discontinued such efforts in 2006 due to their ineffectiveness in practice (distortion of bonus incentives used). FONAFE does not communicate with external auditors due to existing regulator arrangements that make auditors accountable to CGR, not to shareholders. It is doubtful that remuneration schemes for SOE boards foster the long-term interest of the company or can attract and motivate qualified professionals.

**Equitable Treatment of Shareholders and Stakeholders**

FONAFE has shown commitment to respecting minority shareholders and stakeholder rights. It also made a major step forward recently by issuing issued Codes of Corporate Governance and of Ethics. In practice, minority shareholders are rare, so it is difficult to assess their effective rights.

**Legally, state and minority shareholders have equal rights.** By law, nonstate shareholders in a company in which the state has significant ownership have the same legal rights as shareholders in other companies. In practice, SOEs have very few minority shareholders. In the case of sales of large blocks of shares, minority shareholders have pre-emptive rights. The state holds special rights (golden shares) in some SOEs. Related party transaction (RPT) rules are not strict in Peru. However, in the particular case of transactions between FONAFE and SOEs, RPTs are well disclosed. In view of strict CGR sanctions, RPTs between directors/executives and the SOE are unheard of. Minority shareholders in state-controlled companies have the same redress rights as in private companies. Shareholders have withdrawal rights. Shareholders have the right to a limited number of lawsuit actions, mostly ineffective especially in view of the slow, unspecialized, and partial court system.

In February 2006, FONAFE drafted the Corporate Governance Code ("SOE CG Code") as a model to be either directly adopted by SOEs or adapted to their specific circumstances. Companies need to comply or explain their non-adherence to the SOE CG Code. A number of SOEs have already adopted the code; the remainder are in the process of complying with this FONAFE requirement. The code is to be applied only to majority-owned SOEs. However, the code notes that most of the 32 principles are equally applicable to minority-owned SOEs.

**FONAFE has achieved remarkable progress in promoting minority information rights.** SOEs are obliged to create their own websites and publish ample sets of disclosures there. These include the annual report, notes, audit report, strategy and objectives, and detailed financial and nonfinancial information. Nonstate shareholders
in SOEs can obtain relevant and timely information without undue cost. Information to which minority shareholders have access includes the SOE founding documents; list of directors and top management, including remuneration; and AGM minutes. Minority participation in the AGM has been facilitated in the law.

Majority-owned SOEs disclose material information monthly on their web pages; listed SOEs have continuous disclosure. FONAFE checks the information filed and can make observations if necessary. SOE compliance with disclosure rules is high, although, using CGR monitoring, quality of disclosure is unclear. FONAFE has limited sanction power over SOEs. SOEs have an active policy of communication, but not of consultation, with shareholders and stakeholders.

Stakeholder rights and redress are established by law; awareness of these issues is increasing. Stakeholder rights are recognized in the legislature (labor law, rehabilitation and liquidation laws; environmental law; consumer protection law), and in the SOE CG Code and the Code of Ethics, which are adopted by all SOEs. In practice, stakeholders have not been actively involved in SOE governance. In the sense of market participants, the public as yet has no awareness of the importance of corporate social responsibility. The exception is the growing environmental awareness. Redress is provided by courts for debt collection, or bankruptcy; and by regulators/ministries/court for employee, environmental, and consumer protection. Arbitration is popular among SOEs, and FONAFE provides and mandates mediation prior to any judicial action. SOEs do not explicitly report stakeholder information. However, in their regular disclosures, they report some issues such as information on employees, external borrowing, relations with suppliers, and public communication policy.

Transparency and Disclosure

FONAFE has sponsored the creation of an online filing system for SOEs. A large number of them have been “listed” at BVL (without privatization) so now comply with the higher transparency and disclosure requirements for listed companies. In 2005, for the first time, FONAFE published consolidated financial statements (2004) for Peruvian SOEs. While, by law, SOEs observe high standards of transparency, the quality of their disclosures is difficult to assess due to lack of effective monitoring by either FONAFE or CGR.

FONAFE has developed consistent, aggregate reporting on SOEs and publishes annual consolidated statements. SOEs submit monthly, quarterly, and annual financial and nonfinancial information to FONAFE via the internal electronic system. FONAFE consolidates this information and discloses on its website the consolidated budget plan for SOEs; consolidated financial statements, quarterly cash holdings, investments, financing, and other aggregate figures.

SOEs’ external auditors are not appointed by the SOE board or FONAFE and do not report to or communicate with them. CGR controls the selection of external auditors. The external auditor’s duty is to report on strategic and operational goal achievements; SOE compliance with tax duties; the financial audit; as well as the quality and appropriateness of use of public resources. In practice, external auditors perform only limited oversight focused mostly on financials and procedural compliance by SOEs. Stakeholders note that the CGR external audit contract-awarding procedure tends to select small audit firms that are ill-equipped in resources, qualifications, and personnel to perform effective external audits on the sizeable and influential SOEs.

SOEs internal auditors also are selected by and report to CGR, not to the SOE board or FONAFE. Internal auditors are qualified. However, deficient technology worsens traceability, and CEOs lack managerial accounting training. The internal auditors are perceived by market participants to act from a fault-finding, formalistic, policing perspective—more like a control organ than an internal audit organ. There are no mandatory audit committees.

All corporations (Sociedad Anónima - SA) (including SOEs) use International Financial Reporting Standards (IFRS) but not the more recent International Accounting Standards (ISA). IFRS are updated periodically and are relatively up to date. In contrast to private companies, which use the 1998 version of ISA, SOEs are audited according to the CGR audit norms, which differ significantly from ISA.

SOEs disclose some material information. SOEs’ annual reports describe their activities and levels of achievement of objectives. SOEs’ strategic plans are publicly available online. Neither FONAFE nor LGS has
express regulations on ownership disclosure. Major shareholders of over 5 percent are listed in the annual reports of listed SOEs, as well as on the FONAFE website, for all majority-owned SOEs. On the website, current budget and financial information is continuously updated; other information is not fully up to date. Capital structures, voting rights of shares, and golden shares are not disclosed in the annual reports. Some SOEs have more than one share class. There is no requirement for SOEs to have or disclose risk policies (except for financial SOEs under Peru’s banking regulator, SBS). SOEs disclose subsidies, grants, and other direct transfers, but they need not disclose RPTs. IAS 24 leaves significant scope for interpretation as to RPT disclosure. In practice, transactions between FONAFE and SOEs are well disclosed. For listed companies, CONASEV also requires RPTs to be disclosed as material facts but has limited enforcement capacity.

Responsibilities of State-Owned Enterprises’ Boards

Despite model regulations and a very promising SOE CG Code, SOEs’ boards do not have sufficient autonomy and competencies to carry out their functions with excellence. FONAFE has tried hard to make SOE director and management appointments less politicized and more technically based. FONAFE also has undertaken massive training for SOE staff in corporate finance, strategic planning, and other management areas. However, FONAFE has no plans to train SOE directors and management.

SOE boards are not able to independently exercise their responsibilities. Reform of director nomination procedures has somewhat limited political influence on SOEs; more efforts are needed. SOE boards are nominated by FONAFE’s board, which is composed of five ministers. Until June 2006, 4 of the 5 SOE board members nominated by FONAFE’s board were selected at the behest of the line minister of the respective SOE. Recent FONAFE legislation discourages concentration of the nomination influence in a single ministry but fails to isolate SOE boards from political pressures. FONAFE strengthened the selection criteria for SOE board members. Nevertheless, in practice, SOE boards do not play an independent supervisory role in SOEs.

Director accountability is weak; CGR sanctions overly restrict effective board functioning. In practice, director liability has not been invoked due to weak courts. In addition, liability definitions include as cause the “failure to act in the interests of the state.” This general concept is open to potential abuse and could result in excessive risk aversion and paralysis by boards regarding decisions. An important achievement toward director accountability was the June 2006 passage of the rule that directors who have been removed from any board are ineligible for reappointment. (In the past, political pressures made it difficult for FONAFE managers to credibly threaten directors with removal). In practice, the driving motivation behind directors’ decisions is not FONAFE liability rules, but CGR sanctions. Inflexibility and unpredictability of sanctions limit board freedom and independent action.

Boards remain passive and subject to political influence. Boards remain passive and beholden to the ministries. They tend to consult on more important or sensitive decisions with FONAFE via a general meeting approval. Each successive party in power replaces SOEs’ boards and CEOs, and no mechanism ensures a smooth transition in such political reshuffles.

SOE boards have the responsibility to select, compensate, monitor, and replace key executives. However, ministerial influence permeates here as well. FONAFE reformed standards for hiring CEOs to improve professionalism and isolate the hiring process from political influences. Fewer than half of the SOEs have full-time board chairpersons, who frequently conflict with the autonomy of the CEOs.

Current board composition does not facilitate objective and independent decisions. There are no rules on independent or nonexecutive directors. SOE directors typically are not ministry employees, civil servants, or elected officials. Nonetheless, a considerable portion of officer and management positions are occupied by career bureaucrats. In the opinion of stakeholders, current arrangements are not sufficient to ensure the SOE board’s independence vis-à-vis the ownership entity and the political machine, nor SOE management’s freedom in day-to-day operations vis-à-vis the board. The FONAFE board determines director remuneration, which is limited to two payments per month, and reportedly restricts the amount of attention directors consecrate to their duties. Stakeholders believe directors’ pay to be inadequate to ensure due time spent in the performance of their duties, although director pay does not seem widely out of range with international practice (adjusted to the
country’s income level).

**SOE officers and management lack access to effective board and executive training.** Although the SOE CG Code recommends certification/accreditation or training programs for SOE board members, there is none. In June 2006, FONAFE introduced a director database wherein all nominated and appointed directors are listed. Specialized committees are permitted by law and encouraged by the SOE CG Code. However, outside of the financial sector, SOE boards rarely set up specialized committees to support the full board in performing its functions. For listed companies, the CG Code recommends the establishment of audit committees. SBS mandates these for financial firms. SOE boards do not carry out annual evaluations to appraise their own performance, although the SOE CG Code recommends it. There are currently no rules and procedures requiring evaluation of board performance.

**Policy Recommendations**

SOE governance in Peru follows most aspects of good practice by law, and a significant number of them also in practice. Many of the recommendations contained in the OECD Guidelines have been implemented for a number of years:

- The State has largely separated the ownership and regulatory functions for the large SOEs.
- SOEs are subject to the the general company laws and regulations.
- SOEs are subject to the same accounting standards as listed companies.
- SOE disclosure levels are comparable to those of listed companies; many SOEs have been listed to strengthen their disclosure.
- FONAFE has had a significantly positive effect on SOEs since its creation and the centralization of ownership functions of SOEs, especially in the areas of disclosure and shareholder rights.

However, the SOE governance framework diverges from international good practice in a number of areas. These are primarily in compliance and implementation (with a sound legal and regulatory base), as identified in the review of the OECD Guidelines below.

**Stronger institutional base**

In spite of notable advances in SOE governance and ownership framework achieved so far in Peru, exceeding other countries at comparable levels of development, there is a need for further strengthening of the SOE ownership institutional framework.

**Recommendation 1: Strengthen FONAFE and isolate it from political influence.** Consider alternative governance structures for FONAFE. Policy-makers should review differing models of governance for FONAFE that might provide higher levels of autonomy and political insulation. Policy-makers could consider best practice experience such as the French model, in which the SOE ownership entity is accountable to Parliament. The composition of FONAFE’s board leaves SOEs open to political pressure and resistant to changes, including efficiency improvements and performance overhaul efforts.

To solidify FONAFE’s role as an autonomous owner of SOEs, ensure that all SOEs remain within FONAFE’s structure. Developments such as the adoption of the Law to Strengthen and Modernize PETROPERÚ, which took one of the most economically significant SOEs out of the FONAFE framework. The law undermined the FONAFE framework by sending an unintended message about the government’s commitment to SOE development and efficiency improvement.

**Strengthen the governance framework for regional SOEs.** Their governance should be strengthened in three ways:

1. Regional/municipal SOEs should be catalogued.
2. Their creation should be tightly controlled based on whether the existence of the new SOE is warranted per the Constitution and on the proposed object of business.
3. Their accountability and transparency should be increased. Their compliance with the SOE CG Code should be encouraged or mandated. Policymakers should carefully consider with what entity to place the supervision of regional/municipal SOEs under a FONAFE-like framework. The selected supervisory entity should be prepared to have strong financial management and compliance monitoring systems to credibly enforce a good governance framework, disclosure, and control over the functioning of SOEs at the regional/municipal level.

Recommendation 2: Continue developing FONAFE’s ownership policies toward SOEs.

The legal provision for mandatory remittance of 100 percent SOE earnings into the government budget should be repealed. The dividend decision should be proposed by each SOE board and approved by the annual shareholder meeting case by case. FONAFE needs to adopt an explicit voting policy for FONAFE at SOE general meetings as well as internal rules on decisions on capital increases and other major shareholder decisions. FONAFE’s lending policy to SOEs needs a review as well. By best practice, the ownership entity is not a source of financing for SOEs; rather, they are encouraged to obtain external long-term financing from banks or the securities markets. In addition, FONAFE’s lending to SOEs is a related party transaction and, as such, must be subject to stricter scrutiny to ensure market-based (arm’s length) pricing.

Recommendation 3: Give FONAFE the right to approve the appointment of the external auditors, through the annual shareholder meeting, as per board nominations. Given that the auditors are independent, external auditor appointments by CGR are unwarranted and lessen ownership control over the SOE and its performance. Chile’s experience in this regard may be useful.

Progress in SOE efficiency and performance

SOE profitability has increased in recent years, due in part to Peru’s improving economic situation. In spite of this positive development, SOEs’ potential of operational excellence and efficiency is far from being reached.

Recommendation 4: Clearly define and prioritize SOE goals; make mandatory the separation and pricing of noncommercial SOE activities. The areas of noncommercial operation performed by each SOE should be clearly defined and priced at cost in isolation. In view of noncommercial activities that the SOEs perform, goals should be prioritized for each enterprise, especially in cases in which one or more goals might conflict. Separate costing of noncommercial activities also would improve internal management accounting, help isolate operational and profitability factors, and ease performance management. Benchmarking also would become feasible with this process. Benchmarking in turn would permit clearly defining performance measures and aid in outlining operational and efficiency improvements.

Recommendation 5: Overhaul SOE performance management; benchmark with international and regional best practice. Potential for SOE performance improvements exists and should be realized. One performance management option is to benchmark to international and regional best practice. FONAFE should focus on capitalizing on past experience with performance management of SOEs and improving its track record in this respect.

Recommendation 6: Streamline regulation of SOE operational practices; train regulators and overseers. SOE rules and procedures on procurement, investment, budgeting, staffing, and audit control should be streamlined to minimize the nonlevel playing field between SOEs and private firms. Limited operational, managerial, and supervision leeway lowers SOEs competitiveness in a free market environment, and significantly limits the flexibility and efficiency of SOE operations. Such controls considerably slow down business decision-making in the fast-changing commercial environment. To achieve their defined objectives, SOEs need operational autonomy vis-à-vis the state in day-to-day management decisions. As it is, some SOEs behave more like bureaucracies than risk-taking, innovative, value-maximizing business outfits. A clear distinction needs to be made between the need to control SOEs, which are commercial enterprises, as opposed to other public entities, which operate under nonprofit conditions and are financed through governmental budget.

The implementation difficulties of SNIP, CONSUCODE, CGR, regulators, and ministries in SOE regulation and oversight could be resolved more easily with the help of technology upgrades and staff training (including SOE and FONAFE staff). Training topics include areas such as SOE governance, management performance,
case studies of international best practice, modern business management performance/benchmarking, and managerial accounting. This process would aid regulators and overseers to understand SOE operational and oversight needs and improve the efficiency of both SOEs and the oversight agencies in delivering regulatory services to SOEs. Procapitales is in a position to offer such training in the country.

**Empowering and invigorating SOE boards of directors**

Modern corporate governance greatly emphasizes concentrating responsibility in, and increasing the authority of, the board of directors. However, as a general rule, boards of SOEs in Peru are not always considered strong, professional, or accountable.

**Recommendation 7: Strengthen board authority.** SOE boards should be able to independently exercise their responsibilities and act exclusively in the best interests of the SOE, without consulting line ministries. To achieve this effect, no ministry should have a preponderant role or concentration of decision-making power in director appointments. Directors and CEOs should not be changed as functions of elections and political rotations. Such changes weaken succession arrangements and handicap operational continuity of the SOE. Initial efforts to professionalize CEO hiring and isolate political influences should be strengthened by providing boards the exclusive authority in practice (not only by law) to select and remove the CEO, avoiding rubber-stamping ministerial nominations. This authority would strengthen the board by increasing its power over management, and lowering the perception of political interference in SOEs. However, such reforms would not achieve their full effect unless carried out hand-in-hand with the training and qualification suggestions outlined below.

**Recommendation 8: Improve board composition.** Board composition should facilitate objective and independent decisions. Excessive influence of MEF and line ministries should be prevented. The FONAFE executive should have a generally applicable policy on appointment and removal of nominated directors, and should have full control over their removal. Rules on independent or nonexecutive directors should be envisioned that will minimize career bureaucrats on the board and increase the number of qualified, professional directors from the private sector. Good practice options include certifying directors and using professional consulting firms (head-hunters) to hire CEOs and directors to ensure the requisite professional and ethical qualifications. These efforts would build on the current FONAFE directors’ database, and would contribute to the improved quality of SOE boards. *Training for directors and executives in performance management, corporate governance, SOE efficiency management, and international/regional best practice is a major need.*

**Recommendation 9: Mandate audit committees.** SOE boards should have audit committees, composed of the directors with financial qualifications. Internal auditors should report to the board audit committee, not to CGR. By best international practice, audit committees also oversee the independence of the external auditor and monitor internal controls.

**Recommendation 10: Institute effective board accountability framework.** FONAFE should have the effective power in practice (already provided by law) to remove SOE directors. FONAFE management (as opposed to its board) should be able to credibly enforce director removal. The predictability of CGR sanctions should be enhanced. To avoid the potential for arbitrary use, the offense of “failure to act in the interests of the state” should be defined more specifically. As recommended by the SOE CG Code, boards should undertake regular evaluation of directors’ performance.
Table 1. Implementing agencies for each recommendation

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Implementing agency</th>
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<tr>
<td>Recommendation 1: Strengthen FONAFE and isolate it from political influence.</td>
<td>Congress. Reform to Ley No 27170 required</td>
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<tr>
<td>- Consider alternative governance structures for FONAFE</td>
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<td>- Strengthen the governance framework for regional SOEs</td>
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<tr>
<td>Recommendation 2: Continue developing FONAFE’s ownership policies toward SOEs.</td>
<td>Congress. Reform to Ley No 27170 required, or FONAFE could provide a blanket “exception” to all SOEs.</td>
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<tr>
<td>- 100% SOE dividends</td>
<td>FONAFE</td>
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<tr>
<td>- FONAFE voting policy</td>
<td>FONAFE</td>
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<tr>
<td>- FONAFE lending policy to SOEs</td>
<td>FONAFE</td>
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<tr>
<td>Recommendation 3: Give FONAFE right to appoint external auditors</td>
<td>Congress. Reform to Ley No 27785 required</td>
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<tr>
<td>Recommendation 4: Clearly defined and prioritized SOE goals; mandatory separation and pricing of noncommercial SOE activities</td>
<td>FONAFE</td>
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<tr>
<td>Recommendation 5: Overhaul SOE performance management; benchmark with international and regional best practice</td>
<td>FONAFE</td>
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<tr>
<td>Recommendation 6: Streamline SOE operational practices; train regulators and overseers</td>
<td>All SOE overseers: MEF and line ministries, SNIP, CONSUCODE, CGR, sector and market regulators</td>
</tr>
<tr>
<td>Recommendation 7: Strengthen board authority</td>
<td>FONAFE, SOEs</td>
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<tr>
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Guideline-by-Guideline Review of Corporate Governance of State-Owned Enterprises

This section assesses Peru’s compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a principle is less than fully observed. “Observed” means that all essential criteria are met without significant deficiencies. “Largely observed” means only minor shortcomings are observed, which do not raise questions about the authorities’ ability and intent to achieve full observance in the short term. “Partially observed” means that while the legal and regulatory framework complies with the principle, practices and enforcement diverge. “Materially not observed” means that, despite progress, shortcomings are sufficient to raise doubts about the authorities’ ability to achieve observance. “Not observed” means no substantive progress toward observance has been achieved.

SECTION I: ENSURING AN EFFECTIVE LEGAL AND REGULATORY FRAMEWORK FOR SOES

The legal and regulatory framework for state-owned enterprises should ensure a level playing field in markets in which state-owned enterprises and private sector companies compete to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.

Guideline IA: 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.

Assessment: Largely observed.

State’s ownership function. There is a single ownership entity for all SOEs on the national level, the Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE), which exercises the state ownership rights. FONAFE was created in 1999 as a public enterprise that acts as a holding for the SOE shares held by the central government, and wields administrative powers.

Other state functions. As the main or sole shareholder, FONAFE regulates and approves SOE activity for the 36 SOEs it owns, in areas such as budget/investment approval, nomination and election of directors, SOE financing by FONAFE, dispute resolution among SOEs, strategic and operational management goals and bonus payments, and regulations on limits of staff increases. SOEs in certain sectors are subject to control by regulatory bodies. All SOEs conform to CONSUCODE (under MEF) in their procurement practices, and also are overseen by INDECOPI on antitrust issues and by DGAA on environmental concerns. The line ministries outline sectoral policies, which also affect the SOEs. MEF approves SOE major investments (via SNIP) and financing. Ministries also play an informal governance role, via FONAFE’s board, in nominating SOE directors. Stakeholders have noted that such powers have resulted in SOE boards who are beholden to the ministries, not to their shareholders. FONAFE has been focusing on solving this problem (section VI). Listed SOEs are overseen by CONASEV and BVL rules and regulations. All SOEs are registered with the company registrar and owe disclosure obligations to it. Finally, the State Audit Oversight Body, Contraloría General de la República (CGR), supervises SOEs’ reporting and compliance.

Overlap of ownership with other state functions. The Ley de FONAFE functions in the area of ownership and indirectly precludes any FONAFE actions as regulator or industry policy setter. The respective line ministries make industrial policy decisions and clear SOE sectoral objectives. Regulatory control over SOEs is carried out by OSIPTEL (telecommunications), OSINERG (electricity), OSITRAN (transport), SUNASS (water and sanitation), and INDECOPI (antitrust and free competition). Regulators are somewhat autonomous, but not independent, of the line ministries. The former report to the Ministerial Council, and their resources come from fees and fines as well as from the Treasury. Regulators set prices for companies operating in their sector, supervise the fulfillment of the companies’ obligations, exercise regulatory powers, and must hear and address user complaints.

Due to the lack of a clear definition of the limits of the ministry and regulator functions, ministries and regulators may find themselves encroaching on ownership/governance functions. Examples are regulators setting strategic goals or performance measures for SOEs, or ministries effectively controlling SOE board decisions or passing legislation that would impose obligations on SOEs contradictory to those imposed by FONAFE.

Guideline IB. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. The SOE legal form or arrangement should allow creditors to press their claims and to initiate insolvency procedures.

Assessment: Partially observed.

SOE legal form. SOEs are organized as commercial companies and subject to Company Law (Ley General de Sociedades, LGS). There are two SOEs on the national level—-the overall SOE ownership entity, FONAFE, and the central bank (Banco de la Nación)—that possess administrative powers and are organized as enterprises under public, not commercial, law. All national-level SOEs under commercial law are organized as S.A ordinaria (SA) or S.A. Abierta (SAA).
SOE Corporate Governance Assessment Peru

Streamlining SOE operational practices. SOEs are subject to general commercial law. However, they fall under the jurisdiction of several additional regulations specific to SOEs, including rules on procurement, investment, budgeting, staffing and remuneration, audit control, as well as the regulations related to the ownership entity, FONAFE. These additional regulations make for a complex set of operational and procedural requirements that force SOEs onto a nonlevel playing field vis-à-vis their private sector counterparts and significantly limit the flexibility and efficiency of SOE operations. FONAFE, regulators, and ministries have considerably standardized SOE practices.

SOE legal form and creditor rights. The SOE legal form enable creditors to press their claims and to initiate insolvency procedures (section IVA).

Guideline IC. Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.

Assessment: Materially not observed.

Article 60 of the Peru Constitution 1993 imposes three criteria for permitting an SOE to function in the commercial sector: (1) if the SOE is authorized via special legislature; (2) if the SOE activity is unlikely to be picked up by the private sector; and (3) if the SOE activity is of significant public interest or of national importance. In practice, most SOEs are engaged in commercially viable areas. In addition, SOEs perform noncommercial activities in pursuit of social, developmental, and other desirable goals.

The SOE CG Code states that SOE objectives should be clearly defined (§1). They are defined via the following process:

The line ministries outline a sectoral policy, following which all SOE CEOs design their own strategic plans (Plans Estratégicos, which are approved by the board and cleared by the line ministry and FONAFE), operational goals, and management contract (Plans Operativos and Convenios de Gestión; approved by FONAFE but deemphasized by FONAFE as of 2006). The strategic plan expresses the mission, vision, strategic objectives, strategies, indicators to be monitored, and goals/aims of an SOE (§1.1). The plan spans five years. The plan is harmonized with the strategic plans and strategic objectives of FONAFE and the strategic plan of the corresponding sector (from the line ministry). Their strategic plans take into account the goals in SOEs’ founding documents. In this sense, SOEs’ objectives are clear in the short (1 to 5 years) term but not fixed by policy or legislation. Mandated by the FONAFE Transparency Directive, SOEs’ strategic plans are publicly available on SOE websites.

Given their objectives, there is no separation between commercial and noncommercial SOEs, either by laws and regulations or in SOEs’ founding documents. Founding documents typically contain a general description of SOE activities and business objectives although not necessarily in terms of social policies and goals. The cost for pursuing social policies and public (noncommercial) objectives is not explicitly calculated or separately covered. This fact obscures the determination of SOE efficiency or any benchmarking analysis. It should be noted that SOEs do not receive subsidies. Any SOE losses would be accumulated, or possibly compensated by an injection of capital by FONAFE.

Guideline ID. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.

Assessment: Partially observed.

Article 60 of the Peru Constitution states that public and private enterprises should be treated equally. LGS (Company law) is equally applicable to SOEs and private companies. SOE Bylaws and Articles are filed with the Registrar of Companies. However, there seem to be a significant number of provisions and rules that apply to SOE governance and management decisions, for example, for dividend payments, board elections, external auditor selection, procurement, investment, and capital structure determination. These rules overrule LGS and impose a nonlevel playing field for SOEs. Of day-to-day management decisions, it would seem that very few are truly within the SOE’s domain, including operational contracts in the course of business, short-term borrowing, and trade credit.

In more detail, SOEs are subject to the following additional regulations as compared to their private counterparts:

- **Dividend payments**: For example, under LGS, the board proposes dividends to the AGM for approval (this decision also can be delegated to the board) (LGS §230-231). Shareholders representing 20 percent of voting capital may demand a dividend of up to 50 percent of net profits. On the other hand, SOEs that are majority owned by the state are mandated by law to remit 100 percent of their earnings as dividends into the Treasury via FONAFE.

- **Corporate liability**: SOEs have liability only when third parties are concerned. For direct sanctions, only their employees are responsible. Given formal director appointment by the line ministry or MEF, there is an issue with SOE director removal and informal ministerial backing of directors. FONAFE has issued recent legislation to address this.

- **Labor law**: SOEs face stricter limits on hiring and firing of employees. The employees of SOEs are subject to the labor law for private enterprises but have the following additional requirements. Expenditure on personnel is supported by an annual personnel plan included in the budget package that details every approved staff position for a budget period.
along with the salary and benefits to be paid (Cuadro de Asignación de Personal, CAP). The CAP details staff positions and salaries by category of employee position. CAP is drafted by the CEO, approved by the board, cleared by FONAFE and MEF, and disclosed on FONAFE’s website. FONAFE also approves the Gasto Integrado de Personal and the Tope de Ingreso Máximo Annual. There could be additional onerous labor regulations on SOEs, such as 2003 law that required existing SOEs to rehire the 3800 state workers who had lost their jobs in privatizations and reorganizations of SOEs. Although limited by the CAP, SOE pay levels are not linked to the civil servant pay scale. However, linking them is projected for the future and is pending implementation. This change will lower SOE efficiency and drain talent from the state’s productive sector.16

- **Austerity norms**: Imposed by Congress, these norms could include a savings drive requiring SOEs to halve their transport fleets and donate the cash raised to the Treasury. These norms are largely a short-term tool to respond to public opinion pressures on public spending. In the past, SOEs have experienced some ad-hoc tax-like levies, for example, a state share tax.

- **Competition/antitrust law**: These laws (implemented by INDECOPI) treat SOEs and private companies equally. INDECOPI is an Organismo Público Descentralizado and reports to the Ministerial Council. Its board is composed of two representatives of the Council of Ministers (including the chairman), and a representative of MEF.17 There have been lawsuits initiated by private companies against SOEs accusing them of crowding out the private sector.18

- **Procurement**: All purchases of goods and services are performed in compliance with the Law on Purchases and Procurement of the State. FONAFE has established maximal annual amounts allowed for purchases and procurement for each SOE by type (SOEs are classified into four types). SOE procurement is structured in a complex procedure regulated by CONSUCODE (Consejo Superior de Contrataciones y Adquisiciones del Estado). CONSUCODE is an organismo público descentralizado that reports to MEF. The former has a president appointed by MEF and no board.19 The internal auditor of each SOE monitors the procurement process for compliance with legal requirements, and periodically informs FONAFE on this (as mentioned, sanctions are not on SOEs but on their employees). SOEs also file the required related documentation with FONAFE and CONSUCODE via an electronic portal.20 **SOEs are unanimous in their ranking of procurement procedures as one of the most onerous regulations.**

In addition to regulating SOE procurement practices, CONSUCODE promotes other goals, such as SMEs as service providers. CONSUCODE conducts procurement training of SOE staff and promotes public awareness of procurement pracices. In theory, procurement should take 20 days, but in practice it takes 2–3 months and could even take a year. FONAFE has regulated certain restrictions in SOE spending, notably in the areas of mobile phones; corporate events; petrol and transportation; advertising, promotion, and publications; employee training; remodeling work spaces; construction or purchase of real estate/office buildings; and domestic and international travel.21

- **Investments**: Based on the amount, SOE property, plant, and equipment investment may require internal SOE approval, approval by the line ministry, or at the MEF level (Sistema Nacional de Inversión Pública, or SNIP). Budget approval also is required for all investments (FONAFE). Each company has a 5-year PMO (Plan Maestro Optimizado), which includes operational goals and the investments needed to achieve them. All investments must receive budget clearance by FONAFE, and a viability (business plan) clearance by SNIP.22 Given the complexity and typical backlog of SNIP approvals (which can take up to 1 year, although approval itself takes only 2–3 months), few SOEs submit proposals for new investments. SNIP’s objective is to improve the provision of government services. SNIP conducts on-site inspections and can provide technical assistance, especially with complex feasibility studies. Sale of real estate must be accompanied by the required legal and technical information and published on the SOE website.23

- **External financing**: SOEs debt with maturity of over a year is considered public debt, and therefore is subject to Ley de Endeudamiento del Sector Público and MEF approval, and is counted toward the government deficit. External financing also requires budget approval (FONAFE). Given Peru’s historical deficit, SOE borrowing has been strongly discouraged. However, SOE debt is not associated with any explicit or implicit government guarantee so is treated by banks as any other large company debt. Banks can fully invoke debt collection or bankruptcy procedures on SOEs and can seize SOE assets (vehicles, buildings, everything short of public property, such as parks). Retained earnings are limited due to the legal obligation to remit all earnings to the Treasury.24 SOEs have considered issuing bonds tied to certain cash flows but so far the idea is within the realm of exploratory steps. Any SOE share issues on the stock exchange would require three steps:

  1. **Institution of privatization procedures**
  2. Approval of PROINVERSION (Agencia de Promoción de la Inversión Privada para el Desarrollo de Inversiones en el Perú), the public entity charged with promotion of private investment,25
  3. Adoption of a Resolución Suprema approved by the chair of the Ministerial Council and by the respective line minister (§4 Decreto Legislativo No. 674).

- **Budget planning**: SOEs submit their annual budget plans for approval to FONAFE, Comisión de Presupuesto y Cuenta General de la República del Congreso de la República, CGR, and Dirección Nacional del Presupuesto Público.

- **Changes in control**: Mergers and acquisitions are approved by FONAFE but also require a prior nod by PROINVERSIÓN.

- **State audit**: SOEs are controlled by the Supreme Audit Body, CGR. The Constitution (§82) charges CGR with...
supervising the legality of the execution of the public sector budget, public credit operations, and generally the operations of the entities of the public sector. As its supreme oversight body with guaranteed unlimited access to records, the National Control System Law (Sistema Nacional de Control) defines the role and responsibilities of CRG. CRG’s mandate was broadened to include not only financial audit but also performance management functions.26 The emphasis is reported to be on financial audit and box-checking rather than on management performance issues. CRG has the authority to invoke internal audit units as deemed necessary, and appoints the internal auditor of each SOE as well as selects its internal auditor. Stakeholders note that CRG tends to select small audit firms ill-equipped in resources, qualifications, and personnel to perform external audit for the sizable and influential SOEs. It is CRG’s role to enforce various regulations on SOEs, such as procurement and compliance with the strategic, operational, and management performance plans. CRG has the right to sanction for infractions committed by its regulated entities, their employees, audit companies, and legal persons or individuals who manage the state resources or assets, or who have been asked information or to be present in relation to these parties.27 There have been several cases of CRG sanctions on SOE employees. Market participants note that CRG enforcement is not preventive/participatory, but ex-post punitive. Concern is reported over the materiality in the CRG approach, as sanctions are not sufficiently tailored to the significance of the offense. Sanctions on SOE employees are sufficiently serious to eliminate any initiative or deviation from established SOE practices. Sanctions further are reported not to distinguish on the basis of the seriousness or magnitude of the offense. SOEs submit regular reports to CRG and FONAFE on the progress made in complying with the recommendations listed in the audit reports.28 CRG is perceived to need training and modernization. It is also seen as unpredictable in its actions and opinions and as exhibiting a poor understanding of the functioning and intricacies of SOEs. CRG’s pay scale is low, precluding it from retaining high-quality staff.

• Short-term liquid assets: MEF has regulations on the placement and riskiness of SOE short-term liquid assets.

• Planning: SOE Strategic Plans are approved by the sectoral ministry and FONAFE. The SOE board and upper management periodically review and update a SOE’s strategic plan. SOEs report every quarter on their Operational Plans to FONAFE, and semiannually on their strategic plans, including an annual evaluation of achievements of the goals outlined.29

• Regulated sectors (see also IA): Prices for regulated SOEs are fixed by the respective regulator and publicly available. Regulators also may carry out on- and off-site inspections and are responsible for certain technical approvals. SOEs and private companies are treated equally by regulators. However, due to the dearth of private companies under regulation, the approach of certain regulators to SOEs might be somewhat intrusive to their day-to-day business, such as performance contracts linking efficiency achievements to permitted tariff rates.

Guideline IE: The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.

Assessment: Materially not observed.

External financing is a serious problem for SOEs. SOEs’ debt with maturity of over a year is considered public debt and therefore is subject to Ley de Endeudamiento del Sector Público, MEF borrowing approval, and FONAFE budget approval. Such debt is counted toward the government deficit. Financing is carried out via capital injection by FONAFE, FONAFE (related) loans, or exceptions to the 100 percent dividend policy granted by FONAFE.30 As a result, financing is used by SOEs only as a last resort to stabilize a shaky financial position, but not for new investments or initiatives. In the past 10 years, SOEs have been heavily under-invested in, due to government budget deficits and austerity measures.

SOE registration at the stock exchange has been the fruit of a careful FONAFE policy. The intention was not a response to capital needs but to increase transparency. Most “listed” SOEs remain 100 percent state-owned. IPOs or secondary offerings would require having in place a privatization policy, including the approval of PROINVERSION, the public agency in charge of investment promotion. Two recent attempts to issue bonds have folded due to insufficiently high credit ratings and MEF concerns. CONASEV/BVL do not actively engage in SOE-specific issues. SOE share issuance is subject to the general rules of Company law on it. Specifically, an AGM quorum of two-thirds is required, as well as majority approval at the AGM meeting (including FONAFE approval, which is effected at the level of the FONAFE board of directors). Company law provides for preemptive rights during capital increases.31 In minority state-owned SOEs, the exercise by FONAFE of its preemptive rights might be considered in contravention to the Constitution.32

By Ley FONAFE, majority-owned SOEs transfer 100 percent of their earnings to FONAFE by April 30 of the year. FONAFE transfers these earnings to the Treasury by June 30. Recently, FONAFE permitted several SOEs to retain some of their earnings. FONAFE has no policy as to how it would determine the proportion of dividends versus retained earnings that it allows. It decides any exceptions to the 100 percent rule case by case. However, the SOE CG Code states that SOEs in which minority shareholders exist should individually draft policies on determining dividend/retained earnings and review these policies annually (§4).

Guideline IF: SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions, and other state-owned companies should be based on purely commercial grounds.
**Assessment: Largely observed.**

Due to the “public debt” nature of their borrowing, SOEs rarely use bank debt. As noted in IE, FONAFE is the most frequent source of financing via a capital injection or related loans. Borrowing is used as a prop in hard economic times, not for entrepreneurial motives. To the extent that SOEs borrow externally, they must do so at market terms from private banks, and no subsidies or explicit state guarantees are involved. However, loans are at very short maturities (30–60 days). SOE long-term borrowing is considered public debt. Therefore, long-term borrowing is subject to multiple approvals and restrictions, in addition to increasing the budget deficit, for which reason it is strongly discouraged. Because banks treat SOE long-term debt as any other large company debt,\(^{33}\) lending must be carried out at market prices.\(^{34}\) SOEs are fully subject to insolvency and rehabilitation laws.\(^{35}\) Banks can fully invoke debt collection or bankruptcy procedures on SOEs, and can seize SOE assets (short of public property such as parks). SOEs have considered issuing bonds tied to certain cash flows but so far the idea is within the realm of exploratory steps.

SOEs may engage in related lending (such as from their holding FONAFE) at market prices and in the ordinary course of business, or if two-thirds of the board approves. Controlling shareholders who have a direct or indirect conflict of interest may not vote at the general shareholder meeting.\(^{36}\)

**SECTION II: THE STATE ACTING AS OWNER**

The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.

**Guideline IIA: The Government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.**

**Assessment: Largely observed.**

The government ownership policy toward SOEs is outlined in Ley FONAFE and Reglamento. The law outlines the scope of FONAFE’s jurisdiction (municipal companies are not under its powers) as well as the functions of its board and management, and its resources. The law specifies the following overall objectives for FONAFE:\(^{37}\):

1. Oversee SOE activities and issue related regulative norms
2. Administer the resources derived from ownership of the SOE shares
3. Maintain a register and hold custody of the SOE shares\(^{38}\)
4. Direct the budgetary and management processes of the SOEs under its jurisdiction in accordance with the issued norms, directives, and agreements.

The FONAFE board has the duties to “exercise ownership rights,” “approve SOE strategic plans,” “approve current transfers, increases of capital or external financing of SOEs,” and “nominate SOE board members.”\(^{39}\) For majority-owned SOEs, FONAFE exercises several key functions in addition to ownership rights, such as approval of budget and staffing. For SOEs of which the state is a minority shareholder, FONAFE exercises ownership rights only of the shares it holds, “in accordance with the rights provided by the company law.”\(^{40}\)

In addition to the Ley FONAFE and Reglamento, FONAFE’s ownership policy is clarified in several Directives of the FONAFE board applicable to directors: disclosure, a Code of Corporate Governance, and an Code of Ethics.\(^{41}\) As required by LGS, SOEs submit to FONAFE an AGM agenda and AGM minutes signed by the respective state representative, the president and secretary of the AGM. The CEO is responsible for filing and safekeeping the minutes with the company office as well as in public registers, as required. The FONAFE representative is obliged to act and vote per FONAFE instructions.\(^{42}\) FONAFE’s voting decisions on the AGM of the SOEs are decided at the management level (for routine issues), but important issues are cleared with the FONAFE board. SOEs submit to FONAFE the date of board meeting, minutes, and attendance within 15 days of the end of the month, when a board meeting is held. FONAFE management can appoint a representative without a voting right to be present at all SOE board meetings. FONAFE approves director pay and frequency, as well as remuneration of full-time board persons. FONAFE also decides, in its role as an owner, on changes in founding documents, capital reduction, short-term bonds issue, major transactions exceeding 50 percent of capital, special audits and investigations of SOEs, and dissolution/liquidation (LGS §115). FONAFE does not have a role in approving RPTs, which are not strictly regulated. Any RPT cases regulated would be approved at the SOE board level. The decision on appointment and replacement of the external auditor is taken by CGR, not FONAFE. Officially, directors are nominated by the board of FONAFE, but in practice by the line ministries and MEF.

FONAFE regulations on SOE disclosure to shareholders and FONAFE are presented in section IIIB; and for board and director issues, in section VIA. The remaining ownership rights are specified in LGS (Company law), which regulates SOEs. In the case of minority-owned SOEs, FONAFE limits itself to carrying out ownership functions per the LGS (Company law), without excessive intervention.

The Corporate Governance Code was drafted by FONAFE in February 2006 as a model to be either directly adopted by SOEs or adapted to their specific circumstances. A number of SOEs have already adopted the code, and the remainder are
in the process. The code is to be applied only to majority-owned SOEs. However, the code notes that most of the 32 principles are equally applicable to minority-owned SOEs. The principles have much in common with the OECD SOE Guidelines and focus on SOE objectives, AGM disclosure, dividend/retained earnings decisions, classes of shares and their rights, dispute resolution policies, SOE debt, stakeholder rights, risk management, changes of control, conflicts of interest and insider information policies, SOE public reporting on corporate governance, disclosure policies and procedures (including ownership disclosure), quality of accounting and audit standards, director nominations, independence, duties and responsibilities, board committees, CEO hiring and functions, communication between the board and management, board and management evaluation and pay, and succession plan.

Guideline IIB. The Government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.

Assessment: Materiaally not observed.

Certain areas of SOE day-to-day operations are controlled by FONAFE and various other regulatory/state organs, specifically, budget, staffing, investments, and borrowing (section ID). SOE budget planning is controlled by FONAFE, the National Department for Public Budgeting, CGR, and the Congressional Budgetary Commission. FONAFE and MEF (also via SNIP) are involved in investments (of any amount) and borrowing (with a maturity over 1 year) approvals for SOEs. The hiring of workers requires FONAFE approval. Labor law makes it close to impossible to remove employees. Operational contracts and trade credit with suppliers/clients are SOE internal decisions, with two exceptions: when procurement rules are concerned (all SOE supplier goods and service contracts) and when CONSUCODE clearance is required. Short-term investments of cash funds are internal SOE decisions, except that they are subject to MEF’s risk restrictions on liquid SOE assets.

The requirements above leave SOEs with very little operational, managerial, and supervision leeway and may preclude their effective functioning.

Guideline IIC: The state should let SOE boards exercise their responsibilities and respect their independence.

Assessment: Materiaally not observed.

SOE boards are nominated by the FONAFE board. In practice, SOE boards do not play an independent role and, given the ministries’ influence on director nomination, tend to consult frequently with line ministries on decision-making. Due to CGR sanctions concerns, the CEO invariably will clear most important decisions with the SOE board. In certain cases, a full-time chair of the board is appointed representing MEF who is housed within the SOE and can interfere with the CEO functions. Board members and managers, being political appointees, also face frequent changes without a due succession plan. FONAFE has been somewhat successful in increasing the technocratic element and decreasing ministry/concentrated influence on SOE boards. This work was furthered most recently by a June 2006 FONAFE regulation eliminating the rule that the relevant line ministry nominated 4 of 5 SOE directors (section VIC).

Guideline IID: The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralization of the ownership function.

Assessment: Largely observed.

There is a single ownership entity for all SOEs on the national level, the Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE),
which exercises the state’s ownership rights. FONAFE was created in 1999 as a public enterprise that acts as a holding for the SOE shares held by the central government and wields administrative powers.

The board of FONAFE is composed of 5 members: the MEF Minister, who is also the Chairman, the President of the Council of Ministers, the Minister of Energy and Mining, the Minister of Transport and Communications, and the Minister of Vivienda, Construction, and Sanitation.
The FONAFE board meets monthly. The executive director is appointed by MEF Resolución Ministerial and does not have a definite term of office. The functions of the FONAFE board include oversight over consolidated SOE budget and strategy (as well as those of FONAFE); ownership functions (including voting the shares, designating a representative to the SOE AGMs, and appointing and remunerating SOE board members); regulatory powers over SOEs; establishing a framework for FONAFE functioning, internal organization, and CEO role; approval of FONAFE’s annual report.

FONAFE employs approximately 60 people, of whom 35 are involved in FONAFE’s functions as specified by law. FONAFE’s pay scale is not as high as that of the private sector but is above civil servants’ comparable pay scale. FONAFE’s operational expenses in 2005 were US$2.1 million. Its employees undergo training, including on corporate governance issues.

Since its creation and the centralization of ownership functions of SOEs, FONAFE has had a significantly positive effect on SOEs. The entity has carried out a concerted training effort for SOEs in corporate finance, strategic planning, and other management areas. However, FONAFE has no plans to train SOEs directors and management. FONAFE has sponsored the creation of an online filing system for SOEs, administered by MEF. A considerable number of SOEs have been “listed” at
CONASEV and now comply with the higher transparency and disclosure requirements for listed companies. In 2005, for the first time, FONAFE published consolidated financial statements (2004) for Peruvian SOEs. FONAFE has issued a Code of Corporate Governance and a Code of Ethics. Aggregate purchases, introduced by FONAFE for some procurement items, save SOE costs. The entity is working to make director and management appointments more technocratic and less politicized. FONAFE has administered brave attempts to improve SOE efficiency, although political resistance is considerable since SOE boards/management are entrenched and beholden to the ministries. FONAFE has shown commitment to respecting minority shareholders’ rights. The entity also has been actively building the SOE regulatory framework, although it has not taken up the practice of prior public online consultation on newly proposed regulations.

FONAFE has limited enforcement powers vis-à-vis SOEs and has to rely on CGR for sanction compliance. SOEs must present to FONAFE all requested information within five working days. Absence of SOE officers or employees at meetings convoked by FONAFE and noncompliance with instructions of the FONAFE board is cause for their removal. SOEs determine the employees responsible for noncompliance with FONAFE’s directives and regulations as well as their own sanctions and the civil and criminal liability to which the employees are subject. FONAFE communicates quarterly to SOEs and their internal auditors the infractions observed, which are then sanctioned by the internal auditor and monitored by CGR.

A recent concern has surged with the adoption of the Law to Strengthen and Modernize PETROPERÚ, which takes the SOE out of the FONAFE framework. This SOE is one of the most influential and economically significant enterprises in the country. Allowing it to lobby its way out of the SOE framework sends an unwelcome message to the business community about the government’s support of FONAFE and commitment to SOE development and efficiency improvement.

**Guideline IIE: The coordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.**

**Assessment: Not observed.**

**Accountability to the Parliament.** FONAFE is not legally mandated to report to any particular state entity. FONAFE submits a report to the Congressional Budgetary Commission, as well as to CGR, regarding the economic and financial situation of the holding and of each SOE. Congress can request any information from FONAFE. The effect of FONAFE’s structure is that it seems clearly beholden to the 5 ministries represented on its board. This structure allows considerable influence on FONAFE by the ministries and MEF. Another factor undermining FONAFE’s fully successful functioning is its weak executive vis-à-vis its board. Finally, in practice, FONAFE is not as powerful or weighty a player as some of the more economically important SOEs.

**Relations with the State Supreme Audit Institution.** There is no regulatory or de facto framework for coordination of FONAFE with CGR on SOE issues. FONAFE has registered some coordinating efforts with CGR, but there is no significant cooperation between the two entities (section IA).

**Other relationships.** Cooperation of FONAFE with regulatory bodies and ministries is weak and is entirely dependent on the good will of the executive directors of FONAFE and the respective entity (sections IA and ID).

**Guideline IIF: The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:**

**Assessment: Partially observed.**

**1) Being represented at the general shareholders meetings and voting the state shares**

**Representation and voting.** FONAFE assigns a representative for each SOE AGM (usually a FONAFE employee) and gives the representative precise voting instructions by which s/he is bound. FONAFE has no written voting policy; its board issues specific voting instructions in each SOE case. Similarly, FONAFE has no internal rules on how to decide on capital increases, dividend decisions, and other major shareholder decisions. In practice, since the decisions are issued by the FONAFE board, they are heavily ministry driven.

By LGS, AGMs must be held within 3 months of the financial year’s end and are convened by the board. The notice, containing the agenda, must be published 10 days in advance for SAs (25 in the case of SAs LGS §258). The quorum is 50 percent of voting capital for nonfundamental issues; for fundamental issues, decisions are by simple majority.

Fundamental corporate changes are decided at the shareholders meetings. The right to decide on a capital increase may be delegated to the board for up to 5 years. Sales of assets with a value of more than 50 percent of capital stock require approval of shareholders representing the majority of voting capital.

**2) Establishing well-structured and transparent board nomination processes**

**Board nomination process.** SOE directors are nominated by the board of FONAFE, which is composed of five ministers. The nomination document is published in the Official Gazette. FONAFE then approves the nominations at the SOE AGM in its role as
**State representation in fully or majority owned SOEs, and actively participating in the nomination of all SOE boards.**

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By LGS, shareholders elect directors for a minimum term of 1, and a maximum term of 3, years, after which the board is replaced in its entirety. In the case of SOEs, boards are replaced by each new party in power.

Four FONAFE SOEs do not have their directors nominated by the FONAFE board: AGROBANCO, PERUPERO, SIMA and PETROPERÚ.

**State representation in minority state-owned companies.** For SOEs with minority participation, the minority representative directors are chosen by cumulative voting as provided by LGS.

**SECTION III: EQUITABLE TREATMENT OF SHAREHOLDERS**

The state and state-owned enterprises should recognize the rights of all shareholders, and in accordance with the OECD Principles of Corporate Governance, ensure their equitable treatment and equal access to corporate information.

**Guideline IIIA: The coordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.**

**Assessment: Largely observed.**

**Equal rights for state and minority shareholders.** By law, nonstate shareholders in a company in which the state has

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<th>(3) Setting up reporting systems allowing regular monitoring and assessment of SOE performance.</th>
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<td>FONAFE typically allows SOEs to define their own strategic and operational/performance management plans, which it approves. Those documents are available on SOE websites. The plans should align with FONAFE's strategic plan and the ministerial sector policies. These documents typically are conceived at the board, not management, level, although FONAFE regulations direct the CEO to draft them. Compliance with these objectives is supposed to be monitored by law, by CGR, the Supreme Audit Body. However, CGR’s control emphasizes financial audit and procedure enforcement, but does not focus on performance management. FONAFE receives regular updates by SOEs on their achievement of strategic and operational/performance objectives. In some cases, regulators have stepped in to conclude price-setting agreements with SOEs. Such increases in prices charged are made conditional on the achievement of certain performance objectives, without due coordination with FONAFE.</td>
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<th>(4) When permitted by the legal system and the state’s level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.</th>
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<tr>
<td>Cooperation with auditors. CGR, not FONAFE, selects the external auditor for SOEs. FONAFE has no relationships, by law or in practice, with SOE external auditors. SOEs file the long and short audit reports with FONAFE, as well as periodic updates on their progress in complying with the recommendations of the audit report.</td>
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<tr>
<td>Cooperation with CGR. There is no regulatory or de facto framework for FONAFE to coordinate with CGR on SOE issues. FONAFE has registered some coordinating efforts with CGR, but there is no cooperation between the two entities (section IIE). Note that FONAFE is subject to CGR audit and control as well. Another level of relationship between FONAFE and CGR is that FONAFE has limited enforcement powers vis-à-vis SOEs and must rely on CGR for enforcement and compliance.</td>
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<th>(5) Ensuring that remuneration schemes for SOE board members foster the long-term interest of the company and can attract and motivate qualified professionals.</th>
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<td>The functions of the FONAFE board include remunerating SOE board members. The pay depends on the size of the SOE, which presumably correlates with its complexity and oversight needs. Overall, however, director remuneration is limited to two payments a month of roughly $300 each per board session. This amount is reported to be inadequate to ensure due time spent in the performance of directorial duties.</td>
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<td>The legal framework or the SOE CG Code does not suggest a regular revision of board pay. However, to permit board members’ functions to be carried out with high professional standards, the SOE CG Code directs that remuneration be determined as a function of market conditions as much as possible and within reasonable budgets,</td>
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**July 2006**
significant ownership have the same legal rights as shareholders in other companies. In practice, minority shareholders (especially private ones) are very few and mostly trivial percentages in SOEs. This is by the force of circumstance, not choice. Only eight SOEs that are majority owned by the state have minority shareholders, and only in the case of SEAL is there an active minority shareholder. Minority shareholders have preemptive rights in the case of sales of large blocks of shares. The state holds “golden shares” in some SOEs in the electricity sector, which give the state voting rights in specific cases.

Related party transactions. RPT rules in Peru are not strict in Peru, although transactions between FONAFE and SOEs are well disclosed. In view of the strict CGR sanctions, RPTs between directors/executives and the SOE are unheard of. By LGS, directors may engage in RPTs if they are at market prices and in the ordinary course of business, or if two-thirds of the board approves the RPT. The same rule applies to loans and guarantees. By FONAFE regulations, directors are prohibited the following:

1. Use, on their own or for third parties, any assets, goods, or services of the SOE, or its commercial opportunities, or its private information
2. Enter into any type of contract, or obtain loans or guarantees or other personal advantages for themselves or their families, unless these relations are at market prices and in the ordinary course of business of the SOE. Directors with a conflict of interest must inform the board and abstain from voting.

Transactions among SOEs, and between SOEs and FONAFE, technically are related party transactions (RPTs). By tax law and for tax purposes, any SOE transactions need to take place at market value. Any transaction value over or under market value will be adjusted by the tax authorities (Superintendencia Nacional de Administración Tributaria, or SUNAT). Furthermore, operating at market terms without special benefits or particular treatment is a central principle for the operation of SOEs.

Redress. Minority shareholders in state-controlled companies have the same redress rights as they do in private companies (see also IIID). In the case of delisting, minority shares must be purchased at a fair market price. Takeover rules (by LGS, although it is unclear that these would apply to SOE privatizations) also appear to adequately protect minority shareholders, with the exception of owners of nonvoting and investment shares, who do not benefit from tag-along rights. The SOE CG Code states that changes of control and full share divestiture by the state should be adequately publicized to the market, with succession plan provisions and full shareholder participation in the control premium (§13).

Rights to information. Minority shareholders can ask for the annual report before the AGM, but SOEs are not legally obliged to send it. Shareholders with 5 percent of voting rights have the right to request any information from SAAs; for SAs, the voting rights requirement is 25 percent. Shareholders owning 25 percent of shares can have their shares listed, even if the other shareholders do not want to follow suit. Shareholders have withdrawal rights in cases in which they voted against certain fundamental decisions or were not present at the AGM. Shareholders have the right to a direct suit against the company. Derivative suits can be brought against directors or the board as a whole by a minimum of 33 percent of the voting shares. Note, however, that the Peruvian court system is slow, and lacks specialization and impartiality. FONAFE has not issued implementing norms for administrative sanctions, which leaves SOEs as well as their minority shareholders with very weak protection against irresponsible directors. The June 2006 FONAFE directive permits FONAFE to remove directors for cause, and strengthens the qualification criteria for nominated directors.

No SOE has employee or pension plan shareholders except Electroperú, which is wholly owned by the Fondo Consolidado de Reservas, the pension fund for public employees (civil servants).

The SOE CG Code states that SOE boards should ensure that minority shareholders should see their voting rights and rights to information well respected, and should have sufficient access to redress (§6).

Guideline IIIB: SOEs should observe a high degree of transparency toward all shareholders.

Assessment: Largely observed.

Periodic information. SOEs are obliged to create their own websites and publish the following information there:

- General information (vision, mission, business description, earnings and sales, organizational structure).
- Procedure for inquiries, requests for information, and complaints, including a contact person, and statistics on number of inquiries, requests for information, and complaints, as well as reaction time by the SOE, within 20 days of the end of each quarter.
- Plan Estratégico, Plan Operativo, Convenios de Gestión (including progress to date and actions taken), within 20 days of the end of each quarter.
- Annual report, by June 30 of the following year, including audited statements, notes, and the auditors’ report. However, as of July 24 2006, SOEs’ annual reports for 2005 have not been posted on their websites.
- The SOE budget, within 20 days of its approval by FONAFE, as well as all changes within 20 days of the board decision, and the actual spending relative to budget, within 20 days of the end of each quarter. This should include revenues, costs, financing (with details on the source), and operating income.
- Borrowing (the amount of external borrowing from banks, government, suppliers, international organizations; name of
the lender, principal, and interest), within 20 days of the end of each quarter.

- Investments (information on the 10 major investment projects or those that comprise at least 70 percent of the investment amount of the current year, whichever is smaller; total investment amount, current year investment amount, and amount invested to date; name and description of project; source of financing; goals of project overall and for the current year; progress to date), within 20 days of the end of each quarter.

- Human resources information (categories of employees; number of employees by category; salary range and labor regime by category; total salary costs; total benefits/costs; pension regimes; number of pensioners; amounts outstanding), within 20 days of the end of each quarter.

- Directors and management (names, performance parameters, monthly remuneration).

- Procurement (annual plan in the same format as submitted to CONSUCODE), within 20 days of the end of each quarter, including the following details (which vary by type of procurement): description of the goods/services procured; details on the winning bidder; value of the contract; amount disbursed.

- Main suppliers (names of the 50 largest suppliers, amounts involved), within 20 days of the end of each quarter.

- Main acquisitions of goods and services (description of the 50 main purchases; amounts involved), within 20 days of the end of each quarter.

**Information for minority shareholders.** Nonstate shareholders in SOEs can obtain relevant information, in a timely fashion, and without undue cost. By law, however, minority shareholders typically need to request the information (even such information as the annual report prior to the AGM), and would not be automatically sent the information by the SOEs. Information to which minority shareholders have access includes the SOE founding documents (available from SOEs and the Company Register); consolidated audited financial statements (SOE and FONAFE website, with a delay, available from SOEs prior to the AGM); list of directors and top management, including their remuneration (SOE website); strategic and operational plans/Covenios de Gestion (SOE website); minutes of AGM (available from SOEs). External auditors’ contracts are announced (with maximum allowed fee, but not actual awarded pay) on the Official Gazette. Due to the dearth of minority shareholders, it is difficult to assess how these information rights function in practice. The information is available in its complete form. Additional (nonpublic) information is available to minority shareholders by the Ley de Transparencia y Acceso a la Información Pública, at the cost of copying the materials. Any citizen can complain to FONAFE for failures of SOEs to comply with the FONAFE Transparency Directive.

**Material facts.** Majority-owned SOEs are not required to continuously disclose all material information but must publish material events monthly on their websites. Compliance is relatively high. The Code further urges SOEs to guide themselves by the high standards of disclosure of listed companies. Listed SOEs disclose material information continuously, although due to intermittent approval and public reaction concerns, they find it difficult to disclose in real time. The SOE CG Code posits that SOEs should disclose material facts on a continuous basis (§26).

For nonlisted SOEs, materiality is defined only in the SOE CG Code as “affecting commercial or financial decisions of stakeholders in their interaction with the SOE. CONASEV regulations define material facts more carefully.

**Additional information.** As a minimum, SOEs should maintain the following information in paper and/or electronic form and make it available to all shareholders: internal rules and regulations; internal policies as part of their strategic plans; manuals and internal procedures; description of the organizational structure; list of SOE documents by category, registers, and archives, and the names of staff responsible for them; description of the procedures and rules to obtain information from the SOEs; and the procurement costs of the goods, services, and work obtained and offered by the SOE. For listed companies, consolidation and segment reporting are mandatory. Ownership disclosure is not mandated. Companies need to comply or explain their adherence to the Code of Corporate Governance. FONAFE also makes certain disclosures (see VA).

The SOE CG Code advises SOEs to determine their own disclosure, ownership disclosure, and insider information policies and procedures and policies, subject to existing regulations, and provide documentation free of charge (§27, 28, 31).

**Enforcement.** FONAFE checks the information filed and can make observations if necessary. SOE compliance with disclosure rules is high, although quality of disclosure is unclear due to CGR (not FONAFE) monitoring. FONAFE does not have sanction power over SOEs. CGR is responsible for monitoring SOE compliance with FONAFE regulations because they are part of the overall legal framework. SOE employees can be sanctioned for failure to accomplish their employment obligations. In certain cases, SOE employees may be subject to penal (criminal) responsibility for abuse of authority (for example, refusal to disclose at the request of a citizen under the Transparency Law). Relative to the past, there is an overall stakeholder and public perception of wider access to SOE information. However, disclosure regulations, as well as SOE listings, are a recent phenomenon, and their enforcement and quality remain to be assessed.

To boost SOE transparency, FONAFE’s policy is to encourage SOEs to list and register with CONASEV. Listing disclosure rules are stricter in their requirements and in some definitions than the respective SOE rules. SOEs in the process of listing do not consider the costs of compliance with disclosure requirements excessive. CONASEV has imposed the following sanctions in the first half of 2006: 3 warnings for material fact disclosure offenses and a fine for failure to protect minority shareholders.
**Guideline IIIC: SOEs should develop an active policy of communication and consultation with all stakeholders.**

**Assessment: Largely observed.**

SOEs must have a process for public consultation, information requests, and complaints, published on its website. The Transparency Directive defines the basics of the public consultation process, the costs (limited to reproduction costs), and the deadlines for response (generally within 30 days) (see also section IIIB).

**Guideline IIID: The participation of minority shareholders in shareholder meetings should be facilitated to allow them to take part in fundamental corporate decisions such as board election.**

**Assessment: Largely observed.**

The SOE CG Code states that adequate AGM disclosure should be assured, including notice, voting rights, ownership and shareholder agreements; as well as adequate participation of all shareholders in fundamental SOE decisions (§2).

The AGM notice, containing all the agenda, is published in the Official Gazette 10 days in advance for SAs, 25 for SAAs. Background documents for AGMs must be explicitly requested by minority shareholders and will not be automatically sent by SOEs. If the AGM is not called, shareholders, representing 20 percent of the shares for SAs or 5 percent for SAAs, may petition for an AGM (LGS §117, 225). Shareholders cannot force items onto the agenda. Shareholders may appoint a representative. Cumulative voting (in election of directors) is mandatory (LGS §163-164). With 20 percent of voting rights, shareholders can request the court to suspend AGM decisions. The same percentage can demand the distribution of a dividend of up to 50 percent of earnings (LGS §145). Shareholders owning 25 percent of shares can postpone a general shareholder meeting for 3–5 days (LGS §131).

Nonstate shareholders are rare in Peruvian SOEs. They hold trivial numbers of shares, and are not active. (Most are state entities that have not become shareholders by choice but by circumstance.) AGM procedures facilitate participation; however, due to the very few cases of minority shares, practice is difficult to assess.

**SECTION IV: RELATIONS WITH STAKEHOLDERS**

**Guideline IVA: Governments, the coordinating or ownership entity and SOEs themselves should recognize and respect stakeholders’ rights established by law or through mutual agreements, and refer to the OECD Principles on Corporate Governance in this regard.**

**Assessment: Largely observed.**

**Protections within the legal framework of SOEs.** Stakeholder rights are recognized both in the legislature (labor law, rehabilitation and liquidation laws, environment law, consumer protection law) and the FONAFE SOE CG Code and Code of Ethics. The SOE CG Code states that stakeholder rights should be respected; SOEs should be socially responsible. Stakeholders should have adequate recourse to redress. The board should be informed regularly and decide in atypical situations (§9). The Code specifically focuses on SOE debt and insists that it be at market terms (§8). Finally, the Code suggests the approval by the board of the Code of Ethics, to be observed by all employees and officers, including its incentives and sanction for compliance, and regular compliance updates to the board (§11, see section IVC). In practice to date, stakeholders have not been actively involved in SOE governance. In the sense of market participants, as of yet, the public has no awareness of the importance of corporate social responsibility. However, environmental awareness is growing.

**Protections within the legal framework of SOEs: Employees.** SOE employees do not have special rights. They are not represented on the board, and the unions that exist are not consulted in enterprise restructurings, which is an exclusive decision domain of the AGM. SOEs and private companies with more than 100 employees must have Internal Employee Rules (Reglamentos Internos de Trabajo) to regulate employee functioning and relations. Union labor representatives can seek redress from the Ministry of Labor for violations of labor law. Consumer and environmental issues also can be resolved with the respective ministries.

**Stakeholder redress.** Creditors can initiate judicial proceedings for debt collection or bankruptcy. Environmental rights can be defended by any citizen initiating a proceso constitucional de amparo. This process could achieve the elimination of the particular environmental threat but would not result in any indemnification.

Employees also have judicial redress possibilities. In companies with 20 or more employees, they can organize in unions. In firms with fewer than 20 employees, workers have the right to designate 2 delegates to represent them in front of the employer and the Ministry of Labor. Employee delegates can file against companies with the Ministry of Labor. Individual employees also can file an action with the civil court. In the 1990s, decisions primarily indemnified workers but did not restore them to their positions. However, recently, as a result of pronouncements by the Tribunal Constitutional, employees have a better chance to be restored to their positions.

Customers for SOEs in regulated industries can file complaints with INDECOPI’s Commission of Consumer Protection...
Arbitration exists in Peru. Almost all SOEs sign arbitration clauses for large contracts with the Camara de Comercio. Per FONAFE’s Dispute Resolution Directive, it is mandatory for SOEs to attempt to resolve disagreements through FONAFE’s mediation procedure before going to arbitration. Arbitration is perceived by SOEs as faster, fairer, more reliable, and specialized, but more expensive. The SOE CG Code advises that SOEs should have dispute resolution policies that place a priority on the state interests as a whole before the particular SOE’s interests (§7).

Regarding disputes among shareholders, the Code states that SOEs should maintain neutrality and that preference should be given to arbitration and conciliation as dispute resolution mechanisms.

**Guideline IVB:** Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

**Assessment: Largely observed.**

SOEs report detailed information on their relations with suppliers, as well as a full record of communications, requests of information, and complaints from the public. Extensive employee information appears on the SOE website and is updated quarterly. This information comprises categories of employees and number by category; salary range and labor regime by category; total salary costs; total benefits/costs; pension regimes; number of pensioners; amounts outstanding. There is similarly on the web extensive quarterly information on external borrowing by SOEs (amount of external borrowing from banks, government, suppliers, international organizations; name of lender, principal, and interest).

**Guideline IVC:** The board of SOEs should be required to develop, implement, and communicate compliance programs for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

**Assessment: Largely observed.**

**Code of Ethics.** In February 2006, FONAFE published the Código Marco de Ética de los Trabajadores de las Empresas del Estado. All majority-owned SOEs approved the Code of Ethics and are implementing it. Implementation includes the revision of the Internal Employee Rules (Reglamentos Internos de Trabajo) to incorporate the sanctions for noncompliance with Code of Ethics requirements.

The ethics code applies to all employees, contractors, and service providers of the enterprise, including directors. It imposes a set of the ethical principles on SOE employees, namely, integrity, efficiency, suitability, veracity, and loyalty. Employees are held to the ethics duties of political and economic neutrality; transparency of their work; discretion with sensitive information; appropriate use of company property; and awareness of the environment, and community and social responsibility. The Code of Ethics lists certain prohibitions, namely, positioning one’s personal interest in conflict with one’s professional duties; obtaining private benefits by dint of one’s professional position; pursuing political goals using company property; misusing insider information; and attacking someone's personal dignity. The CEO is responsible for disseminating and implementing the Code of Ethics, and establishing the corresponding incentives. Code breaches are an employee offense and punishable by labor law. Staff is obliged to denounce Code of Ethics breaches.

Corruption and bribes are considered criminal offenses. As such, SOE directors have the obligation to report to FONAFE and CGR any knowledge of such offenses among directors or employees. The internal auditor polices management and employee misconduct in SOEs and reports to CGR. The law has no “whistleblower” protections.

**SECTION V: TRANSPARENCY AND DISCLOSURE**

**State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.**

**Guideline VA:** The coordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.

**Assessment: Largely observed.**

FONAFE issues consolidated financial statements for all SOEs by May 31. FONAFE discloses on its website the following information on SOEs: consolidated budget plan (by December 31 of the previous year); consolidated balance sheet and outstanding amounts of cash, investments, and financing by quarter; audited financial statements (within 120 days of the end of the financial year); and SOE performance criteria for signed management contracts and achieved results relative to the criteria. Congress and CGR can ask SOEs for any info they judge necessary. Every citizen has the right to all information on public entities, including SOEs.

FONAFE’s Transparency Directive mandates that SOEs disclose certain information on their websites: general information on the SOE; Strategic and Operational Plans (within 20 days of each quarter); audited annual report (by June 30 of the following year), and monthly statements; schedule of corporate debts (within 20 days of each quarter); investments (within 20 days of each quarter); employee information (each quarter); procurement and purchases (within 20 days of each quarter).
Additional details on SOE disclosure duties are described in IIIB.
SOEs submit monthly, quarterly, and annual financial and nonfinancial information to FONAFE via the internal electronic system, within 15 days of the end of the month/quarter; and for the annual information, by the end of February. Within several days, paper copies signed by the chief executive officer (CEO) or the chief budget officer (CBO) also are submitted to FONAFE. The information includes a profile statement, balance sheet, income statement, budgeted revenues and expenses, schedule of debits, net worth (capital social), capital expenditures, schedule of investment projects, projected cash flows, cash holdings, as well as a financial and budgetary evaluation relative to plan and relative to the same period the previous year. CEOs also submit to FONAFE the long and short audit reports by the end of February, and a copy of their report to CGR detailing compliance with the recommendations of the latest external audit report and the internal auditor.

Guideline VB: 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 company organ.

Assessment: Not observed.

Internal audit. SOEs in general do not have internal audit functions by law. However, under the National Control System Law, CGR has the authority to invoke internal audit units whenever deemed necessary. In the case of majority-owned SOEs under FONAFE, CGR appoints an internal auditor (Órgano de Auditoría Interna) who reports to CGR and is compensated by the SOE. The internal auditor does not depend functionally on nor report to the SOE board or management, or to FONAFE. Internal auditors monitor the compliance of SOEs and their employees and management with various rules, regulations, and procedures established for SOEs (for example, procurement). Accounting capacity at the SOE level is adequately qualified. However, there is a deficiency of technology, which worsens traceability, as well as an insufficient training of CEOs in management accounting issues. The internal auditors are perceived by market participants to act from a formalistic, fault-finding, policing perspective, more as a control than an internal audit organ. Internal auditors do not consult with external auditors. FONAFE’s communication to internal auditors is somewhat one-sided: FONAFE relies on the auditor for enforcement but obtains no information/reporting from the auditor.

Audit committee. SOEs have no mandatory audit committees except for financial entities under SBS. Financial companies must form an audit committee. The audit committee is composed of a minimum 3 members, who must be nonexecutive directors. Each member rotates every two years. The members should possess adequate knowledge and experience. The audit committee functions are to

1. Oversee the internal control system
2. Inform the board on policies and measures to ensure its good functioning
3. Ensure that the functioning of internal and external auditors is adequate for the company needs
4. Coordinate with the internal auditor.

Audit committees should contribute to improving audit quality. The use of audit committees and other good corporate governance practices have enhanced companies’ internal controls over the financial reporting process and strengthened the role of external auditors. These good practices thus have improved the quality and reliability of the financial information communicated to stakeholders.

Guideline VC: SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.

Assessment: Matteredly not observed.

External auditor appointment. LGS does not regulate the procedure for appointment and replacement of auditors, although it gives shareholders the formal power to designate the external auditor. For majority-owned SOEs under FONAFE, the National Control System Law (Ley Orgánica del Sistema Nacional de Control y de la Contraloría General de la República) abrogates this rule and confers the right to appoint the external auditor to CGR. CGR maintains a register of eligible auditors. For an auditing firm to be included in the CGR Auditor Register, (1) all of its partners and experts must be members in their respective professional association (accountants or lawyer’s association), and (2) all partners must have a minimum of 60 hours of continuing education at the Escuela Nacional de Control (professional school) in the past 2 years (this training requirement is suspended pending creation of the school).

Stakeholders note that the CGR external audit contract-awarding procedure tends to select small audit firms that are ill-equipped in terms of resources, qualifications, and personnel to perform external audit for the sizable and influential SOEs. In contrast to auditing few large SOEs, the Big 4 and the largest domestic audit firms service primarily listed firms and financial institutions. The Accounting and Audit ROSC 2004 reports low audit quality, trivial licensing requirements, insufficient professional training, and ineffective enforcement of legal provisions for audit quality and compliance with audit standards.

External auditor functions. The external auditor’s contract includes the duty to report on four facets: the level of achievement of the goals of the Strategic and Operational Plans; compliance with the tax duties of SOEs, the audit opinion.
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on the financial statements, and the quality and appropriateness of use of public resources.\textsuperscript{87} In practice, external auditors perform only a limited version of this audit and focused on the financial audit. SOEs are required to form a committee, “Comisión Especial de Cautela,” which is composed of employees not related to the audit department or functions in the SOE. This commission helps provide information and coordinate with the external auditor and provides all administrative support to the external auditor. This commission is reported to be of little substantive use. There is limited communication between the external auditor and the SOE, since the auditor reports to CGR. Neither do external auditors interact with FONAFE or other shareholders. The external auditor submits the report to CGR and to the CEO; the latter files a copy with FONAFE.

**External auditor independence.** The independence of the external auditor is defined for SOEs by CGR.\textsuperscript{90} A stronger definition is provided for listed companies (including listed SOEs).\textsuperscript{91} Rotation is required for SOEs: external auditors can be used for at most two consecutive years.\textsuperscript{92}

**External auditor liability and redress.** External auditors must report any illegal activities, fraud, or insider abuse by management and directors to CGR and the CEO. There is no obligation to report this to FONAFE or other shareholders. Directors and senior management have civil liability under a very general regime of damages caused to the corporation. They also could incur criminal liability for fraud (there are no preset liabilities or maximum penalties). There is no express procedure for shareholders to sue external auditors.\textsuperscript{93} Auditor accountability to investors and other stakeholders is constrained, due in part to the lack of professional insurance (outside of internationally affiliated firms), the fact that LGS does not provide for auditor sanctions, and a legal system that does not facilitate lawsuits against auditors. Some disputes have been observed involving CGR and independent auditors. In contrast, companies/shareholders have not initiated lawsuits against external auditors.

Minority shareholders do not have the right to request an independent audit at company expense. SOEs cannot hire directly external audit companies for audit services, or for services revising/assessing audit opinions or work already carried out by the external auditor contracted by CGR.\textsuperscript{94}

**Guideline VD:** SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and nonfinancial information according to high quality internationally recognized standards.

**Assessment:** Materially not observed.

**Accounting standards.** SOEs comply with the accounting standards for all SAs, which are based on IFRS and updated periodically.\textsuperscript{95} The SOE CG Code of FONAFE urges SOEs to present financial information using the highest accounting standards and apply the highest standards of audit (§§29,30).

**Audit standards.** Peru has adopted a 1998 version of ISA. SAs must be audited only if the bylaws or 10 percent of the shareholders request so. Listed companies and SAAs undergo a mandatory audit. Banks, insurance companies, and pension funds must present audited financial statements in accordance with the SBS pronouncements, which differ significantly from international standards.\textsuperscript{96} SOEs are audited according to the CGR audit norms, which differ significantly from ISA. The audit report format differs from the standard ISA audit opinion and is a long report on SOE compliance with a set of regulations and standards. Minority-owned national-level SOEs have no fixed format for their annual reports (short of prescriptions by IFRS). In practice their reporting is incomplete (for example, the financial statements do not contain notes). Minority-owned national-level SOEs must have their statements externally audited but need not disclose them publicly.

**Guideline VE:** SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public. Examples of such information include:

- A clear statement to the public of the company objectives and their fulfillment;
- The ownership and voting structure of the company;
- Any material risk factors and measures taken to manage such risks;
- Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE;
- Any material transactions with related entities.

**Assessment:** Partially observed.

SOE and FONAFE public disclosures are listed in sections IIIB and VA.

1. **Company objectives.** The annual report describes the activities and the level of achievement of objectives of SOEs. SOE objectives also are spelled out in the Strategic Plans published on the SOEs’ websites. Objectives are not clearly prioritized and contain conflicting directions. Noncommercial objectives are not distinctly isolated and priced.

2. **Major share ownership and voting rights.** Major shareholders over 5 percent are listed in the annual reports of listed

\textsuperscript{87} There is no legal or professional requirement for SOEs to have a standard audit report.

\textsuperscript{90} The external auditor is defined in the SOE CG Code of FONAFE.

\textsuperscript{91} Rotation is required for SOEs: external auditors can be used for at most two consecutive years.

\textsuperscript{92} Some disputes have been observed involving CGR and independent auditors. In contrast, companies/shareholders have not initiated lawsuits against external auditors.

\textsuperscript{93} Auditor accountability to investors and other stakeholders is constrained, due in part to the lack of professional insurance (outside of internationally affiliated firms), the fact that LGS does not provide for auditor sanctions, and a legal system that does not facilitate lawsuits against auditors.

\textsuperscript{94} SOEs cannot hire directly external audit companies for audit services, or for services revising/assessing audit opinions or work already carried out by the external auditor contracted by CGR.

\textsuperscript{95} SOEs comply with the accounting standards for all SAs, which are based on IFRS and updated periodically.

\textsuperscript{96} SOEs are audited according to the CGR audit norms, which differ significantly from ISA. The audit report format differs from the standard ISA audit opinion and is a long report on SOE compliance with a set of regulations and standards.
SOEs as well as on the FONAFE website for all majority-owned SOEs. For listed firms, CONASEV and BVL must be informed within 5 days by owners crossing the 10 percent ownership threshold.97 SOEs are mostly state owned at 95 percent, and there are very few significant minority shareholders. Nonlisted SOEs with minority state participation do not need to publish their ownership structure (in practice, it is well known). There are no express regulations by FONAFE or LGS on ownership disclosure. Capital structures, voting rights of shares, and golden shares are not disclosed in the annual report. Some SOEs have more than one share class.98 Special voting rights are reflected in the bylaws, publicly accessible at the Registro Público de Personas Jurídicas. The CG Code (§5) encourages SOEs to have as few classes of shares as possible, with clearly stipulated voting rights. Information on share classes and voting rights is encouraged to be made sufficiently available to shareholders.

3. Foreseeable risk factors. There is no requirement for SOEs to disclose risk policies. Few SOEs (mainly financial companies) have a risk management policy or actively manage risks (for example, COFIDE has a risk committee). The SOE CG Code charges the board with responsibility for an adequate system for risk management in the SOE (§10), urges them to disclose financial and nonfinancial risks in the annual report (§29), and encourages the use of risk-rating agencies (§32).

4. Reporting on financial assistance from the state. Subsidies, grants, and other direct transfers are disclosed. In some cases, direct transfers are made via officially published resolutions in the Official Gazette. State debt and debt from state-owned institutions is reported on SOE websites within 20 days of each quarter, as well as in the annual report.

5. Related party transactions. SOEs need not disclose information on related party transactions. IAS 24 leaves significant scope for interpretation as to RPT disclosure. In practice, transactions between FONAFE and SOEs are well disclosed. For listed companies, CONASEV also requires RPTs to be disclosed as material facts but has limited enforcement capacity.

SECTION VI: THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

Guideline VIA: The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company’s performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equitably.

Assessment: Partially observed.

Nomination. By LGS, SOEs must have unitary board of directors. Until June 2006, 4 of 5 board members were nominated by the line ministry of the SOE, and the chair by MEF. Recent FONAFE legislation discourages concentration of the influence of a single ministry, although it keeps the mandatory MEF representation on SOE boards.99 FONAFE can remove any SOE director (including in minority-owned SOEs) without cause.100 A director can hold at most two board seats in private enterprises, in addition to an unlimited number of board seats in SOEs. Although there are no legal requirements for SOE boards to meet regularly, in practice, their meetings are limited by the legal maximum of two payments a month per board session. The board meets at the request of the chair or when a director or manager requests a session.101 Quorum is half plus one, and decisions are adopted by simple majority. Directors are reported to spend an insufficient time on their duties.

Around 40 percent of FONAFE SOEs have a full-time chair, typically a political appointee. Salaried by and housed at the SOE,102 this Chairman frequently conflicts with the autonomous functioning of the CEO.

Eligibility criteria. The nominated directors must be honorable; expert and well recognized for their professional experience and high ethics and morals; familiar with the intricacies of the business in which the SOE operates; and experienced in taking strategic decisions and in corporate management.103 SOE directors must comply with the following criteria: have a university degree and 5 years of experience; never have been removed for disciplinary or administrative reasons; comply with company law criteria for directors; are not parties to legal proceedings involving the SOE for whose board they have been nominated; are informed of the family relations prohibitions of Law 26771 and the general limitations of Laws 27588 and 28175 on the rules of public entity employment; and have no history of police or penal decisions linked to business activity. Directors must inform FONAFE of any changes in their personal circumstances related to these eligibility criteria.

In June 2006, FONAFE strengthened the qualification criteria for SOE board members to ensure that they are qualified and behave professionally. The recent changes include a director database in which all nominated and appointed directors are listed with historical information, to be maintained by FONAFE’s executive. The implementing procedure establishes a point system for evaluation of board candidates, emphasizing the type of educational degree, length of experience, personal qualities, and continuing training of the candidate. The procedures also note the right of MEF to have at least one representative on SOE boards.

Liability. Directors have liability for damage to the company and shareholders, for acting against the law or bylaws, and for fraud, abuse of position, or gross negligence.104 Directors must carry out their functions with the diligence, order, and care of an owner-businessperson; with the loyalty and honesty that a representative owes to her/his represented party; and with efficiency and responsibility, observing FONAFE regulations, laws, and SOE bylaws.105 “Failure to act in the interests of the state” is not well defined and is open to potential abuse. This phrase also might result in excessive risk aversion and paralysis of board decisions. In addition to civil liability, directors can be criminally liable, as well as be removed by FONAFE.

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from their positions. In the past, political pressures have made it difficult for FONAFE to credibly threaten director removal. FONAFE is tackling this problem, including with the recent June 2006 regulation on directors. There is no business judgment rule. There have been recent lawsuits against directors. In practice, the driving motivation behind director decisions is not FONAFE liability rules but CGR sanctions. There is no director insurance. However, directors can have the SOE cover their defense costs in administrative, civil, and penal proceedings for actions/omissions/decisions in the exercise of their board functions.

Board functioning. Directors have extensive information rights. The SOE CG Code notes that the communication between the board and management is managed by the board, and facilitated by management. The board should be periodically informed of the individual requests for information by directors (§20). Directors must keep themselves informed on company business; evaluate factors that could affect the latter; come prepared to board meetings; oversee existing policies on staff hiring/remuneration, internal cost control measures, procurement policies, and budget planning and procedures; and ensure the accomplishment of SOE objectives. SOE boards do not produce or publish a Directors’ Report to shareholders. The SOE CG Code requires the annual publication of a board report on compliance with the corporate governance principles (§23). The board, as well as directors individually, must submit reports to the FONAFE executive on any matter that the latter requests. FONAFE’s executive has the right to attend any SOE board meeting (including minority-owned). The SOE CG Code recommends the clear definition and disclosure of the duties and functions of the board, and the presentation of sufficient information to the board to enable quality decision-making (§16). In practice, SOE boards do not play an independent role. Inflexibility and unpredictability of CGR sanctions limit board freedom and independence of action. Boards remain passive, beholden to the ministries, and tend to consult on the more important or sensitive decisions with FONAFE via a general meeting approval. The board and CEO are replaced by each party in power, and there is no mechanism ensuring the smooth transition in such political reshuffles. The SOE CG Code urges a succession plan (§22).

Guideline VIB: SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the Government and the ownership entity. They should have the power to appoint and remove the CEO.

Assessment: Partially observed.

The board is empowered with the faculties of management and legal representation, except for those matters attributed to the AGM (LGS §172). The board selects and oversees management, unless the bylaws reserve this power for the AGM (LGS §185). SOE boards have responsibility to monitor management and provide strategic guidance of the following functions: corporate strategy (with FONAFE approval); operational (business) plans (with FONAFE approval); and performance oversight (although the board typically does not actively monitor implementation and corporate performance). The board also oversees new borrowing, sale of new equity and other changes in capital structure (with FONAFE/MEF approval, and subject to severe restrictions), major capital expenditures, and acquisitions and divestitures (with FONAFE/MEF/SNIP approval).

Specifically, SOE boards have the responsibility to select, compensate, monitor, and replace key executives, including the CEO. Standards for hiring SOE CEOs are being reformed to improve professionalism of the selected candidates and the hiring process from political influences. The SOE CG Code requires high professional standards for the CEO (§18). The board sets remuneration of the CEO and other senior officers. The ceilings for such remuneration are fixed by the FONAFE board via its approval of the SOE’s Remuneration Policy. The SOE CG Code urges management functions to be clearly delineated and follow the lead of the board, but also to have sufficient autonomy to be effectively carried out (§19). In practice, important decisions that should be taken by the CEO usually are cleared with the board.

Guideline VIC: The boards of SOEs should be composed so that they can exercise objective and independent judgment. Good practice calls for the Chair to be separate from the CEO.

Assessment: Materia not observed.

Independence and conflicts of interest rules. There are no rules on independent or nonexecutive directors. The SOE CG Code recommends that director decisions be independent and objective, and that at least one director (but as many as possible) be free of political links to the government, have never been employed by the SOE or the line ministry, and have had no past contractual relations with the SOE (§15). There is no express prohibition against elected politicians’ serving on the boards of SOEs. In practice in the past five years, this has been very rare. Ministers also are allowed to serve on the boards of SOEs (without pay) (case in point is FONAFE), but again this is rare to nonexistent in the SOEs under FONAFE’s ownership. Other high-level officials also are allowed to serve on the boards of SOEs (with the restriction of receiving remuneration from only one state institution).

In the opinion of stakeholders, current arrangements are not sufficient to ensure the SOE board’s independence vis-à-vis the ownership entity or the ministries. Similarly, current arrangements are insufficient to ensure SOE management’s independence vis-à-vis the board. In practice, SOE directors are not typically ministry employees, civil servants, or elected officials. However, a considerable proportion of officer and management positions are occupied by career bureaucrats.

The CG Code further states that there should be a well defined policy on conflicts of interest, enforced by the board.
Conflicts of interest are immediately notified and the conflicted party, who recuses him/herself from related decisions (§25). Directors also must comply with the following criteria: they are not involved in a competing business or in another company in the same sector; are not receiving payments other than their director remuneration and are not involved in any other business relationship with the SOE on whose board they serve. Directors are prohibited from:

- Using, on their own or for third parties, any assets, goods, or services of the SOE, its commercial opportunities, or its private information
- Entering into any type of contract, or obtain loans or guarantees or other personal advantages, for themselves or their families unless these relations are at market prices and in the ordinary course of the SOE’s business
- Violating confidentiality in their addresses to the press.

Directors’ duties include requesting the removal of a director who has conflicts of interest with the SOE; placing company interests before their own, declaring any personal interests conflicting with those of the SOE and abstaining from decision-making on related issues; and treating confidentially the information obtained in their position as a director. Directors who have been removed from any board are ineligible for reappointment to any SOE. Full-time Board Chairs cannot be employed by other SOEs.

Separation of Chairman and CEO. In all SOEs, the Chairman and CEO positions are held by two different people. The SOE CG Code recommends that the CEO not also be president of the board (§16).

Remuneration. The FONAFE board determines director remuneration. Importantly, director pay is limited to two approximately $300 payments a month per board session, which restricts the amount of attention directors consecrate to their duties. Director pay does not seem widely out of range with international practice, adjusted to the country’s income level. Nevertheless, stakeholders believe directors’ pay to be inadequate to ensure that they spend due time performing their duties, Neither the legal framework nor the CG Code suggest a regular revision of key executive and board pay. However, the CG Code recommends market-competitive remuneration policies as well as a remuneration committee (§24).

Guideline VID: 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.

Assessment: N.A.

Employee board members. There is no employee representation on boards of directors in Peru by law or in practice. The July 2006 law that removed PETROPERU from the FONAFE framework also created ad hoc employee representation in that SOE (1 vote of 6). The staff representative is selected via general direct elections among the employees, using secret ballot and administered by the National Electoral Supervision Body (Oficina Nacional de Procesos Electorales). Due to the recent and novel nature of this change, it is too early to assess its functioning in practice.

Guideline VIE: When necessary, SOE boards should set up specialized committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.

Assessment: Materia not observed.

The LGS permits the board to delegate certain functions to specific members, thus allowing for the creation of specialized committees. For listed companies, the CG Code recommends the establishment of audit committees. SBS mandates these for financial institutions (among SOEs, COFIDE, Agrobanco, and MIVIVIENDA each have one). The SOE CG Code encourages the formation of specialized committees, including audit, nomination, remuneration, and evaluation (§17). Very few SOEs set up board subcommittees.

Guideline VIF: SOE boards should carry out an annual evaluation to appraise their performance.

Assessment: Materia not observed.

No rules and procedures require evaluation of board performance. However, the SOE CG Code recommends an annual evaluation of board and management, for which the board is responsible (§21).

Training. There are no certification/accreditation or training programs for SOE board members. In June 2006, FONAFE introduced a director database in which all nominated and appointed directors are listed. Although the SOE CG Code (§14) recommends director training, SOE officers and management are in significant need of training.

1 Data from the World Bank CFAA 2001. The SOEs under Dirección Nacional del Presupuesto Público and the public beneficiary
societies have a negligible share in the government budget. The size and importance of SOEs under local government is not measured. The SOEs under FONAFE represent a major part of the economy.

2 This includes Electroperú, which is not property of the state. However, its management is entrusted to FONAFE. PETROPERÚ is excluded in the above figures as of July 2006, with the passage of the law on Strengthening and Modernization of PETROPERÚ. This law resulted from the SOE’s successfully lobbying its way out of the FONAFE system (as well as out of the systems of SNIP and CONSUCODE. See ID). www.fonafe.gob.pe. Additionally, 19 SOEs at the national level are liquidating, and 5 are not operational.

3 Decreto Supremo No. 07-94-EF.

4 24 SOEs are in liquidation or not operating. Their better assets were carved out at privatization, so these SOEs are being wound up.

5 Regional/municipal SOEs are not under a single ownership entity, as noted in the SOE overview in the previous section.

6 Ley del Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado–FONAFE No. 27170 y su Reglamento.

The regulators are Organismos Públicos Descentralizados. Regulators’ boards are composed of representatives from the Ministerial Council (2 directors, including the Chairman), MEF, INDECOPI, and the line ministry. Ley Marco de los Organismos Reguladores de la Inversión Privada en los Servicios Públicos No. 27332 §2; Ley del Poder Ejecutivo (Decreto Legislativo No. 560) §§6, 19.

7 There is a dearth of private companies in regulated sectors, which propitiates a more active role for regulators than is perhaps warranted. For example, SUNASS signs performance agreements with its regulated companies in which SOE efficiency is linked with tariff rates allowed by the regulator. Such agreements are not necessarily coordinated with FONAFE, or with the SOE strategic plans agreed with the line ministries. As another example, MEF issued certain economic policies such as budgetary efficiency, state standardization of processes, cost reduction measures, and austerity rules that impede or affect SOE goals and functioning in a manner not coordinated with FONAFE.

8 A closed SA can have at most 20 shareholders, need not have a board of directors, and can restrict share transfers. No SOEs are organized as closed SAs. Companies with more than 750 shareholders, or 35 percent of whose capital is held by at least 175 shareholders, and are registered with the Registro Público del Mercado de Valores, are organized as open SAs. There are very few open SAs among the SOEs. Ordinary SAs can list as well.

9 In addition to Ley General de Sociedades and Ley de FONAFE, the laws governing commercial SOEs are:

- Ley de la Actividad Empresarial del Estado y su Reglamento, Ley General de Sociedades.
- Procurement (Ley de Contrataciones y Adquisiciones del Estado y su Reglamento, Directiva de Gestión y Presupuesto)
- Governance and boards (Directiva aplicable a los Directores de las Empresas en las que el Estado participa como Accionista)
- SOE audit (Ley Orgánica del Sistema Nacional de Control y de la Contraloría General de la República, Ley No 27785)
- SOE operational strategies (Directiva de Formulación del Plan Estratégico de las Empresas bajo el Ámbito de FONAFE)
- Dispute resolution (Directiva para la Resolución de Controversias Patrimoniales entre las Empresas del Estado bajo FONAFE)
- Disclosure (Ley de Transparencia y Acceso a la Información Pública)
- Procurement (Ley de Contrataciones y Adquisiciones)
- Taxation (Ley del Impuesto a la Renta)
- Debt enforcement and bankruptcy (Ley No. 27809, Ley del Sistema Concursal)

10 These were created mostly as a result of the 1979 Constitution, which enabled the state to act as an entrepreneur.

11 §1.2, Directiva de Formulación, Suscripción, Seguimiento y Evaluación de Convenios de Gestión de las Empresas bajo el Ámbito de FONAFE–Acuerdo de Directorio N° 001-2005-003-FONAFE. The strategic plan is drafted by all SOEs under FONAFE excluding those not in operation and excluding minority-state-owned SOEs. The structure of the Strategic Plan is as follows: SOE role (regulatory basis: law of creation, statutes/bylaws and regulation of the organization and functions, brief history, and goals of existence per the SOE law of creation); mission; vision; macroanalysis of external factors affecting the SOE + internal SOE factors affecting the strategic
objectives (Diagnóstico General); strategic objectives (which, among other requirements, should be measurable); strategies; monitoring indicators and goals (§1.4). Currently, the Strategic Plan for 2005–09 is in force. Sectoral Strategies are published on each ministry’s website.

Per the Directiva de Programación, Formulación y Aprobación del Plan Operativo, y Presupuesto de las Empresas bajo el Ámbito de FONAFE para el año 2006, the operational plan, combined with a budget plan, is drafted by all SOEs under FONAFE excluding minority-state-owned SOEs. For 2006, SOEs would not set specific commitments to management objectives (Convenios de Gestión) (§1.7). The operational and budget plan is harmonized with the respective plans of FONAFE (§2). The plans are cleared with Comisión de Presupuesto y Cuenta General de la República del Congreso de la República, la Contraloría General de la República y a la Dirección Nacional del Presupuesto Público, and FONAFE (§3).

The Convenios de Gestión are a set of measurable performance (efficiency improvement) goals for SOEs, which (if achieved) give rise to bonus payments of 4 percent–6 percent to the employees of the SOE financed out of the generated cost savings. Convenios de Gestión were discontinued as it was felt that the bonus was perceived as an entitlement, not an incentive, due to increasingly trivial performance goals proposed by the SOEs and approved by FONAFE. The Convenios were based on incremental requirements over historical performance and failed to truly optimize the potential for efficiency improvements by the SOEs. FONAFE also has met with disapproval by CGR on the grounds that bonuses have been distributed in unprofitable enterprises. Furthermore, SOEs voiced the opinion that the commitment bonus was capped from above, irrespective of the savings achieved. Oversight of the functioning of the Convenios de Gestión is carried out by CGR.

14 A case of the lack of clarity of SOE objectives is TANS Peru’s stated goal to cover unprofitable routes not serviced by private airlines. Its line ministry (Defensa) altered these objectives by directing Tans Peru to serve commercial routes and engaged in what amounted to a price war against the private airlines. The practice was discontinued by INDECOPI under antitrust law.

15 Decreto Supremo modificando la Ley de FONAFE/Procedimiento para la Evaluación de las Personas Propuestas como Miembros de los Directorios de las Empresas en las que FONAFE participa como accionista.

16 Ley de Empleo Publico provides for the existence of such a pay scale, including for SOEs, but the pay scale has not been implemented.

17 Ley de Organización y Funciones del INDECOPI No. 25868 §1; Reglamento de Organización y Funciones del INDECOPI, aprobado por Decreto Supremo No. 077-2005-PCM §§1, 4.

19 For example, a lawsuit was initiated against Editora Perú, which publishes the Peru Official Gazette and undertakes other publishing activities in direct competition with the private sector. Another example is a lawsuit against TANS, an airline company that has the goal of servicing under-serviced routes but has expanded into fully commercial routes in a price-cutting exercise, provoking the wrath of the private competition (see n. 14).

19 Decreto Supremo No. 040-2006-EF §3.

20 Directiva de Gestión y Proceso Presupuestario de las Empresas bajo FONAFE, Acuerdo de Directorio 003-2005-018-FONAFE §1.3.

21 Directiva de Gestión y Proceso Presupuestario §1.4, 1.6.

22 SNIP is under MEF, Ley de SNIP 27293. Directiva de Gestión y Proceso Presupuestario §1.7.

23 Directiva de Gestión y Proceso Presupuestario §1.5.

24 In certain cases, with FONAFE approval, SOEs can retain earnings. Examples are PETROPERÚ, which is keeping 50 percent of its earnings, and COFIDE, which also will receive 50 percent of its retained earnings for technical support this year.

25 PROINVERSION is governed by a board composed of 6 ministers. They represent MEF (who chairs); Ministerial Council (its chair), and the Ministries of Transport and Communications, Energy and Mining, External Relations, Industry, and Commerce.

26 As of 2000, oversight of the efficiency of use of public resources, value for money, performance, as well as—as of 1999—reporting on environment and natural resources. Law on General Accounts 27213.

27 Ley Orgánica del Sistema Nacional de Control y de la Contraloría General de la República, Ley No. 27785, §41, 43, 44. The Reglamento de Infracciones y Sanciones estableshes the procedures, ranges, and criteria for determining infractions and sanctions, as well as other procedural rules. Fines can reach 30 percent of the remuneration or compensation of the penalized individual. CGR can impose an admonition, fine, suspension, or exclusion from the Auditor Register.

28 Directiva de Gestión y Proceso Presupuestario §3.

29 Directiva de Gestión y Proceso Presupuestario §1.1.

30 §4.2 de la Ley de FONAFE No. 27170, §17 del Decreto Supremo No. 072-2000-EF (Reglamento Ley FONAFE). Technically, other public bodies could contribute to the capital increase (for example, Superintendencia de Bienes Nacionales). However, the shares will still be issued in the name of FONAFE.

31 Preemptive rights exist by law on both private and public placements of capital. They can be waived at an AGM with a majority of the votes present. LGS §259.

32 §60 of the Peru Constitution 1993 restricts SOE activities to noncommercially viable areas.

33 Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros.
34 §32 y siguientes de la Ley del Impuesto a la Renta.
35 Ley No. 27809, Ley del Sistema Concursal.
36 LGS §133, 179. Directors with a conflict of interest inform the board and abstain from voting.
37 Reglamento Ley FONAFE, §3.
38 El Libro de Matrícula de Acciones (the share register of each SOE) is kept by the SOE, in the charge of the CEO (LGS §190).
39 Ley FONAFE No. 27170 §§4, 6; Reglamento Ley FONAFE §10.
40 Reglamento Ley FONAFE §4.
41 Directores de las Empresas en las que FONAFE participa como accionista; Directiva de transparencia en la Gestión de las Empresas bajo el Ámbito de FONAFE; FONAFE’s Código Marco de Buen Gobierno Corporativo de Empresas del Estado; FONAFE’s Código Marco de Ética de los Trabajadores de las Empresas del Estado; and the Decreto Supremo modificando la Ley de FONAFE/Procedimiento para la Evaluación de las Personas Propuestas como Miembros de los Directorios de las Empresas en las que FONAFE participa como accionista.
42 Directiva de Gestión y Proceso Presupuestario §5.
43 As noted in the SOE overview in the previous section, regional/municipal SOEs are not under a single ownership entity.
44 Ley del Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado–FONAFE No. 27170 y su Reglamento.
45 By FONAFE regulations, the board should have 6 members, including the minister who has jurisdiction over PROINVERSION. However, since PROINVERSION is under MEF, the total size of the SOE’s board is 5.
46 It is called by the MEF Minister. An extraordinary session could be called by any FONAFE director or the executive director. Reglamento Ley FONAFE §11.
47 Reglamento Ley FONAFE §12.
48 Reglamento Ley FONAFE §9.
49 Since 2002, by Decreto de Urgencia No. 062-2002, FONAFE also has been charged with managing the state portfolio of bad debt, which involves 25 FONAFE staff.
50 Directiva de Gestión y Proceso Presupuestario §8.
51 In determining the severity of the sanction, SOEs must consider the presence or absence of intent, damages caused, issues of fortuitous circumstances or force majeure, circumstances in which the infraction was committed, and past history of such infractions by the individual. Directiva de Gestión y Proceso Presupuestario §7.
52 23 de julio de 2006 la Ley No. 28840–Ley de Fortalecimiento y Modernización de PETROPERÚ.
53 The capital increase is capped at 100 percent of paid-up capital. LGS §115 (5). The modifications of certain bylaws following general meeting instructions can be delegated to the board/management, LGS §198, §206.
54 Directiva aplicable a los Directores de las Empresas en las que FONAFE participa como accionista No 002-2004-008-FONAFE, §1.
55 Decreto Supremo 085-2006-EF.
56 PETROPERÚ (Ley No. 28840) has a 6-member board composed of the Minister of Energy and Mining, 4 representatives of the state to be determined by Decreto Supremo, and an employee representative. AGROBANCO (Ley No. 27603) has a 7-member board composed of a Chairman selected by MEF, 2 more representatives of the executive branch, and 4 representatives of the private shareholders, in proportion to their ownership shares. SIMA (Ley No. 27073) has a 9-member board composed of the CEO, 6 representatives of the Defense Ministry, 2 representatives of FONAFE, and a MEF representative. PERUPETRO (Ley No. 26225) has a 5-member board composed of 3 representatives of the Ministry of Energy and Mining, including the Chairman, and 2 representatives of MEF.
57 Decreto Supremo 072-2000-EF (Reglamento Ley FONAFE), §24, as modified by Decreto Supremo 085-2006-EF.
59 SOEs in the hydrocarbon and electricity sectors under the PROINVERSION framework (EGASA, EGESUR, ETECEN, EGEMSA, ELECTRO UCAYALI, ELECTRO NORTE, HIDRANINDA, SEAL) have “class C” shares, with special rights related to company liquidation, privatization, capital reduction, issue of convertible bonds, listing, change of business, transformation, merger and dissolution, and guarantees provided to other companies (Ley No. 26844 y del articulo 10 de la Ley No. 26876).
60 LGS §179.
61 Directiva aplicable a los Directores de las Empresas en las que FONAFE participa como accionista No 002-2004-008-FONAFE §9. LGS §§180, 189 mandate that directors must not adopt resolutions that favor personal interest or the interest of related parties above the interests of the company, nor use business opportunities derived from their position to their own benefit or the benefit of third parties.
62 Texto Único Ordenado de la Ley del Impuesto a la Renta, aprobado por Decreto Supremo No. 179-2004-EF §32; Lineamientos para el Desempeño del Estado como Propietario §D; Nacional Constitución §60.
Environmental regulations include the general law on the environment, Ley 28,611 of 23 Jun 2005, which replaces the Environment and Natural Resources Code of 1990 and creates the Consejo Nacional del Medio Ambiente/CONAM; Ley marco del sistema nacional de gestion ambiental No 28,245; Ley del Consejo Nacional del Ambiente No 26,410 of 16 Dec 1994; Environmental impact evaluation regulations (Ley 26,839 of 8 Jul 1997, Decreto Supremo 038-98-PCM of 19 August 1998). The information is made public immediately.

LGS §§122. Bylaws can mandate that only shareholders, directors, or managers can act as proxies.

In determining the severity of the sanction, SOEs must consider the presence or absence of intent, damages caused, issues of fortuitous circumstances or force majeure, circumstances in which the infraction was committed, and past history of such infractions by the individual. Directiva de Gestión y Proceso Presupuestario §7.

Examples of SOEs in which trade unions are active are PETROPERÚ, CORPAC, ENAPU, SERPOST, and SEDAPAL.

In determining the severity of the sanction, SOEs must consider the presence or absence of intent, damages caused, issues of fortuitous circumstances or force majeure, circumstances in which the infraction was committed, and past history of such infractions by the individual. Directiva de Gestión y Proceso Presupuestario §7.
Auditors are hired in compliance with the regulations of the Sistema Nacional de Control §1.10. Each SOE must ask CGR to carry out the procedure for hiring an external auditor within the first three months of each financial year.

Fixed-price contracts in the context of a small audit budget and required audit experience in the specific area of SOEs are factors precluding the competitiveness of the SOE audit market. Smaller audit firms also pose an independence concern as they temporarily hire the same set of qualified additional experts to help them fulfill a large SOE audit contract. Thus, it is possible that an auditor works on the same SOE for more than two years on a row.

CONASEV regulations require that auditors have no financial interests or dealings with an audited company. That is, (1) they must not have held a position with the company during the accounting year or the previous year; (2) they cannot have any direct or indirect financial interest in the company; (3) they cannot be immediate relatives of decision-makers in the company; and (4) they cannot have any economic or administrative ties with the company.

Reglamento para la Designación de Sociedades de Auditoría §44. This also applies to partners/personnel carrying out the audit.

Auditors cannot provide direct audit services to SOEs without the intermediation of CGR; (2) auditors cannot be hired by the SOE for other consulting, control, or accounting services for two subsequent years. Reglamento para la Designación de Sociedades de Auditoría, aprobado por Resolución de Contraloría No. 140-2003-CG §10.

CONASEV regulations require that auditors have no financial interests or dealings with an audited company. That is, (1) they must not have held a position with the company during the accounting year or the previous year; (2) they cannot have any direct or indirect financial interest in the company; (3) they cannot be immediate relatives of decision-makers in the company; and (4) they cannot have any economic or administrative ties with the company.

Reglamento para la Designación de Sociedades de Auditoría, Articule 10.

Directiva sobre Políticas y Prácticas Contables para las Empresas bajo el Âmbito de FONAFE - Acuerdo de Directorio 003-2005/015.

Directiva aplicable a los Directores §17.

Reglamento para la Designación de Sociedades de Auditoría §44. This also applies to partners/personnel carrying out the audit.

Some SOEs have “class B” shares, for example, EGEMSA, CORPAC, PETROPERÚ, COFIDE, EGASA, ELECTROSUR, EGECEN, SEDAPAL, EGESUR, SEAL, SAN GABAN, ELECTROUCAYALI, ELECTRONORTE, ELECTROSURESTE, and HIDRANDINA.

Reglamento Ley FONAFE §29; Directiva aplicable a los Directores §10. The remuneration of the full-time Chairman is determined by FONAFE. Currently, it is capped at about U$S6,790.

There is no express prohibition of foreigners serving on SOE boards. There are no foreigners currently serving as directors.

Reglamento Ley FONAFE §26. FONAFE regulates director liability also in the following specific cases for: (1) voting at board meetings against the laws, SOE bylaws, AGM decisions, FONAFE regulations, and in general, the interest of the state; (2) not disclosing to FONAFE or CGR as required any irregularities noted; (3) failure to comply with FONAFE directives and agreements; and (4) failure to fulfill the legal duties of the board and the directors.

Directiva aplicable a los Directores de las Empresas en las que FONAFE participa como accionista No 002-2004-008-FONAFE §8.

Directiva aplicable a los Directores §18.

LGS §173; Directiva aplicable a los Directores §7.

Directiva aplicable a los Directores. By LGS, The submission of financial statements for AGM approval is a responsibility of the board that cannot be delegated (LGS §174). The board is responsible for overseeing disclosure and communication (LGS §§175, 221).

Directiva aplicable a los Directores de las Empresas en las que FONAFE participa como accionista No 002-2004-008-FONAFE §9.

Acuerdo de Directorio No. 013-2006/004-FONAFE clearly places the responsibility to hire the CEO with the SOE boards. The regulation also mandates the use of headhunters, who would select four candidates from whom the board would choose.

Directiva aplicable a los Directores de las Empresas en las que FONAFE participa como accionista No 002-2004-008-FONAFE §9. LGS §§180, 189 mandate that directors must not adopt resolutions that favor personal interests or the interests of related parties above the interests of the company, nor use business opportunities derived from their position to benefit themselves or third parties.

Reglamento Ley FONAFE (Decreto Supremo No. 072-2000-EF, modificado por Decreto Supremo No. 028-2004-EF and 085-2006-EF) §§25, 27, 28; Directiva aplicable a los Directores de las Empresas en las que FONAFE participa como Accionista. The exact pay amount depends on the size of the SOE, which is presumably correlated with its complexity and oversight needs.