



# Corporate Governance of State-Owned Enterprises

IN LATIN AMERICA

*Current Trends and Country Cases*  
July 2014

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# **Corporate Governance of State-Owned Enterprises in Latin America**

*Current Trends and Country Cases*

July 2014



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# Main Abbreviations and Acronyms

## General (throughout document)

CDB	China Development Bank
CEO	Chief Executive Officer
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
MF <sup>1</sup>	Ministry of Finance
OECD	Organization for Economic Co-operation and Development
QFA	Quasi fiscal activities
SOEs	State-owned Enterprises

## Country Cases and Examples

### *The Case of Brazil*

BNDDES	Brazilian National Development Bank ( <i>Banco Nacional de Desenvolvimento Econômico e Social</i> )
DEST	Department of Coordination and Control of State Enterprises ( <i>Departamento de Coordenação e Controle das Empresas Estatais</i> )
ELETROBRAS	Brazilian Power Electricity Company ( <i>Centrais Elétricas Brasileiras S.A.</i> )
PDG	Comprehensive Plan of Expenditures ( <i>Plano de Dispendios Globais</i> )
PETROBRAS	Brazilian Oil Company S.A. ( <i>Petróleo Brasileiro S.A.</i> )
SEST	Secretariat of Coordination of State-Owned Enterprises ( <i>Secretaria de Controle de Empresas Estatais</i> )
SIIF	Integrated Financial Information System ( <i>Sistema Integrado de Informação Financeira</i> )

### *The Case of Chile*

CODELCO	National Copper Corporation ( <i>Corporación Nacional de Cobre</i> )
CORFO	Production Development Corporation ( <i>Corporación de Fomento de la Producción</i> )
ENAP	National Oil Company ( <i>Empresa Nacional del Petróleo</i> )
SAE	Enterprises Management System ( <i>Sistema Administrador de Empresas</i> )
SEP	State-Owned Enterprise System ( <i>Sistema de Empresas Públicas</i> )
SVS	Chilean Securities and Insurance Supervisor ( <i>Superintendencia de Valores y Seguros de Chile</i> )

### *The Case of Colombia*

CONPES	National Council of Economic and Social Policy ( <i>Consejo Nacional de Política Económica y Social</i> )
DNP	National Planning Department ( <i>Departamento Nacional de Planeación</i> )
ECOPETROL	Colombian Oil State Company ( <i>Empresa Colombiana de Petróleos</i> )
MCC	Mixed-capital Corporations
OPN	National Budgeting Office ( <i>Oficina del Presupuesto Nacional</i> )

### *The Case of Paraguay*

ANDE	Paraguayan Power & Electricity Company ( <i>Administración Nacional de Electricidad</i> )
ANNP	National Administration of Ports and Waterways ( <i>Administración Nacional de Navegación y Puertos</i> )
CNEP	National Council of SOEs ( <i>Consejo de Empresas Públicas</i> )
COPACO	Paraguayan Telecom Company ( <i>Compañía Paraguaya de Comunicaciones</i> )
CTI	Inter-Institutional Technical Commission ( <i>Comisión Técnica Inter-institucional</i> )
DGEP	General Directorate of SOEs ( <i>Dirección General de Empresas Públicas</i> )
ESSAP	Paraguayan Water & Sewage Utility ( <i>Empresa de Servicios Sanitarios del Paraguay</i> )
INC	National Industry of Cement ( <i>Industria Nacional del Cemento</i> )
PETROPAR	Paraguayan State Oil Company ( <i>Petróleos Paraguayos</i> )
PGN	National Budget ( <i>Presupuesto General de la Nación</i> )
UMEP	State-Owned Enterprises Oversight Unit ( <i>Unidad de Monitoreo de las Empresas Públicas</i> )

### *The Case of Peru*

CGR	National General Comptroller ( <i>Controladoría General de la República del Perú</i> )
CORPAC S.A.	Peruvian Corporation of Airports & Commercial Aviation ( <i>Corporación Peruana de Aeropuertos y Aviación Comercial</i> )
FONAFE	National Fund for Financing State Business Activity ( <i>Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado</i> )

### *The Case of Spain*

IGAE	General Comptroller and Accounting Directorate's ( <i>Intervención General de la Administración del Estado</i> )
POA	Annual Operational Plan ( <i>Plan Operativo Anual</i> )
RTVE	Spanish Radio & Television ( <i>Radiotelevisión Española</i> )
SEPI	State Holding for Industrial Participations ( <i>Sociedad Estatal de Participaciones Industriales</i> )

### *The Case of Uruguay*

ANCAP	State Oil Company ( <i>Administración Nacional de Combustibles, Alcoholes y Portland</i> )
ANTEL	National Telecom Company ( <i>Administración Nacional de Telecomunicaciones</i> )
BROU	Bank of the Oriental Republic of Uruguay ( <i>Banco de la República Oriental del Uruguay</i> )
DEP	Department of State-Owned Enterprises ( <i>Departamento de Empresas Públicas</i> )
IAS	International Accounting Standards
OPP	Office of Planning and Budgeting ( <i>Oficina de Planeamiento y Presupuesto</i> )
SIIF	Integrated Financial Information System ( <i>Sistema Integrado de Información Financiera</i> )
TCR	National Court of Accounts ( <i>Tribunal de Cuentas</i> )
UTE	State Power & Electricity Utility ( <i>Administración Nacional de Usinas y Transmisiones Eléctricas</i> )

### *Leading State-Owned Enterprises: The Cases of the Panama Canal and PEMEX*

ACP	Panama Canal Authority ( <i>Autoridad del Canal de Panamá</i> )
CA	Management Council ( <i>Consejo de Administración</i> )



CAED	Audit and Performance Evaluation Committee ( <i>Comité de Auditoría e Evaluación de Desempeño</i> )
CNH	National Commission of Hydrocarbons ( <i>Comisión Nacional de Hidrocarburos</i> )
CRE	Energy Regulatory Commission ( <i>Comisión Reguladora de Energía</i> )
OIC	Internal Control Agencies ( <i>Órgano Interno de Control</i> )
PEMEX	Mexican State Oil Company ( <i>Petróleos Mexicanos</i> )
SENER	Energy Secretariat ( <i>Secretaría de Energía</i> )
SFP	Secretariat of Public Administration ( <i>Secretaría de la Función Pública</i> )

## Notes

1. The acronym “MF” is used throughout the document for Ministry/Secretariat of Finance, Ministry/Secretariat of Economy and Finance, and Ministry of Finance and Public Administration.

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# Executive Summary

***The main objective of this report is to provide a descriptive analysis of the current practices and trends of corporate governance of State-owned Enterprises (SOEs) in several Latin-American countries.*** It provides practitioners of SOE corporate governance with a stocktaking of current practices and trends in several Latin American countries, as well as international experiences and good practices elsewhere. This report intends to contribute to the discussion and growing interest on SOE corporate governance and to provide an impulse for further analytical work in this area.

***In most Latin American and Caribbean countries, the SOE sector contributes significantly to GDP and represents an important part of consolidated public expenditures.*** In several cases, the SOEs are also key and strategic actors in the country's economy—providing essential goods and services—and frequently hold a dominant market position in critical sectors, such as petroleum, electricity, and transportation. They also operate in competitive markets such as financial services, telecommunications, etc. SOEs are also increasingly under pressure, by both their governments and by international competition, to operate and achieve their goals more efficiently and effectively. Within this context, achieving good corporate governance practices is critical to SOEs effectively providing goods and services, and achieving their short-, medium-, and long-term goals, within a sustainable fiscal framework.

***This report has been prepared with the direct collaboration of government officials involved in the SOE sectors of eight countries in Latin America and the Caribbean, and Spain.*** It is mainly based on financial information and other relevant data on the above-mentioned countries, covering the period from 2010 to 2013. As part of data collection for the report,

representatives of the SOE sectors in Brazil, Chile, Colombia, Dominican Republic, Mexico, Panama, Paraguay, Peru, Spain and Uruguay, attended the *Technical Workshop on SOE Supervision in Latin American and Caribbean Countries*, organized by the SOE Monitoring Unit of Paraguay and the World Bank in December 2011 in Punta del Este, Uruguay.

***Part I of the report, called Trends in Corporate Governance of SOEs in Latin America is based on three complementary and closely inter-related concepts.*** Chapter I.1 presents an analysis of the legal framework in several countries of the region under which SOEs operate. Specific corporate governance issues are then discussed; beginning with the function of the state as owner of SOEs (Chapter I.2). The next two chapters discuss how the state exercises that function in two key areas: Performance Monitoring (Chapter I.3) and Board Procedures (Chapter I.4). Finally, the chapter on Fiscal Risk (Chapter I.5) identifies the main risks inherent in the performance of the SOE. It then surveys the management of those risks by the state, including supervision, preparation of financial reports and specific risk mitigation measures. The presentation of the conceptual framework of each of these topics is followed by a descriptive analysis of current practices and trends in six Latin-American countries: Brazil, Chile, Colombia, Paraguay, Peru and Uruguay using the information presented under Part II (Country Cases) as well as specific inquiries the Bank team made to the representatives from the SOE sector in the respective countries as a basis.

***Part II of the report, Country Cases, reviews SOE corporate governance in the six above-mentioned Latin-American countries, as well as in Spain. It also features case studies on two particularly notable SOEs: PEMEX, the Mexican petroleum company, and the Panama Canal.*** As mentioned above, the country cases have been developed in close collaboration with government officials involved in the SOE sector. Each country case first presents a brief description of the country's SOE portfolio and an assessment of its economic relevance. Then, key aspects of SOE corporate governance are analyzed, using criteria based on principles and guidelines from the Organization for Economic Co-operation and Development (OECD). These include the state ownership function and accountability, as well as issues related to performance monitoring, information disclosure, auditing mechanisms and the role of the board in the companies. All country cases conclude with a brief summary of current SOE corporate governance challenges identified for the country.

# Corporate Governance Practices and Trends in Latin American SOEs

## Institutional and Organizational Framework

**Generally, the organization of SOE ownership function maintains its own characteristics, depending on the country considered.** The institutional and organizational framework that determines SOE ownership function does not correspond to a defined typical organization structure in each of the six countries analyzed. Nor does it appear to depend on the number or size of SOEs, or on the strategic importance of the SOE sector. Rather, it is rooted in a set of historical, economic, political, and institutional aspects of each country.

**However, there are institutional arrangements in use that gradually point toward greater centralization.** Indeed, except for Colombia, in the other five countries there is a “hybrid” type of organizational and institutional framework for SOE ownership in which institutional agreements of the traditional, *decentralized* model are combined with those of the *centralized* model. Within the sample, Peru and Chile turn out to be cases in which SOE ownership function is clearly carried out in a centralized manner. In the predominant SOE ownership scheme in other cases, the sectorial ministries play an important role. There are important efforts being made toward more centralized supervision, especially in Brazil, and more recently in Paraguay.

## Accountability and Supervision Mechanisms

### *Planning Documents*

**The preparation of the annual budget and its approval and scrutiny are respected processes in most cases.** SOEs have achieved greater budgetary flexibility over time, for several reasons. Nevertheless, they should generally comply with goals and financial constraints specified by the central government. Also, in several of the countries, the SOE budgets are part of the national budget and therefore subject to scrutiny and annual approval by Congress.

**On the other hand, some countries have achieved important advances in the development of a performance management framework for SOEs.** Several factors make achieving a solid and effective framework to manage the performance of SOEs not an easy task. Some of those factors are

structural—such as the prevalence of “dual” institutional arrangements of SOE ownership and the limited use of results-based budgeting tools. Others are more specific, such as the frequent failure to internalize the conflicts between commercial and non-commercial objectives, the low degree of institutionalization of those objectives, or simply the complex, dynamic nature of the activities usually performed by SOEs. Within the sample of countries, Chile, Peru, and Paraguay represent the strongest recent experiences of the implementation of performance management contracts between the government and the SOEs. However, the degree of development of the contracts and the results achieved in their implementation vary among the countries.

### *Board and Management Proceedings*

***Several countries have taken steps toward granting the SOE board and management greater financial autonomy and decision-making power.***

However, the decision-making process of the companies is still commonly associated with compliance with sector-specific policy objectives and with financial constraints established by the central government.

***At the same time, there has been concrete progress in the implementation of good practices by the boards of directors and management of SOEs.*** Within the sample of the six Latin American countries, there is a clear separation between the board and the management of the SOEs; moreover, the board generally is in charge of appointing the management of each company. Furthermore, in the cases of Chile and Peru, which are regional front-runners in the implementation of integrated reforms of SOE governance, regulations promote the nomination and appointment of directors and managers based on merit and qualifications; the practice also exists in Brazil.

### *Financial Reports and External Audit*

***Several Latin American countries have been undertaking significant advances in the harmonization of regulatory requirements for SOE information disclosure and application of accounting standards.***

Nowadays, the governments usually have relevant and timely financial information from the SOEs and other decentralized entities through modern information systems. Although there are disparities in accounting standards among the countries studied, this study found a general trend toward the application of homogeneous standards for SOEs, commonly with requirements similar to those applied in the private sector and in some cases even more advanced requirements. For example, in Chile the standards are in accordance with the International Financial Reporting Standards (IFRS).

***The preparation and submission of annual financial reports by SOEs is common in all the countries studied, and adequate institutional procedures generally guarantee the reports' compliance and transparency.***

In some cases, the reports are prepared quarterly. The management of each SOE is responsible for presenting an annual financial and accounting report to the respective ministry of finance or ministry of planning, as well as to other government control agencies (internal and external). In most cases, the information is also available to the public through the Internet.

***In the cases of Chile and Peru, the respective central agencies usually consolidate the information of the companies under their supervision in an annual report.*** SEP in Chile develops an annual report that consolidates the financial performance of the SOEs under its supervision and sends it to the President and both chambers of the Congress. FONAFE in Peru uses an electronic data system, which enables centralizing the delivery of the SOEs' financial reports.

***In all of the countries analyzed, the annual financial statements of the SOEs are audited by an external public control entity or by a specialized accounting firm from the private sector.*** In most of the cases, this audit is carried out by specialized companies and in accordance with international quality standards. Within this general practice, each country shows specific characteristics. In the case of Paraguay for example, the external audit process of the financial statements has been notably improved over the past years through the establishment of the SOE Council (CEP) in 2008. In Uruguay, all SOEs are audited by the Court of Accounts (*Tribunal de Cuentas de la República*), and additionally by international audit companies. In Peru on the other hand, this process is carried out by audit companies from the private sector, which are selected through a call for proposals led by the Comptroller General (*Contraloría General*).

***The evaluation of fiscal risk and of contingent liabilities linked to SOEs and other public entities is starting to be developed.*** This is especially relevant when taking into account the important relative size of the SOE sector and its strategic function in the economy of each country. Currently, the cases of Chile, Colombia, and Peru are the most advanced and regulated in this area. Brazil also has made progress through an annex on fiscal risk that is attached to the country's annual budget. Furthermore, several countries have recently advanced in the mitigation of the above mentioned risks through the reduction of quasi-fiscal activities—for example, introducing budgetary transfers to cover the real operating costs of the SOEs, taking into consideration explicitly their commercial and non-commercial objectives—and also by strengthening several corporate governance processes and systems, as discussed in this report.



## Future Challenges

***All countries studied in this report have achieved significant progress in the corporate governance of their SOEs, but there is still a long way to go.***

There is a general recognition among the countries of the region that the implementation of good corporate practices can help the SOEs achieve their goals and objectives more effectively and efficiently. Several reform measures have been undertaken in recent years to strengthen those practices. However, there are several challenges ahead:

- *Strengthen—in some cases—the legal-institutional framework that defines the state role as owner of the SOE.*
- *Continue to implement measures to promote greater independence and professionalism of the SOE board and management.*
- *Increase the standards for financial reporting to achieve the level of internationally accepted practices.*
- *Continue to improve the identification, assessment, and management of the fiscal risk associated with the SOE sector, and the preparation and disclosure of relevant reports.*
- *Continue to develop a solid and effective performance management framework.*
- *Continue to advance in the identification, assessment, and management of the fiscal risk associated with the SOE sector, and the preparation and disclosure of relevant reports.*

# Introduction

**Despite undergoing deep structural changes during the past few decades, the State-Owned Enterprise (SOE) sector continues to play a significant and strategic role in most Latin American countries.** In many countries, SOEs still represent significant public expenditures and management of public assets. They also contribute substantially to the delivery of public and commercial services to citizens. As a consequence, SOEs find themselves increasingly under pressure, from both domestic voters and global competition, to operate and achieve their goals in the most effective and efficient way. In this context, good corporate governance practices are crucial to ensure that SOEs provide efficient services, to guarantee that companies adhere to fiscal discipline, and to allow enterprises to achieve their short-, medium-, and long-term strategic objectives, within a sustainable fiscal framework.

**SOEs face several challenges, and the implementation of good corporate governance practices is considered essential to improving SOEs' overall performance.** Some of the major challenges are commonly connected to the efficiency and effectiveness of service delivery. Others have to do with the management of fiscal risks associated with the operation of SOEs. There is a consensus that the degree of success that a country can achieve in coping with these challenges, and therefore improving the overall

performance of its SOEs, is linked to the country's legal and regulatory framework governing SOEs.

**In this context, this report is aimed at providing an overview of SOE corporate governance practices and trends as observed in several countries of Latin America.** By describing and comparing SOE corporate governance practices and trends in different countries of Latin America, this report helps identify the region's successful practices as well as major challenges and opportunities for improvement.

## **Scope and Methodology**

**The main objective of this report is to provide a descriptive analysis of the current practices and trends of corporate governance of State-Owned Enterprises (SOEs) in several Latin-American countries.** It provides practitioners of SOE corporate governance with a stocktaking of current practices and trends in several Latin American countries, as well as international experiences and good practices elsewhere. This report intends to contribute to the discussion and growing interest on SOE corporate governance and to provide an impulse for further analytical work in this area.

**For the purposes of this report, the “SOE sector” in each country refers to commercial companies, in which the Government holds at least 20 percent of the shares.** Exceptional cases, such as companies with lower levels of state ownership or non-profit public enterprises, are identified in the report. Also, subnational SOEs, although they may exercise a very important economic and social role in some countries, especially in those with a federal structure, are not included.

**This report has been prepared with the direct collaboration of government officials related to the SOE sector of eight countries in Latin America and the Caribbean, and of Spain.** It is mainly based on financial information and other relevant data of the above-mentioned countries, covering the period from 2010 to 2013. As a part of data collection for the preparation of the report, representatives of the SOE sectors in Brazil, Chile, Colombia, the Dominican Republic, Mexico, Panama, Paraguay, Peru, Spain, and Uruguay attended the *Technical Workshop on SOE Supervision in Latin American and Caribbean Countries*, organized by the SOE Monitoring Unit of Paraguay (UMEP) and the Bank in December 2011 in Punta del Este, Uruguay.

**This report consists of two parts. The first part, *Trends in Corporate Governance of SOEs in Latin America*, is based on three closely inter-related conceptual topics.** The first chapter presents an analysis of the

legal framework in several countries of the region under which SOEs operate. Specific corporate governance issues are then discussed, beginning with the function of the state as owner of SOEs (Chapter I.2). The next two chapters discuss how the state exercises that function in two key areas: Performance Monitoring (Chapter I.3) and Board Procedures (Chapter I.4). Finally, the chapter on Fiscal Risk (Chapter I.5) identifies the main risks inherent in the performance of the SOE sector. It then surveys the management of those issues by the State, including supervision, development of financial reports, and specific duties of risk mitigation. The presentation of the conceptual framework of each of these topics is followed by a descriptive analysis of current practices and trends in six Latin American countries—Brazil, Chile, Colombia, Paraguay, Peru and Uruguay—using the information presented under Part II (Country Cases) as well as specific inquiries the Bank team made to the representatives from the SOE sector in the respective countries as a basis.

**Part II of the report, called *Country Cases*, reviews SOE corporate governance in the six above-mentioned Latin American countries as well as in the case of Spain. It also features case studies on two particularly notable SOEs: PEMEX, the Mexican petroleum company, and the Panama Canal.** As mentioned above, the country cases have been developed in close collaboration with public officials involved in the SOE sector, and include Brazil (Chapter II.1), Chile (Chapter II.2), Colombia (Chapter II.3), Paraguay (Chapter II.4), Peru (Chapter II.5), Spain (Chapter II.6), and Uruguay (Chapter II.7). The cases of PEMEX and the Panama Canal are presented in Chapter II.8. The country cases use a common structure, providing first a synthetic description of the country’s SOE portfolio and an assessment of the sector’s economic relevance. The cases then analyze key aspects of SOE corporate governance, using criteria based on the principles and guidelines formulated by the Organisation for Economic Co-operation and Development (OECD),<sup>2</sup> including: State ownership, oversight and accountability, performance monitoring, information disclosure, audit mechanisms, and the role of the board of directors. All chapters conclude with a brief consideration of current corporate governance challenges faced by the SOE sector from each country.

## **Main Principles of Corporate Governance**

**The main pillars of SOE corporate governance, as defined in the OECD guidelines, have provided the conceptual rationale for this report** (See Box I.1). These guidelines include an effective legal and

BOX I.1

## **Extract of OECD Guidelines on Corporate Governance of State-Owned Enterprises**

**I. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises.** To avoid market distortions, the legal and regulatory framework for State-Owned Enterprises should ensure a level playing field in markets where State-Owned Enterprises and private sector companies compete. The framework should build on and be fully compatible with the OECD Principles of Corporate Governance.

**II. The State Acting as an Owner (ownership function).** 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.

**III. Transparency and Disclosure.** State-Owned Enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance. These include in particular: publication of annual aggregate report on SOEs by the ownership entity; development of internal audit functions in SOEs, monitored by the board and audit committee or equivalent; annual independent, external audits based on international standards; the same high quality accounting and auditing standards for SOEs as for listed companies; and disclosure of material information described in the OECD Principles of Corporate Governance.

**IV. 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.

*Source: OECD, 2005.*

regulatory framework; ownership function and oversight mechanisms; transparency and disclosure of information; and the role of the boards of directors. The OECD guidelines provide a benchmark to steer governments in improving the performance of their SOE sectors.

**The legal and regulatory framework for SOEs should ensure a level playing field for SOEs and private sector companies.** This requires the State to clearly separate its ownership function from other functions that it

performs; to actively exercise its ownership function in the definition of SOEs' objectives and their implementation, while carefully limiting its participation in the daily management of SOEs; to grant powers to the boards of directors of SOEs to manage their enterprises independently and without political interference; to guarantee equal treatment to their shareholders, including minority shareholders; and to create mechanisms for public accountability and disclosure of information on financial and non-financial performance of its SOEs to the public. Legal aspects of SOEs are covered in Chapter I.1.

**The organization of SOE oversight can be categorized by three models of State ownership: decentralized, centralized, and dual.** The State ownership function is addressed in Chapter I.2 and also in all country cases. In situations of dual ownership the supervision of SOEs is partly carried out by sector ministries or other government units, and partly by the ministry of finance, though in close coordination. In the case of centralized ownership, the oversight function is the responsibility of one agency or holding company. In the decentralized model, each sector ministry takes responsibility for SOEs that fall into its sector. While the decentralized model prevailed up to the 1980s, the current trend points to the centralized model.

**Transparency and disclosure of information includes reporting on performance and financial status of the SOE to the ownership entity and the general public through several mechanisms.** These mechanisms are divided into *ex ante*, *ex post*, and consolidated reporting, and they are analyzed in both Part I and Part II of the report. *Ex ante* information mainly entails the setting of objectives for an SOE's performance for a future period, while *ex post* information includes financial and performance reports prepared by the SOE. In cases where there is a consolidated report on SOEs, it typically is presented annually, and is commonly prepared by a centralized entity or a government audit entity. This consolidated reporting aims both at reporting to the legislature and the general public. The transparency of the work of SOEs depends not only on the disclosure of such documents, but also on the quality of the content, its relevance, and the timeliness of disclosure.

**Annual publication of external audits of SOE financial statements is also considered a critical factor for SOEs' good governance.** Financial audits are critical to assuring the entity exercising ownership, and the public, that an SOE's financial statements fairly represent its financial situation and performance. The performance and publication of financial audits represent an important element of accountability. Other issues affecting the quality of external audits of SOEs include the choice of auditor (since the increasing trend is to rely on independent external audit firms); the adoption

of rules guaranteeing the independence of the auditor; the role of the supreme audit institution; and the existence of audit committees on the boards of directors of SOEs. Relevant country practices in Latin America are provided in Part II of the report.

**The fulfillment of responsibilities of an SOE board of directors can be illustrated by referring to the hypothetical example of a three-legged stool.** One leg represents the owner, the second is the board of directors, and the third is management. As with a stool, if one leg is too short (or too weak in this analogy), or one leg is too long—or too strong—the stool is unstable and will fall over. Accordingly, OECD Guidelines suggest that a good governance model for SOEs should comprise three distinct layers, each having a distinct role: (i) the State ownership function which is responsible for defining the ownership policy and high-level objectives for SOEs; (ii) a board which is authorized by the State to oversee the development of a strategy to achieve the State's objectives, and to monitor progress; and (iii) the executive management, which is accountable to the board for implementing the strategy in directing the SOE's operations. The role of SOE boards of directors and management, including empirical evidence from several countries in Latin America, is surveyed in Chapter I.4 and in the country cases.

## **Note**

2. OECD, 2005.



PART I

**TRENDS IN CORPORATE  
GOVERNANCE OF SOES  
IN LATIN AMERICA**





## CHAPTER I.1

# Legal Framework

### I.1.1 Legal Frameworks on Corporate Governance of SOEs

**The management of companies adheres to two main models of corporate governance.** There are two models of corporate governance applicable to private companies and State-Owned Enterprises listed on the stock exchange: one model based on rules of strict compliance and the other based on voluntarily adopted principles. The first model involves strictly enforced commercial laws and regulations that impose transparency requirements on the disclosure of companies' financial and non-financial information. Under the second model, also known as "comply or explain," companies voluntarily adopt a corporate governance code whose recommendations go beyond the provisions of commercial law. Administrative regulations require companies that adopt these codes to report their compliance to financial regulatory bodies.<sup>3</sup>

**The "comply or explain" model offers clear advantages for SOE management.** The flexibility of the "comply or explain" model allows SOEs to adapt the application of corporate governance best practices according

## BOX I.2

### Corporate Governance Models

There are two corporate governance models applicable to private enterprises and State-owned Enterprises listed on the stock exchange:

**Strict compliance model:** An example of the strict compliance corporate governance model is the United States' legal system, which has federal laws such as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; regulations issued by the Securities and Exchange Commission, stock exchanges, and other regulatory bodies; and the commercial laws of each State.

**“Comply or explain” model:** An example of the “comply or explain” model is the adoption of the Colombian Code of Best Corporate Practices or “Country Code,” which establishes standards with respect to the shareholders general meeting, board of directors, disclosure of financial and non-financial information, and dispute resolution. Colombian corporations registered or whose securities are registered with the National Registry of Securities and Issuers shall submit to the Financial Superintendence of Colombia (SFC) the “Best Corporate Governance Practices Survey,” which is based on the Country Code. Through this Survey, companies can explain their reasons for not implementing a specific standard or for adopting different measures from those recommended in the Code.

*Sources:* Bernal et al., 2012; Colombia Capital, 2009.

to various commercial and public policy objectives which, under certain circumstances, may be incompatible.<sup>4</sup> The same model can be applied to the management of every SOE, in the sense of the voluntary adoption of standards that exceed the minimum requirements established in the legislation and in the oversight of its implementation by the State ownership entity. In Peru, for example, FONAFE issued a Framework Code of Good Corporate Governance for companies under its scope of authority, which establishes minimum standards for the development of codes of good governance as well as an action plan for their implementation by each company.<sup>5</sup> As for specific SOEs, the Colombian oil company ECOPETROL issued the “Declaration of the Nation in its capacity as Majority Shareholder” which deals with issues such as special decisions by the shareholders meeting and participation of minority shareholders in the board of directors.<sup>6</sup>

**SOEs exist under various legal forms that vary depending on the moment of their creation, their ownership entity, their role in the public administration and their mission.** Generally speaking, SOEs are entities separated from the public administration and, depending on the applicable law, they have legal personality under public law or private law. Each country defines its SOE categories differently, using various criteria, including the State's participation in the company's capital, its effective control, and the company's mission, among others.

#### **BOX I.3**

### **Definitions of State-Owned Enterprise in Some Latin-American Countries**

There is a variety of definitions of State-owned Enterprise according to several criteria, such as participation in the company's capital, effective control, and the company's mission, among others.

**Brazil:** Brazilian law provides for two types of SOEs: **public enterprises** and **public/private joint ventures**. Both types of companies are created under private law. Public enterprises are fully-owned by the State, and they can take any corporate form under commercial law. In public/private joint ventures, the State owns more than half of the shares with a right to vote and, under applicable law, these companies must be limited liability companies. An example of public enterprise is the National Bank for Economic and Social Development (*Banco Nacional de Desenvolvimento Econômico e Social*—BNDES). Examples of public/private joint ventures are the Bank of Brazil, PETROBRAS, and ELETROBRAS.

**Chile:** The Chilean law includes the public enterprises established by law, without a specific typology. The law States that all SOEs established by law form part of the public administration, jointly with the ministries, *Intendencias*, *Gobernaciones* and the organs and public services created to carry out the administrative functions. Examples of SOEs established by law are the mining company *Corporación Nacional del Cobre* (CODELCO) and the postal services. Furthermore, there are corporations for which the Government of Chile is the single or majority shareholder, and which are not created by law, and which need a legal habilitation previous to their establishment (for instance Metro S.A.) These corporations are ruled by the common legislation applicable to the corporations listed on the stock market.

*(box continues on next page)*

**BOX 1.3** *continued*

**Paraguay:** In Paraguay, SOEs of two types exist: public enterprises and corporations in which the State is a shareholder. Examples of public enterprises are the national electricity company ANDE, the national cement producer INC, and the oil company *Petróleos Paraguayos* (PETROPAR). Each of these companies has been created through its respective organic law, which defines the company as an independent institution with its own legal personality, and defines the objective of its creation. Examples of corporations with State shareholder participation are the telecommunication company COPACO, and the water and sanitation company ESSAP.

**Uruguay:** In Uruguay the SOEs can be defined as those entities over which the State exercises the control of the management, either directly or through other public enterprises, by the ownership of the majority of their capital or via other instruments which grant this control.

**Peru:** Peruvian law provides for three types of State-owned Enterprises: SOEs with a sole shareholder, SOEs with a private shareholder, and SOEs with public powers. State-owned enterprises with a sole shareholder are limited liability companies where the State owns all the shares. State-owned Enterprises with private shareholders are companies where the State owns the majority of shares. State-owned Enterprises with public powers are companies whose enabling laws give them the power of public law to exercise its function. Examples of State-owned Enterprises created under private law are the Electricity Company of Peru (*Empresa de Electricidad del Perú—Electroperú*) and the Drinking Water and Sewage Service for Lima (*Servicio de Agua Potable y Alcantarillado de Lima—Sedapal*). An example of a State-owned Enterprise created under private law is the National Bank (*Banco de la Nación*).

*Sources:* Report authors, in collaboration with staff from the SOE sector of the respective countries and based on current legislation.

**SOEs created as limited liability corporations are governed by commercial law.** Generally speaking, SOEs that have adopted legal forms of private law, such as public/private joint ventures and State industrial and commercial companies in Colombia, as well as public/private joint ventures in Brazil, are governed by commercial law,<sup>7</sup> particularly regarding their creation procedures, the structure and powers of the board of directors,

shareholders' rights, disclosure of financial and non-financial information requirements, and liquidation procedures. Companies that issue financial instruments in national and international stock exchanges are also governed by regulations issued by the relevant securities commissions. For example, PETROBRAS is subject to the regulations issued by the Brazilian Securities Commission<sup>8</sup> and to the provisions of the Sarbanes-Oxley Act and rules issued by the United States Securities and Exchange Commission. Private law companies are also subject to public law, including budget laws, public procurement laws, and administrative procedure statutes to challenge agency actions.

**SOEs that have adopted legal forms of public law are governed by administrative law.** SOEs with a legal form from public law are usually subject to a general law that governs the public administration or to a special SOE law, which sets forth their objectives and regulates their creation, operation, control, and oversight. For example, in many countries, SOEs that operate in key sectors of national economies, such as the National Copper Corporation (*Corporación Nacional del Cobre-CODELCO*), PEMEX, and the Panama Canal Authority (*Autoridad del Canal de Panamá*) are governed by special laws that provide for their creation, or by organic laws. Public law enterprises are also subject to laws that impose liability on government officials as well as to budget laws, among other laws.

#### BOX I.4

### Examples of Administrative Laws Applicable to State-Owned Enterprises in Latin America

**Colombia:** In Colombia, government-owned public utility companies are regulated under Law 142 of 1994, which establishes the legal framework for public utility services and other provisions.

**Ecuador:** In Ecuador, SOEs are regulated under the recently passed Organic Law of State-Owned Enterprises.

**Mexico:** In Mexico the decentralized bodies and companies with majority ownership by the government are regulated by two codes: the Organic Law of Federal Public Administration (*Ley Orgánica de la Administración Pública Federal*) and the Federal Law of Parastatal Entities (*Ley Federal de Entidades Paraestatales*).

*(box continues on next page)*

**BOX I.4** *continued*

**Uruguay:** In Uruguay, the creation of autonomous bodies and decentralized services, the appointment and removal of directors, disclosure of financial information requirements, and challenge to its decisions are set forth in the Constitution of Uruguay, Articles 185-201.

In several countries, major SOEs that operate in key sectors are governed by their own laws.

**National Copper Corporation (*Corporación Nacional del Cobre, CODELCO*):** Rules related to the corporate governance of CODELCO are included in Law No. 20.392 that modifies the Organic Statute of the National Copper Corporation.

**Mexican Oil (*Petróleos Mexicanos, PEMEX*):** PEMEX is regulated under the Mexican Oil Law (*Ley de Petróleos Mexicanos*).

**Panama Canal Authority (*Autoridad del Canal de Panamá*):** The Panama Canal Authority is governed by Law No. 19 of 11 June 1997, which structures the Panama Canal Authority.

*Source:* Data prepared based on applicable legislation.

**In some cases administrative laws require the subsidiary application of commercial law.** In Peru, for example, protection of minority shareholders and distribution of dividends in State-Owned Enterprises are governed by the Corporations Law (*Ley General de Sociedades*).<sup>9</sup> In Chile, on the other hand, commercial law rules on conflicts of interest preclude members of CODELCO's Board of Directors from voting in decisions on matters in which they have an interest.<sup>10</sup>

**The application of securities law implies more robust standards of transparency and information disclosure.** In Latin America, important SOEs such as ECOPETROL, CODELCO, and SEDAPAL list their shares in local stock markets and have minority participation of private shareholders through initial public offers in the national market.<sup>11</sup> The application of the legal framework on stock market financing to SOEs allows them to compete with the private sector and establishes more robust standards of financial and non-financial information disclosure. However, regulating SOEs under private law is not enough to isolate them from the political pressures they often face. This requires clear rules that define the role of the State and companies' corporate governance.

**The OECD and the CAF have issued guidelines that provide direction on amending laws applicable to SOEs in order to improve the**

**efficiency and transparency of their operations.** According to the OECD Guidelines on Corporate Governance of State-Owned Enterprises and the CAF Guidelines for Good Corporate Governance of State-Owned Enterprises, the legal framework of SOEs should tend to achieve the following: first, the separation between the State’s ownership function and other functions that the State performs; second, the active exercise of the ownership function by the State, particularly regarding the definition of objectives and mechanisms to implement them; third, the grant of powers to the board of directors of SOEs to manage their enterprises independently and without political interference; and fourth, the creation of mechanisms to facilitate accountability and disclosure of information on financial and non-financial performance of enterprises to the public.

## **I.1.2 Legal Framework and Exercise of State Ownership Rights of SOEs: Recent Trends in Latin America**

**In several Latin American countries, general laws (or framework laws) are regulating the establishment and functioning of SOEs.** In Brazil, for example, the Decree Law 200 of 1967 establishes the definition of the SOEs—public enterprise and joint ventures—and States that both types should be regulated through private law. Similarly, Law 489 of 1998 in Colombia and Law 27170 which creates FONAFE in Peru established a general legal framework for the SOEs in those countries.<sup>12</sup> On the other hand, in such countries as Chile, Uruguay, and Paraguay, the creation of SOEs is addressed in the respective constitutions, which implies a level of more generalization and the frequent use of specific laws to govern different companies.<sup>13</sup>

**The majority of the countries in the region have specific or sector laws (commercial or administrative) which create and regulate the functioning of the SOEs, in particular the big companies operating in strategic sectors.** Law 5662 of 1971 which creates BNDES in Brazil and the case of ELECTROPERU, which falls under the general electricity law in Peru are examples. On the other hand, in Paraguay with the absence of a legal framework, the public enterprises are regulated through organic laws, while the corporations with State shareholder participation are regulated in accordance with specific laws and statutes. Similarly, the most important SOEs in Chile are created by specific laws, which also establish their legal form. In that country, there is also a group of commercial corporations, where the State is the majority or single owner of all shares, and these are regulated by the corporation law, which normally applies to private companies.



**The effective exercise of the State's ownership rights requires that the State set forth limits to its participation in the daily management of SOEs.** The government must avoid interfering in the daily management of SOEs beyond the exercise of its ownership rights, which requires outlining the limits of the State's participation in the management of its SOEs. This is important because in many cases the State's ownership function is vaguely defined and falls in different ministries. To that effect, the legal framework in several Latin American countries guarantees equal conditions for State- and privately-owned enterprises, as well as competitive conditions to access financing. The law also defines clearly the minimum liabilities of the State as a shareholder.

**The law should assure that no competitive advantages for SOEs over private sector companies are established.** The law must neither offer advantages to SOEs over private sector companies nor establish exceptions to the application of laws on State aids that distort economic competition.<sup>14</sup> In Brazil, the Federal Public Administration Act provides that State-Owned Enterprises and public/private joint ventures shall be subject to the same operating conditions as private-sector companies; the only difference lies in that the first ones are subject to the supervision of the line ministry.<sup>15</sup> However, in some other Latin American countries, SOEs are still being aided by subsidies and exemptions derived from the application of tax laws.<sup>16</sup>

**The law should also specify the State responsibilities as a shareholder.** The minimum responsibilities of the State as a shareholder include, at least, to be represented in the shareholders general meeting and to vote its shares, to participate in the appointment of the board of directors and to maintain a continuing dialogue with oversight bodies.<sup>17</sup> Countries that apply commercial law to the internal management of SOEs, as Chile does, require that the ownership entity, be it the ministry of finance, the sector ministry, or the ownership entity, participate in and represent the State in the shareholders meeting.<sup>18</sup>

**SOEs must maintain a high level of transparency with respect to monitoring and oversight.** This presumes the application of accounting and audit standards and the preparation of performance reports. In Latin America, SOEs that are corporations created under private law are better aligned with international accounting and audit standards. In Brazil, the Law on Limited Liability Corporations and Law 11638 of 2007 set forth obligations on accounting, preparation of financial statements, and independent audits. The latter law provides that corporations may choose to comply with regulations on financial statements issued by the National Securities Commission.<sup>19</sup>

### **I.1.3 Toward Best Practices of Corporate Governance: Reforms and Recent Trends in Latin America**

**In recent years several countries have tried to reform their good corporate governance practices through legislative and regulatory reforms.** With respect to corporate governance in general, with support of “New Public Management” scholarship and the works of OECD and CAF, Latin America has developed Codes of Corporate Governance with which compliance is voluntary. As for SOEs specifically, attempts have been made to put the management of these companies on an equal standing with privately-owned companies, in particular by subjecting them to the legal framework applicable to limited liability companies.

#### **BOX I.5**

#### **Changes to the Legal Framework on SOEs Corporate Governance in Latin America**

**Chile:** Chile introduced changes to the legislation applicable to the Public Enterprise System (SEP) and to the organic statutes of the mining company CODELCO, one of the most important companies of the country, as a result of joining the OECD. The SEP Code includes 30 principles on corporate governance for companies under its scope, including the applicable legal framework, exercise of ownership rights, treatment of shareholders and board of directors’ liability. The Code also includes a code of ethics and explains applicable rules on transparency, employment, procurement of goods and services, budgets, and investments.

**Peru:** Peru created the National Fund for Financing State Business Activity (*Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado—FONAFE*) to regulate and manage the State’s business activity. FONAFE issued a Code of Good Corporate Governance for SOEs under its scope. This code comprises 32 principles that represent the best practices of corporate governance of SOEs where the State is a majority or absolute owner. The principles are grouped into the following areas: objectives; legal framework; property rights, board and management risk policies and ethics code; and transparency and

*(box continues on next page)*

**BOX I.5** *continued*

dissemination of information. The board and the general shareholder assembly of each SOE approve the Code for Good Corporate Governance, whose compliance is reported on in an annual report, approved by its board.

**Paraguay:** In Paraguay, Law 5058/2013 was approved and created the National SOE Council (*Consejo Nacional de Empresas Públicas—CNEP*), institutionalizing the previously existing Consejo de Empresas Públicas (CEP) to give sustainability to the progress achieved during the process. The CNEP is constituted by the Minister of Finance, two sector ministers and the Attorney General. With this law, the SOE Monitoring Unit (*Unidad de Monitoreo de Empresas Públicas—UMEP*), which was the executing unit for the CEP, is transformed in the General Directorate of SOEs (*Dirección General de Empresas Públicas—DGEP*); it is composed by a technical team and a director, who is nominated by the President of the Republic.

*Sources:* Report authors, based on current laws.

**During this time there has also been a significant process of expansion and restructuring of specific SOEs in strategic sectors.** In Latin America, several SOEs have voluntarily changed their governing statutes to promote efficiency in their management and, in some cases, facilitate their

**BOX I.6**

**Changes to the Organic Statutes of State-Owned Oil Enterprises in Latin America**

In Latin America several State-owned oil enterprises have voluntarily changed their organic statutes to promote good corporate governance, establishing standards that exceed the minimum requirements set forth in legislation. For example, the Brazilian company *Petróleo Brasileiro* (PETROBRAS) changed its statutes to improve management by its Board of Directors and protect shareholders' interests. The company also approved a Code of Best Practices of Corporate Governance and a Code of Ethics. Likewise, the Colombian company ECOPETROL changed its corporate form and voluntarily adopted corporate governance practices to facilitate the issuance of shares in the Colombian Stock Market.

*Source:* Núñez et al., 2012.

participation in capital markets. In general, the standards adopted have exceeded the requirements set forth in those countries' commercial laws.

**In several Latin American countries applicable laws set forth the basic powers of the board of directors of SOEs.** In Peru, for instance, Peruvian administrative law provides that the board of directors of a SOE must establish and enforce the company's strategies and main policies. Its functions shall be clearly stated in the company's statutes. In Mexico, on the other hand, the Law of Parastatal Entities includes a comprehensive list of powers of the board of directors of companies of which the State is the majority owner.

#### BOX I.7

### **Minimum Obligations of the Board of Directors under Peruvian and Mexican Law**

**Peru:** Peruvian administrative law provides that the powers of the board of directors must be clearly defined in the company's statutes. The board of directors must approve internal guidelines to avoid conflicts between its own functions and the general manager's functions. These positions must be filled by different persons. The board of directors must carry out an annual evaluation of its performance and submit a report to the shareholders' meeting; it must also issue reports on operations that might affect minority shareholders and on extraordinary or strategic operations of the SOE.

Other rights and obligations of the board of directors are established in the corporations law.<sup>20</sup>

**Mexico:** In Mexico, the Law of Parastatal Entities authorizes the board of directors of companies with majority State participation to formulate the companies' institutional programs and budgets; adopt relevant measures so that the functions of the entity are carried out efficiently; establish quality control procedures for the services rendered; establish oversight systems and performance evaluation mechanisms; set the prices of goods and services they produce; approve loans; approve and authorize the publication of financial statements; approve guidelines for government purchases; authorize the creation of committees; agree on extraordinary payments; and approve the conditions of debt cancellation with third-parties.<sup>21</sup>

*Sources:* Regulations to the Legislative Decree No. 1031.

**In some countries administrative laws also set forth general responsibilities to SOE minority shareholders.** For example, in Peru applicable regulations require State-Owned Enterprises with minority shareholder participation to establish internal policies to ensure the fair treatment of shareholders, particularly regarding voting rights and access to company information.<sup>22</sup> FONAFE has also developed a specific policy to deal with minority shareholders of SOEs under its scope of authority.

**BOX I.8**

**Public Policy on Protection of Minority Shareholders in Peru**

In Peru, FONAFE recently developed a specific policy for the protection of minority shareholders of SOEs under its scope. This policy provides that the rights and obligations of SOE shareholders are those set forth in the Corporations Law, except for the information disclosure requirements provided therein. Specifically, SOEs must provide shareholders with the following information in their websites: an annual meetings' schedule, information on calls for meetings, proposed agenda and related information, balance sheet, income statement, quarterly budget and cash flow, and annual closing projections.

*Source:* FONAFE Corporation, Board Agreement no. 006-2011/006-FONAFE.

**In some SOEs the legislation requires that employees are represented on the board of directors.** In Latin America, the organic laws of certain large SOEs that perform key activities for the national economy, such as the production of oil or copper, require the representation of their employees on the board of directors. Their appointment requires transparent procedures and rules to solve potential conflicts of interest; these are provided in the law. In Chile, for instance, the organic laws of some SOEs, such as CODELCO, require the representation of employees on the board of directors; however, such members have no voting rights in matters where there is a potential conflict of interest, such as those related to the negotiation of labor contracts.<sup>23</sup>

**In other countries, State-Owned Enterprises have adopted their own internal standards, which exceed the protections set forth in the law.** In Colombia, for example, ECOPETROL's statutes empower all

company shareholders, including minority shareholders, to participate and vote in the Shareholders General Meeting, receive dividends, have timely access to the company's public information, request calls for extraordinary meetings, and ask for authorizations to carry out specialized audits and to prepare proposals related to the company's good corporate governance. Specifically in relation to minority shareholders, in 2007 the company issued a document called "Declaration of the Nation in its Capacity as Majority Shareholder" (*Declaración de la Nación en su calidad de accionista mayoritario de ECOPETROL*) to formalize the protection of minority shareholders with respect to dividend distribution, special decision-making, and the right of withdrawal from meetings.<sup>24</sup>

**Administrative laws usually also require the application of internal and external audit procedures in SOEs.** For example, in Chile, the SEP Code requires SOEs to establish internal audit procedures under the supervision of the Board of Directors.<sup>25</sup> In Peru, the rules require SOEs under FONAFE's scope to conduct external audits, to be carried out by audit companies selected through public tender.<sup>26</sup> In other countries, some major SOEs have changed their internal audit procedures specifically to comply with the Sarbanes-Oxley Act. For example, in Brazil, PETROBRAS established in 2004 an "Integrated Evaluation System and Internal Oversight Methods," which created a risk management committee with participation from employees and executives. In Colombia, on the other hand, ECOPETROL amended its code of good corporate governance to require adoption of efficient internal oversight mechanisms.<sup>27</sup>

## Notes

3. Bernal et al., 2012.
4. Ibid.
5. FONAFE Corporation, Code of Good Corporate Governance for Companies under the oversight of FONAFE, March 2013.
6. ECOPETROL, Declaration of the Nation in its Capacity as Majority Shareholder, 26 of July 2007.
7. Decree No. 200 of February 25, 1967 that provides for the organization of the federal administration, establishes guidelines for administrative reform and other provisions, Art. 5; Law 489 of 1998, which provides rules on organization and operation of national entities; issues regulations, principles and general rules for the exercise of the powers provided for in articles 15 and 16 of article 189 of the Political Constitution; and sets forth other regulations, Art. 85.
8. Law No. 6.404 of 15 December 1976 on Stock Companies, Art. 235.
9. Legislative Decree No. 1031 which promotes the effectiveness of State business activity.

10. Law No. 20.392 which modifies the Organic Statute of the National Copper Corporation (CODELCO).
11. Núñez et al., 2012.
12. In the case of Peru, as by *Decreto Legislativo No. 1031*, the SOEs are regulated by the norms of the entrepreneurial activities of State and its administrative systems, when applicable and additionally by the norms that regulate the private sector, mainly through the General Corporation Law and the Civil Law (*Ley General de Sociedades y el Código Civil*).
13. There are some other laws which affect the SOE sector in one way or another. In Uruguay, for example, starting in 1991, the Parliament authorized that SOEs—upon previous authorization from the Executive—could temporarily or permanently enter into a partnership with other SOEs or national or international private sector companies. Consequently, the legal organizational schemes are many and range from the typical, based on public law, to those where the private sector laws apply, while passing through a broad range of intermediate models. In Paraguay, Law 5058/2013 was recently approved, which created the National Council of SOEs (*Consejo Nacional de Empresas Públicas* (CNEP)), an entity that centralized the supervision and control of SOEs.
14. OECD 2005.
15. Decree no. 200 of 25 February 1967, which provides for the organization of the Federal Administration, establishes guidelines for Administrative Reform, and other provisions, Art. 178.
16. Andrés et al., 2011.
17. OECD, 2005.
18. Enterprise System (*Sistema de Empresas SEP*), SEP Code, Section I, 3b.
19. Law No. 10.303 of October 31, 2001 which modifies and adds certain provisions to Law no 6.404 of December 15, 1976 that regulates Stock Companies; Law no 6.385 of December 7, 1976 which regulates the stock market and creates the Securities Commission; Law no. 11.638 of December 28, 2007 which modifies and repeals certain provisions of Law no 6.404 of December 15, 1976 and of Law no 6.385 of December 7, 1976, and applies the provisions on the preparation and disclosure of financial statements to large corporations.
20. Regulations to Legislative Decree No. 1031.
21. Federal Law of Parastatal Entities, Art. 59.
22. Regulations to Legislative Decree No. 1031, Art. 3.
23. Law No. 20.392 that modifies the Organic Statute of the Copper National Corporation (CODELCO), Art. 8(b).
24. ECOPETROL, Rights and Obligations of Shareholders, at <http://www.ecopetrol.com.co/contenido.aspx?catID=427&conID=41101>; Núñez et al., 2012.
25. SEP Code, Principle 15.
26. Regulations to Legislative Decree No. 1031 that promotes efficiency in the State's business activity, Art. 27.
27. Núñez et al., 2012.

## CHAPTER I.2

# Ownership Function

Despite the wave of privatizations that took place during the 1990s, SOEs are still very important economic actors in the majority of Latin American countries because of both their size and dominant roles—frequently through monopolistic or oligopolistic enterprises in strategic sectors. In the majority of the countries in the region, the SOE sector is usually concentrated in a few companies of great size and economic and strategic importance. Nevertheless, as analyzed in detail in this chapter, the legal and organizational framework defining SOEs' ownership function maintains characteristics specific to each country.

### I.2.1 Conceptual Framework

**The ownership function of SOEs is the form in which the State organizes itself to exercise ownership over State-owned companies.** In some cases, the institution or public entity that exercises ownership rights over the SOE is also the legal owner of said company's assets. In other cases, the entity that is the legal owner of the assets of the SOE may have delegated its ownership rights to another entity or group of entities; for example, a line ministry or a centralized ownership agency.



**The ownership function of SOEs could be exercised not only by the legal owner of the companies, but also by the agency or ministry to which the right to exercise that function has been delegated.** In particular, it could be that in a given country the legal owner of the shares of the most important SOE is the ministry of finance, but the latter may have delegated the rights and functions typically associated with the ownership of the companies to line ministries or a centralized agency.

**The ownership function by the State over the SOE is similar to that exercised by the shareholders of a corporation.** The entities that exercise the ownership function of SOEs will typically be in charge of appointing the members of the board, voting in annual general meetings, and other key functions such as monitoring the performance of the companies, approving additional capital investment, asset sales, and so on.

**Because SOEs usually aim to achieve both commercial and social objectives, the State's role as owner of such companies is often complex, dynamic, and challenging.** For example, the State often exercises its SOE ownership function through multiple institutions—ministry of finance, line ministries, cabinet of ministers, regulating or supervising bodies, or others. In some cases this could lead to the fragmentation of responsibilities and suboptimal accountability. Other complications of State control of SOEs include frequent designation of managers (CEOs) and members of the board through processes where political considerations take precedence; also problematic is the lack of a clear division among the functions of the State as owner of the SOEs, regulator of the markets in which they operate, and public policymaker. Furthermore, the consequences of such complexities are compounded in cases where the State is a joint owner with the private sector.

**Nevertheless, it is possible to improve the accountability of SOEs, even with greater autonomy in operational decision making.** Based on evidence from reforms of the SOE sector carried out in a large number of countries, and following the OECD Guidelines for Corporate Governance in State-Owned Enterprises, some principles that would support the State's more effective exercise of its ownership function over the SOEs include (i) creating clear and effective rules for the State to exercise its ownership rights; (ii) ensuring that the State focuses on the proper exercise of its key function as owner—for example, incorporating clear and transparent rules to appoint directors and CEOs based on professional merits and technical knowledge—and (iii) delegating to the SOE board and administration responsibilities regarding their operational functioning.

## Ownership Models

**The ownership function of the SOE has been changing and transforming over time**, as Governments have tried to improve the productive capacity and the effectiveness of service delivery. Even though there is a significant level of variation depending on the country, SOE ownership models can be roughly grouped within four approaches:<sup>28</sup>

- The *decentralized model*, in which the ownership responsibilities are usually distributed among several line ministries and sometimes also in other public bodies.
- The *dual model*, in which, in addition to the line ministries there is a complementary institution—frequently the ministry of finance, or a supervising agency of which it is in charge, or a group of ministers led by the minister of finance—which shares the ownership rights and responsibilities of the SOEs.
- The *council model*, in which while ownership is dispersed among various ministries and agencies, there is also an advisory or coordination body created with the purpose of advising the ministers in issues related to SOE ownership.
- The *centralized model*, in which the ownership responsibilities lie within a centralized and independent agency, or under the authority of a single ministry.

**The empirical evidence shows that there is no model or approach which is applicable in all cases.** Instead, it appears that the SOE ownership function tends to adjust to the specific situation of each country, taking into consideration the characteristics of the SOE sector as well as factors associated with the political, economic, and institutional context. It also appears in a number of cases, and especially in Latin America, that more than one model is usually in effect at the same time in the same country—some SOEs are supervised following the premises of a centralized or dual model, and other SOEs operate outside of this institutional scheme, in a decentralized manner.

**In general, several variations compatible with the “decentralized” model have been the most frequently observed and traditional form in which the SOE ownership function appears, although in recent years there has been a trend toward a greater centralization.** In particular, it is possible to observe in several regions of the world, including some Latin American countries, the introduction of policies and reforms pointing in the

direction of greater centralization of SOE ownership, thus giving rise to cases in which the traditional model (decentralized) is replaced by a “hybrid” and in some cases *dual* SOE ownership function, and where the corporate governance principles which give rise to the *council* or *centralized* models are considered to be cases of good practices.

## **I.2.2 Recent Trends and Findings in Latin America**

**In general, the organization of the SOE ownership function varies across countries.** The picture of SOE ownership provided by six countries in Latin America—Brazil, Chile, Colombia, Peru, Paraguay, and Uruguay—appears similar to that of other regions of the world. SOE ownership in these countries resembles patterns of the four models described above. But SOE ownership in each does not directly correspond to any typical organization scheme. Nor does the ownership model in a given country seem to depend on the number or size of the enterprises or on the strategic importance of the SOE sector. Rather, the ownership function is shaped by various historical, economic, political, and institutional conditions specific to each country.

**Within the six countries studied, institutional arrangements are moving toward centralization of SOE ownership.** In fact, five of the six country cases—Brazil, Chile, Peru, Uruguay, and Paraguay—exhibit an organizational and institutional *hybrid* type of SOE ownership framework, which combines aspects of the *decentralized* traditional model with aspects of the *centralized* model. For instance, the SOE ownership function may be performed by a group of enterprises (similar to a *holding company*); by an agency or central body which may be created *ad hoc*; or simply by a ministry, typically the ministry of finance, or a public body of similar scope. In contrast, in the case of Colombia, the organizational scheme is more comparable to the decentralized model: Multiple government units, usually various ministries and other government agencies, perform an SOE ownership function concurrently, according to their area of responsibility.

**Within the sub-group of five countries whose SOE ownership framework combines centralized and decentralized arrangements, clear differences still were apparent.** Table I.1 shows details of the institutional framework of centralized SOE ownership models in each of the five countries. Differences are evident in organizational and institutional arrangements as well as in the scope and quality of the supervision and control by central agencies.

**Peru and Chile are the cases in which the ownership function of the SOEs is most clearly centralized.** The National Fund for Financing State

**TABLE I.1: Functions and Characteristics of the Institutional Framework of the Centralized Model in 5 Latin American Countries**

Country	Ministry/Centralized Agency or Group of Companies	Basic Composition	Functions and Characteristics of the Institutional Framework of the “Centralized Model”		
			Scope	Designates Members of the Boards of Its SOEs?	Important Role in General Shareholders Meeting of SOEs?
<b>Brazil</b>	Interministerial Corporate Governance and Federal Government Management of Participation Commission ( <i>Comissão Interministerial de Governança Corporativa e de Administração de Participações Societárias da União</i> —CGPAR) and Department of Coordination and Control of State Enterprises ( <i>Departamento de Coordenação e Controle das Empresas Estatais</i> —DEST)	<ul style="list-style-type: none"> <li>GGPAR: formed by three permanent members: Minister of Finance, Minister of Planning and Minister of State and, if required by other sectorial ministers.</li> <li>DEST technical department in charge of the supervision of the SOE. Depends on the Executive Secretariat of the Ministry of Planning.</li> </ul>	Significant: DEST supervises 122 of 147 SOEs, including the biggest SOEs in the country (PETROBRAS, ELETRONBRAS, and BNDES).	No. The Board of the SOEs is usually made up of several representatives of the related sectorial ministry, and they are appointed by the shareholder’s assembly or presidential decree. A technical representative of the Ministry of Planning is usually part of the Board. Since 2010, there is also a representative of the union on the Board.	No.

(table continues on next page)

TABLE I.1: Continued

		Functions and Characteristics of the Institutional Framework of the “Centralized Model”			
Country	Ministry/Centralized Agency or Group of Companies	Basic Composition	Scope	Designates Members of the Boards of Its SOEs?	Important Role in General Shareholders Meeting of SOEs?
<b>Chile</b>	State-Owned Enterprise System ( <i>Sistema de Empresas Públicas—SEP</i> )	A nine member Council, plus one executive director. All of them appointed by the executive branch according to the legal framework in force.	Limited. Does not include the biggest enterprises.	Yes, and there are clear rules and requirements for appointments.	Indirectly, through the board of the SOEs.
<b>Paraguay</b>	State-Owned Enterprise Council ( <i>Consejo de Empresas Públicas—CEP</i> ) and SOE Monitoring Unit ( <i>Unidad de Monitoreo de Empresas Públicas—UMEP</i> ). Since September 2013, as per Law N° 5058/13—these institutions are named National Council of State-Owned Enterprises ( <i>Consejo Nacional de Empresas Públicas</i> ) and General Directorate of State-Owned Enterprises ( <i>Dirección General de Empresas Públicas</i> ), respectively.	The CEP is a formed by the Minister of Finance, two sectorial ministers and the Attorney General. The UMEP is the technical and executing unit, which depends on the CEP.	High. Practically all the SOEs of the nonfinancial sector, including the largest ones.	No. The appointments are generally made by presidential decree. The SOEs which are not corporations ruled by their own organic acts (among them PETROPAR and ANDE) do not have a board, they are chaired by a CEO, appointed by the President of the Republic. The corporations have their articles of incorporation and they generally have a board, appointed by decree of the PE.	No. The corporations (among them COPACO, ESSAP) have an annual shareholder meeting in which the financial statements are approved and the profits transferred to the national treasury. The sectorial ministers and the Attorney General are involved in the process. The SOEs ruled by their Organic Act do not have annual meetings. Each year a specific transfer of resources to the national treasury is “negotiated,” and is included in the budget. The MF and the CEO of the company are involved.

**TABLE I.1: Continued**

Country	Ministry/Centralized Agency or Group of Companies	Functions and Characteristics of the Institutional Framework of the “Centralized Model”			
		Basic Composition	Scope	Designates Members of the Boards of Its SOEs?	Important Role in General Shareholders Meeting of SOEs?
Peru	National Fund for Financing State Business Activity ( <i>Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado</i> —FONAFE)	Board formed by the Ministry of Economy and Finance (who chairs it), the president of the Ministers Council, and 3 sectorial ministers. It also has an executive director, appointed by the Ministry of Economy and Finance.	Significant. Includes all the SOEs in which the main shareholder is the State, within scope of the central government; except PETROPERU.	Yes. The Board of the FONAFE (particularly, the minister of finance and the corresponding sectorial minister) designates the directors of the SOEs. They are expected to be ratified by the General Shareholders Meeting. There are clear rules and requirements for the designation. The Directors of the SOEs choose their managers (CEO) through a selection process carried out by executive search firms.	Yes, together with the corresponding boards of the SOEs, with FONAFE being responsible for exercising the ownership of the shares of the SOEs (companies with a corporation form) and the rights over the SOEs regulated by public law.

(table continues on next page)

TABLE I.1: Continued

Country	Ministry/Centralized Agency or Group of Companies	Basic Composition	Functions and Characteristics of the Institutional Framework of the "Centralized Model"		
			Scope	Designates Members of the Boards of Its SOEs?	Important Role in General Shareholders Meeting of SOEs?
Uruguay	Department of State-Owned Enterprises ( <i>Departamento de Empresas Públicas</i> ) in the Office of Planning and Budgeting ( <i>Oficina de Planeamiento y Presupuesto</i> )— <i>OPP/DEP</i>  Macroeconomic Advisory Unit ( <i>Unidad de Asesoría Macroeconómica</i> ) of the Ministry of Economy and Finance (MEF/UAM)	<ul style="list-style-type: none"> <li>• <i>OPP/DEP</i>: has a director and a technical staff with six members.</li> <li>• <i>MEF/UAM</i>: has a director and a technical team of 14 people.</li> </ul>	Total. The supervision scope of the <i>OPP/DEP</i> and the <i>MEF/UAM</i> includes all of the SOEs related to the central government, including the six largest SOEs of the country ( <i>ANCAP</i> , <i>UTE</i> , <i>ANTEL</i> , <i>BROU</i> , <i>OSE</i> and <i>ANP</i> ).	No. Art. 197 of the Constitution, states that the Directors will be appointed by the President of the Republic, in agreement with the Council of Ministers, with prior approval of three-fifth of the members of the Senate.	No. Art. 185 of the Constitution establishes that the industrial and commercial services of the State, shall be managed by Boards formed by 3 to 5 members.  According to the provisions of public law, the SOEs are exclusively owned by the State and managed by boards appointed by the executive branch. They do not have annual meetings. The boards of these SOEs meet weekly to make general operational decisions. The payments of dividends to the State is regulated by law and communicated by the <i>OPP</i> at the beginning of the budget cycle.

Business Activity (*Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado*—FONAFE) in Peru and the State-Owned Enterprise System (*Sistema de Empresas Públicas*—SEP) in Chile differ from centralized agencies in other countries in a key area of ownership function: They have the authority to appoint and remove members of the board of the SOE they supervise. At the same time, both FONAFE and SEP delegate the management of operations to the corresponding boards and administrations of the SOEs.

**However, there are several significant differences between the various cases.** First, FONAFE is basically an agency formed by ministers, chaired by the Minister of Economy and Finance, while SEP is a technical advisory body to the State on management control of the SOE. Second, FONAFE, being chaired by the MF, fulfills a key role in the consolidation and approval of the SOE annual budget, while SEP in Chile is limited to providing the draft budget of the SOEs to the Ministry of Finance, following its technical verification by analysis of investment projects. Finally, the SEP’s institutional plan—which represents one of the leading examples of centralized SOE ownership function in Latin America—is in some ways opaque, because of the SEP’s limited sphere of supervision. The SEP supervises 23 of a total 33 companies, but does not include the main SOEs in Chile, such as CODELCO and ENAP.<sup>29</sup>

**Brazil, led by three ministries and a technical department (DEST), has attempted within the last decade to make supervision of SOEs more centralized.** In 2007, the Federal Government created the Interministerial Corporate Governance and Federal Government Management of Participation Commission (*Comissão Interministerial de Governança Corporativa e de Administração de Participações Societárias da União*—CGPAR) as an axis for the centralization of supervision functions. The permanent members of the committee are the Minister of Planning, the Minister of Finance, and the Minister of State, while the representatives of other sectorial ministries can participate upon the request of the permanent members. Meanwhile, DEST—the technical coordination body of the SOEs reporting to the Executive Secretary of the Ministry of Planning, which was established in 1979—focuses on the supervision and strategic planning of the SOE portfolio (122 SOEs of the 147 total, including the most important by size).<sup>30</sup>

**The ownership function of the SOEs in Brazil still maintains several characteristics of the decentralized model, with an important role for the sectorial ministers.** On one hand, the boards of the SOEs are usually composed of several representatives of related sectorial ministries. On the other hand, in practice DEST does not fulfill a significant role regarding the supervision of the SOEs, nor does it supervise the external audit process of their financial and accounting statements. The key role of “owners” fulfilled



by some ministries in Brazil should be considered in the context of the size and strategic importance of some of their related enterprises. For example, PETROBRAS, Brazil's biggest petroleum and natural gas SOE, with a budget of almost seven percent of GDP, is linked to the Ministry of Mines and Energy, and the National Development Bank (BNDES), which fulfills a key role in State policy within the financial sector, is linked to the Ministry of Development, Industry, and Commerce.

**Paraguay is another country in the region which has recently introduced reforms aimed at more centralized supervision of its SOEs.** The country's SOE sector is important because of its size (14.5 percent of GDP) and spans several sectors, focusing on key areas such as petroleum, electricity, and telecommunications. The creation in 2008 of the National Council of SOEs (*Consejo Nacional de Empresas Públicas*—CEP) and of the SOE Oversight Unit (*Unidad de Monitoreo de las EP*—UMEP) was one of the public sector reform initiatives promoted by the Minister of Finance. They represent an attempt to reduce the unwanted quasi-fiscal and social impacts of the SOE administration and the provision of basic services delivered by SOEs.

**The results of Paraguay's initiative have been encouraging, and work continues on its implementation and consolidation.** The reforms followed decades of very deficient supervision and control levels in the traditional, decentralized ownership model. Engaging the Ministry of Finance in the technical-political structure (CEP-UMEP) has produced several specific advances: For example, three-year management contracts between the CEP and five of the main enterprises of the country were implemented, and the UMEP took an active role in promoting transparent and effective annual external audits of the SOEs' accounting and financial statements. In September 2013, the CEP was institutionalized through a law creating the National Council of Public Enterprises (*Consejo Nacional de Empresas Públicas*—CNEP). This strengthened the institutional framework for SOE supervision and helped assure the sustainability of the reforms. The new legislation also increased the rank of the UMEP to General Directorate of SOEs (*Dirección General de Empresas Públicas*).

**Uruguay is another country where SOEs have major economic and strategic significance and where their ownership mixes centralized and decentralized arrangements.** The centralization is evident in the role of two public entities: (i) The Public Enterprise Department (*Departamento de Empresas Públicas*—DEP), within the Planning and Budget Office (*Oficina de Planeamiento y Presupuesto*—OPP), provides budgetary analysis and advice and evaluates SOE investment projects. (ii) The Macroeconomic Advisory Unit, under the Ministry of Economy and Finance (MAU/MEF), provides macroeconomic guidelines to plan the government's financial

program—including impacts specific to SOEs; it also monitors and analyses the quasi-fiscal impacts of SOE operations. Both OPP and MEF participate in other functions, such as monitoring the performance of companies that receive subsidies from the treasury. However, they do not play any role in the supervision or monitoring of external audits of SOE financial and accounting statements; nor are they involved, according to the constitutional provisions in force, in choosing directors of the company.

### **I.2.3 Examples of Good Practice in Other Countries**

**There are examples of effective centralization of SOE ownership in countries outside Latin America.** Keeping in mind that no one model is applicable in all cases, and that the SOE ownership function tends to be adapted to each country’s situation, the purpose here is simply to provide some reference cases of countries in which reforms to centralize SOE management have been effective and consistent with basic principles of corporate governance.

**One good example of increased centralization of SOE ownership function in OECD countries is the creation of State Holding for Industrial Participations (*Sociedad Estatal de Participaciones Industriales—SEPI*) in Spain.** SEPI, created in 1996, is a group of enterprises (*holding*) which is under the Ministry of Finance and Public Administration (*Ministerio de Hacienda y Administraciones Públicas—MHAP*) and has direct, majority participation in 18 SOEs which employ more than 80,000 employees. It also is a direct, minority shareholder in seven SOEs (five of them listed on stock exchanges), and participates indirectly in ownership of more than a hundred companies. Its creation was part of a government reform effort which included the restructuring, greater centralization of outcome-based SOE sector supervision.

**Another case to highlight is New Zealand, which changed from a decentralized model to a dual type.** Unlike several cases where duality is manifested through “sharing” the SOE ownership function between a “key ministry” and sectorial ministries, in New Zealand ownership is reflected directly and explicitly through the division of the capital stock in equal shares between the Ministry of Finance and the corresponding sectorial ministries. The Ministry of Finance is focused on economic efficiency and the fiscal impact of SOE performance. It takes the lead on economic issues, selling of stocks, and financial reports, and has full responsibility for the approval of asset sales. New Zealand’s sector ministries have a business

## BOX I.9

### The Case of SEPI in Spain

#### Highlights

- SEPI carries out government policy, acting as an agent in the restructuring and supervision of public enterprises.
- It functions as a corporation with financial autonomy. Its main funding sources come from: (i) management of its own assets; (ii) income from privatization processes; (iii) earnings from its participation in companies; and (iv) loans from private financial markets, within the limits established by the annual General Budget Act.
- It is made up of a president and an administration council (maximum of 15 advisers). The president, nominated by the MHAP, is named by the government, while the advisers (or directors) are named by the MFPA, generally from nominees of the sectorial ministries.
- SEPI applies an integrated planning and supervision mechanism called “Planning, Monitoring, and Control System” (*Sistema de Planificación, Seguimiento y Control*) to the SOEs under its control. Through this system SEPI applies coherent guidelines for managing SOE accountability, fiscal, and financial issues. The system is applied in three stages: supervision of the SOEs’ budget process; regular oversight (monthly or quarterly) of budget execution; and final assessment of the performance and reporting of results.

#### Future Challenges

*Consolidating SEPI’s role as “owner,” strengthening the mechanism for designating the directors of the SOEs it represents.* In general, the functioning of the Board of the public corporations is regulated through commercial and corporate law, not specific regulations. In practice the directors are named by the boards of their respective SOEs, based on nominations made by the MHAP and the sectorial ministries, and then presented by the board of SEPI to the board of the corresponding SOE.

- *Increasing SEPI’s sphere of supervision.* There are a number of important SOEs in Spain that are directly owned by the central government, be it through the MHAP or the sectorial ministries. The government’s main challenge in corporate governance is continuing to develop and adopt measures that could benefit a wider group of SOEs.

*Source:* Report authors, in consultation with the Government of Spain.

perspective, ensuring that SOEs are successful enterprises in the markets in which they operate. In this way, the sectorial ministries, mainly through an advising unit (CCMAU—the Crown Company Management Advisory Unit, which is part of the Treasury), monitor performance and have full responsibility for appointment of SOE board members.

## Notes

28. It should also be noted that it is possible to observe a simultaneous application of more than one model. For example, when the state exercises the ownership according to the dual model for a group of SOEs and for the other ones, it applies the traditional or decentralized model.
29. Note that in September 2013, a draft law was submitted to the legislature which would legally institutionalize SEP and increase its independence from the executive branch; furthermore, it would establish generally applicable criteria on corporate governance for the enterprises SEP oversees.
30. The other 25 SOEs are funded through the General Treasury, and therefore controlled directly by the MF.



## CHAPTER I.3

# Performance Monitoring

**This chapter addresses one of the key SOE ownership functions: continual monitoring of SOE performance.** Empirical evidence from many countries shows that effective monitoring can lead to better SOE performance, both financial and non-financial. A solid performance-monitoring framework sets clear objectives and targets linked to the SOE strategy. That in turn helps SOE boards and management to more clearly understand government expectations. The monitoring framework enables the board to set and execute the SOE strategy with an appropriate degree of autonomy. It also makes SOEs accountable for their performance to ownership units (and government generally).

**A fundamental challenge for ownership entities when establishing a performance framework lies in the fact that SOEs are usually established and operated with both commercial and non-commercial objectives.** The State's ownership entity must ensure that each SOE is meeting the targets and objectives set for it and must take action if it is not. Non-financial goals often carry financial costs, challenging the SOE board and senior executives to resolve competing priorities. Inside managers have a far better knowledge of their enterprise than external agents do. That asymmetry can allow entrenched managers to conceal poor performance or

exceed their mandate, and can also affect negotiation and monitoring of performance.

### **I.3.1 Conceptual Framework**

#### **Developing a Performance Management Framework**

**A sound performance-monitoring framework seeks to acknowledge inherent tensions related to SOE performance.** Such tensions arise from conflict among commercial and non-commercial objectives, information asymmetries between SOE management and ownership entities, and so on. Performance monitoring needs to be explicit in identifying the core financial and non-financial objectives of the SOE as well as the government's priorities of each SOE's diverse strategic objectives. This helps the relevant ownership unit or entity to develop performance targets appropriate to those priorities.

**To set specific performance targets for individual SOEs, governments must define a mandate, a strategy, and a set of individual objectives for each SOE.** The *mandates* of SOEs usually define the sectors in which they operate and their main lines of business. Mandates sometimes include public services and social obligations or commitments, for instance, relating to employment issues. Thus mandates often explicitly identify the mix of commercial and policy objectives. Based on the mandate, each SOE needs to develop its own strategy, which is then approved by its board (and explicitly or implicitly by the ownership entity). A clear mission, vision, and strategic plan provide conceptual clarity for both management and employees. Clear strategies provide a basis for measuring performance, and they are expected to include specific objectives and goals. Objectives should be clear and realistic, and then measured by key performance indicators.

#### **Structuring Performance Agreements**

**Performance agreements are central to managing SOEs' performance in most countries.** Performance agreements go by different names in different countries, often reflecting their different form or legal status. Examples include objective documents, statements of corporate intent, memorandums of understanding, statements of expectations, shareholders' letters, letters of agreement, and business plans. Ideally, a performance agreement would include all the elements listed in Table I.2 below.

**TABLE I.2: Main Elements of SOE Performance Agreements**

<b>Concept</b>	<b>Short Description</b>
SOE mandate	It defines the core and noncore activities of the business that the board is accountable for delivering. The mandate provides two-way benefits: it serves as a constraint on the company, imposing a discipline against undertaking non-relevant activities that may not be in the best interests of the owner; and it protects the board and management from being asked to undertake activities that are inconsistent with the core business.
SOE strategy	A clear mission, vision, and strategic plan provide conceptual clarity for both management and employees. Clear strategies provide a basis for measuring performance, and they are expected to include specific objectives and goals.
A clear description and explicit financial cost estimate of the SOE's noncommercial objectives.	In particular, those related to social goals such as minimum coverage, affordability for low-income consumers, etc. This helps provide the State with an overall understanding of the cost of meeting social objectives.
Financial and nonfinancial performance indicators and associated targets.	They are the main elements for reviewing and monitoring SOE performance. A common recommendation for developing effective performance indicators is to make sure that they are <i>SMART</i> : Specific, Measurable, Achievable, Result-oriented, and Time-based. Inappropriate performance indicators may lead to unintended consequences—for example, they may encourage SOE management to improve the indicator at the expense of deteriorating performance in meeting enterprise objectives.
Procedures for reporting, including frequency.	When not otherwise described in law or regulation, the performance agreement should explicitly lay out the reporting requirements and deadlines for the SOE.
A statement describing the dividend policy.	The level of dividends for each SOE is driven by its capital structure, its profitability, and its estimate of future capital expenditure. A dividend policy enables the ownership entity to better control SOE expectations, since a "generous" balance sheet may encourage boards to reach beyond their core business and preferred risk profile.

Sources: World Bank, 2014; OECD, 2010.



**The ownership entity and the SOE are responsible for negotiating the content and scope of the performance agreement.** In countries where this process is fully developed, expected targets of relevant performance indicators are monitored, revised, and agreed on annually. In several countries aiming to strengthen accountability, SOE performance agreements are made public and are frequently submitted to the legislature. It is crucial that the government’s expectations for the SOE—as stated by the performance agreement—are formally, clearly, and publicly communicated. To properly negotiate the agreement, the ownership entity needs to have good knowledge of the industry based on research, experience, and dialogue with the SOE. It should also seek help from external experts as needed.

**How performance agreements are prepared and negotiated varies among countries, but there are some widely recognized performance-monitoring frameworks.** These frameworks differ in several ways, in part because of differences in the structure of the government’s ownership entity. For example, in New Zealand—and other countries—the framework is “bottom up,” with a negotiation between the SOE’s board and the ownership entity at the core of the process. Instead, in South Africa—and other countries—the performance agreement is more of an “expectations document” developed by the ownership entity for the SOE.

### **1.3.2 Recent Trends and Findings in Latin America**

**Developing a solid and effective performance management framework for SOEs is an inherent challenge for most Latin American countries.**

First, there are structural factors, such as the prevalence of hybrid models of ownership (see Chapter I.2) and the limited use of performance and results-oriented budgeting tools in the region. Such conditions make it difficult to introduce the logic of standardized performance agreements for institutions operating outside of the central government, such as SOEs. Developing a sound performance-management framework not only requires accommodating commercial and non-commercial goals that may conflict. It also needs to account for contextual factors, such as the complexity of the SOE’s business, the market structure in which the SOE operates, and so forth. Furthermore, where successful performance-monitoring processes have been established, they have evolved over many years—implementing them requires adequate capacity and a relatively high level of coordination between ownership entities and SOEs.<sup>31</sup>

**Within the sample of six Latin American countries, Chile, Peru, and Paraguay provide notable examples of SOE performance monitoring.**

In the case of Chile, both the board and management of SOEs supervised by the ownership entity (SEP) are held accountable—through performance agreements or similar arrangements—by continual monitoring and by evaluating annual goals. Performance agreements include financial and non-financial indicators and associated targets agreed between the SEP and each SOE.<sup>32</sup> In Peru, SOEs supervised by FONAFE develop a five-year institutional strategic plan (*plan estratégico institucional*) that defines the enterprise’s short-, medium-, and long-term objectives. The strategic plans include a set of performance indicators and associated targets for monitoring results. They are approved first by the SOE board and then require approval from the sector ministry and FONAFE’s board; that is followed by ratification through the general shareholder meeting. A similar approach using performance contracts was launched in 2009–2010 in Paraguay between CEP-UMEP and six SOEs, including the country’s largest ones.

**Uruguay has also made recent progress towards SOEs performance monitoring.** The Government of Uruguay, through the DEP, has been working recently on the implementation of performance agreements with SOEs that finance at least part of their operative expenses through General Treasury subsidies. These agreements specify a series of financial and non-financial performance indicators, as well as targets associated to them, and they also contemplate a system of results-based compensations and penalties.

**TABLE I.3: Performance Agreements between Ownership Entities and Individual SOEs**

Country	
Brazil	DEST has implemented contract agreements (pilot cases) with only 4 SOEs over the last decade. There were a few other isolated cases of performance agreements signed between SOEs delivering utilities (water and sanitation, and electricity) and related line ministries. DEST pilot cases included agreed-upon indicators of financial performance, such as: return on liquid assets; service delivery, for example, minimum coverage; and internal management, for example, human resources or internal control. These agreements also provided financial penalties—partial or complete elimination of bonuses or dividends—in cases of failure to achieve agreed-upon targets of these indicators. However, DEST found that compliance was weak. Thus the impact of these accountability tools on improving performance has not been significant.

*(table continues on next page)*

**TABLE I.3: Continued**

<b>Country</b>	
Chile	Directors and managers of SOEs under the supervision of the SEP are held accountable, through performance agreements or similar tools, by continual monitoring and by evaluating annual goals. The SEP evaluates SOEs' performance through specific instruments such as annual management plans (applied to port enterprises and linked to monetary incentives), programming contracts, and performance agreements. These performance contracts include: financial indicators, service delivery indicators, and internal management indicators. The effective achievement of performance-indicator targets is evaluated annually by the SEP Council, while the board can consider sanctions in cases of unjustified non-achievement.
Colombia	There are no performance agreements signed between SOEs and ownership entities (related line ministries). SOE boards define their "financial and performance objectives," which must be aligned with national goals as codified in the National Development Plan. These objectives have to be approved also by shareholders. In practice, SOEs tend to develop their own corporate plans, taking into consideration both the strategic sector plans (such as the National Energy Plan) and their own objectives. No information has been reported regarding the development of performance indicators and follow-up or monitoring activities.
Paraguay	Between 2009 and 2010, the UMEP defined a standardized model for SOE management contracts. These contracts have a time span of three years and are based on both financial and non-financial performance indicators, agreed upon between the SOE and the UMEP, and based on the former's medium-term strategic objectives. The provisions of each management contract also include monthly and quarterly reporting requirements, as well as annual compliance with external audit reports. In fact, the UMEP is currently using an online "dashboard," which allows access to a database of performance indicators for each SOE. UMEP also checks on the results of pre-defined targets based on those indicators. Six SOEs, including the country's largest ones—in oil, utilities, and telecommunications—signed their respective management contracts in 2010–2012 with UMEP and CNEP. New contracts with targets for 2013–2015 were signed in early 2013.
Peru	SOEs in Peru develop Strategic Plans defining the enterprise's short-, medium-, and long-term objectives. These plans are formulated on the basis of performance indicators and associated targets by each SOE for a five-year period. They should be consistent with FONAFE's directives, corporate policies, and corporate strategic plans, and they are also required to be aligned with the SOE sector's policy plans. The plans are approved first by the SOE board, and then by the sector ministry and FONAFE's board. Upon approval, they must be ratified by the general meeting of shareholders of each SOE and published online.

**TABLE I.3: Continued**

Country	
Uruguay	The use of SOE performance agreements is still in early stages of development in Uruguay. The government, through the DEP, has been working recently on the implementation of performance agreements between the Government and those SOEs covering at least part of their operating expenses through general treasury subsidies. These agreements specify a series of financial and non-financial performance indicators, as well as targets associated to them, and they also provide for penalties for cases of underperformance—for instance, board members may be prevented from receiving incentive payments, and even asked to resign; also, the Government may constrain financial assistance or support for access to external financing. DEP is also developing a compensation system for SOEs receiving subsidies to better align compensation with achievement of global, sector, and individual pre-defined goals.

Sources: Developed from information reported in country cases.

**Finally, the Government of Brazil did not implement performance agreements with SOEs at a significant scale over the last decade, and no such agreements have been used so far in Colombia.** DEST has implemented contract agreements (pilot cases) with only four SOEs over the last decade, and has not found the impact of these accountability tools on improving performance to be significant. In the case of Colombia, no performance agreements have been signed so far between SOEs and their respective ownership entities—for instance, related line ministries—because of the current decentralized ownership structure.

### **I.3.3 Examples of Good Practices**

**Useful guidelines and practices can be found in OECD countries where performance monitoring has effectively made SOEs more accountable.** Improving the governance of SOEs is a complex challenge in many countries. There is evidence that effective tools of performance monitoring can strengthen the way governments exercise their SOE ownership function. The following reviews some good practices reported by the OECD.<sup>33</sup>

#### **Setting Objectives**

**In a centralized SOE ownership structure, objectives can be defined for both the ownership entity and SOEs.** For the ownership entity, it can be

useful to identify a number of indicators for the overall SOE portfolio, or at least for a significant portion of it. Box I.10 summarizes the case of APE in France, which has a clear focus on quantitative and financial targets.

**Setting objectives for SOEs through performance agreements or similar tools entails negotiation between each enterprise and the corresponding State ownership entity; this requires both industry knowledge and strong financial modeling skills.** According to the OECD: *It also requires a certain level of operational experience to determine the key levers of performance and the time frame in which it is reasonable to expect results. The combination of this industry knowledge, financial capability, and operational experience should be present in SOE boards, and reflected also within the ownership entity to allow informed and balanced dialogue. . . . To negotiate as an informed owner, the ownership entity should develop appropriate knowledge of the industry, based on research and analysis as well as the history of dialogue with, and feedback from, the SOE boards.*<sup>34</sup> It is also useful to standardize and if possible formalize the process of developing performance agreements through legislation, regulation, or protocol—see, for example in Box I.11, the

#### BOX I.10

### **Specific Indicators to Assess Performance of State Ownership in France**

Objective 1: *Ensure the increase in State shares' value.*

- Indicator 1: Operational profitability of capital (operational results/assets).
- Indicator 2: Financial profitability (net results/equity).
- Indicator 3: Operational margin (operational results/turnover).
- Indicator 4: Indebtedness sustainability (EBITDA/net debt).

Objective 2: *Ensure the success of sales transactions.*

- Indicator 1: Difference between receipts from sales and intrinsic or stock values of sold shares (based on valuations made by the Commission on Participations and Transfers).
- Indicator 2: Level of fees and commissions paid to advisers.

Objective 3: *Contribute to the decrease in State debt.*

- Indicator 1: Decrease in debt and interest charges of entities in public administration.
- Indicator 2: Decrease in debt and interest charges of the State.

Source: OECD, 2010.

## BOX I.11

### **Negotiation of Corporate Objectives in New Zealand**

The main steps related to business planning cycle and drafting of statements of corporate intent are:

- Shareholding ministers write to each Crown company board before the beginning of each planning round to detail the information requirements, the timing (milestone dates) and any special issues the company is to address during the planning round.
- Boards are then required to: assess their business environment; reassess their strategic direction; provide a detailed plan for the immediate year; and provide financial projections for the following two to four years.
- Following the delivery of the boards' outlook and business plans to the shareholding ministers, advisors then prepare a report on these documents for the shareholding ministers' consideration. Draft statements of corporate intent are delivered together with the business plan. The SOE Act, the CRI Act and other relevant company-specific legislation require boards to deliver their draft SCIs to shareholding ministers at least one month before the end of each financial year.
- Shareholding ministers may then, through their advisers, seek further information.
- Shareholding ministers then consult with boards on any issues or concerns they have with the business plans and draft statements of intent. This occurs either by letter or, more often, meetings between shareholding ministers, advisers and the board (referred to as the business planning meeting).
- Following the business planning meeting (if held) shareholding ministers write to boards outlining their understanding of the main outcomes and issues discussed.
- Boards then consider the outcomes from business planning meetings and the shareholding ministers' written comments, and if necessary, revise their business plans and statements of intent. Boards then deliver to shareholding ministers finalized business plans and statements of intent.
- Shareholding ministers table the finalized statement of corporate intent in the Parliament.

*Source:* OECD, 2010.

negotiating of corporate objectives in the “business planning cycle” and the drafting of “statements of corporate intent,” the name for SOE performance agreements in New Zealand.

**A key challenge in setting objectives for performance agreements is to develop relevant performance indicators.** Box I.12 on the next page illustrates some rules used in France and New Zealand for choosing indicators. The indicators can be broadly classified as “financial” and “non-financial.” Associated targets are used in evaluating and monitoring performance. Main sources on which to base appropriate targets are historical performance, benchmarking against peers, and assessment of effective capabilities.

### **Monitoring and Auditing of Performance**

**Performance indicators and periodic results based on their associated targets should be available to main users involved to allow them to monitor SOE performance and to verify their relevance and quality of information.** Depending on the legal and institutional framework, the main recipients of such information would be ownership entities, line ministries, ministry of finance, audit institutions, and other government agencies. Effective SOE performance monitoring by the corresponding ownership entity usually should be an ongoing process—including the use of external information, performance checkups, and regular meetings with SOE boards. Annual SOE performance reviews are also an important information source. The reviews should be produced by the ownership entity and distributed to other relevant public institutions. Note though that the disclosure of performance data may be restricted in cases where commercially sensitive information is involved.

**Performance indicators, as established by performance agreements or similar tools, should also be subject to both internal and independent external audit.** Auditing by the State audit institutions or by private firms assures the State owner, stakeholders, and the public of the quality and accuracy of the information provided by SOEs about the achievement of targets. Without proper, independent audit of performance information, poor quality data, weak analysis, or political pressure to look good might lead to a distorted picture of performance. OECD guidelines also suggest relying on the internal audit function: *[D]evelop 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 SOE organ.*

## Developing Relevant Performance Indicators

### France:

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>• <b>Relevant so as to assess the results obtained</b></li> <br/> <li>• <b>Useful</b></li> <br/> <li>• <b>Reliable</b></li> <br/> <li>• <b>Verifiable</b></li> </ul> | <ul style="list-style-type: none"> <li>– Consistent with the objectives.</li> <li>– Relating to a material aspect of the expected result.</li> <li>– Providing the basis for making a judgment.</li> <li>– Not producing effects contrary to those sought.</li> <li>– Being provided at regular intervals.</li> <li>– Lending themselves to comparisons in time, space and between players.</li> <li>– Being immediately exploited by the agencies concerned.</li> <li>– Being immediately comprehensible or clearly explained.</li> <li>– Being durable and independent of organizational imponderables.</li> <li>– Being reliable beyond question.</li> <li>– Able to be drawn up at reasonable cost.</li> </ul> |
|---|--|

### New Zealand

Performance indicators (financial and non-financial) must:

- Be meaningful to the SOE's business and the SOE Act.
- Be specific and measurable without ambiguity.
- Be timely and capable of being audited, where appropriate.
- Be within the SOE's responsibility or power of control.
- Be consistent with and influence, as appropriate, the SOE's purpose and principles of operation or business.
- Respect commercial sensitivity, where appropriate.
- Encourage and reflect best practice.
- Where appropriate, ensure employee participation in, and ownership of, these indicators.

*Source:* OECD, 2010.



#### BOX I.13

### Monitoring and Audit of SOE Performance in Italy

#### Monitoring

- The Ministry of Economy and Finance, which is the ownership entity, carries on a constant monitoring of SOEs' performance and management. Each company is required to provide the ministry with the following detailed information and documents:
  - The annual budget for the incoming year
  - Half-yearly reports on performance and financial results, with details on the differences with the budget and the previous year's figures
  - The estimated year-end figures
- SOEs are also required to point out potential critical areas and provide all relevant information, including the business plans approved by the board.
- In addition, the shareholder can receive information about each SOE through its representatives appointed in both the board of directors and the board of auditors. (The Italian Civil Code [Art. 2449] allows the State as an owner to appoint one or more members of the board of directors and of the board of statutory auditors with the same rights and duties of board members chosen by GSM.)

#### Audit

- **Internal Audit:** In all SOEs, the internal audit office reports directly to the board, usually every 6 months, on the following matters: evaluation of the efficiency of the internal audit procedures, checks effectively made, and possible risk areas. Moreover, the Ministry of Economy and Finance, as the ownership entity, has actively encouraged all SOEs to appoint a senior officer (usually the CFO) responsible for the company's accounting procedures and financial statements. This officer is appointed by and reports to the board of directors and is accountable to all stakeholders for the company's annual reports and financial data.
- **External and Independent Audit:** All SOEs, both listed and unlisted, are subject to an annual audit by independent external auditors, who are appointed by the GSM. The external auditors of SOEs are required to be duly registered by the Italian Securities and Exchange Commission (*CONSOB*), to ensure that they meet the same high quality auditing standards of listed companies.

- **State Audit:** The activity of SOEs is supervised and audited by the National Audit Office (*Corte dei Conti*). An appointed official of NAO attends SOEs' Board meetings and an annual report by NAO on the performance of each SOE is sent to the Parliament.

Source: OECD, 2010.

## Notes

31. For instance, when introducing a performance monitoring framework, ownership entities usually need to start by gathering baseline information on each SOE. They also must assemble a team of specialists who can develop an understanding of and expertise in the operations of the monitored SOEs.
32. The performance monitoring instruments for the SOEs under SEP supervision are: (i) Annual Management Plans, in the case of the port enterprises, (ii) Management Agreements in the case of companies that have government guarantees for specific loan operations, and (iii) Target Agreements for the rest of the companies. Finally, note that the largest Chilean SOEs—in the mining sector—are outside the scope of SEP supervision and therefore are not subject to these kinds of performance-monitoring arrangements.
33. OECD, 2010.
34. OECD, 2010.



## CHAPTER I.4

# Board Procedures

### I.4.1 Conceptual Framework

**A board of directors is the governing body of a corporate institution such as a State-Owned Enterprise.** It is a collective decision-making team whose effectiveness is a function of its composite skills and experience and how relevant those skills and that experience are to the strategic and operational issues confronting the SOE. The board is typically responsible for the strategic oversight of the enterprise, the approval of its business plan, the appointment and oversight of senior management, and the reporting of performance to shareholders.

**Key elements of good board practices within an effective governance framework include:**

- A robust selection and appointment process designed to appoint directors who have the most appropriate skill set, knowledge, and experience to help the SOE achieve its legal and commercial mandate
- A clearly stated primary objective for the SOE that would guide the board's decision making and the management of the company
- A requirement to actively participate in developing a forward-looking plan or performance agreement—often also termed “business plan” or

“statement of corporate intent” and based upon a mix of financial and non-financial performance indicators—that sets out how the board will oversee the SOE to achieve the primary objective and the SOE’s statutory and commercial mandate

- Periodic (and public) *ex post* reporting against the objectives and targets set out in the forward-looking plan
- Independent audits of the SOE’s annual financial reports that are prepared in accordance with appropriate accounting standards
- A clear separation between the government-as-owner and the board—ensuring that government ministers and officials are not appointed as SOE directors
- Management that is separate from the board, but is held accountable by the board for the performance of the SOE against the objectives and targets as they appear in the forward-looking plan
- A formal process to evaluate the performance of the board, separate from the evaluation of the SOE’s performance against pre-defined objectives and targets

**Legislative framework.** The OECD study of board practices notes: *[T]he role of the board should be clearly defined and founded in legislation, preferably according to general company law and [. . .] the State should inform the board of its objectives and priorities through proper channels to ensure the board maximum authority and independence.*<sup>35</sup>

**SOE directors should have a clear understanding of their role.** This role is usually defined in the legislation establishing the SOE, whether it be an overarching law or entity-specific legislation. The objectives of the director’s role should be clear and unambiguous and be capable of measurement. Directors’ performance should be assessed against the attainment of the SOE objective. In many SOE laws, this is termed as the “primary” or “principal” objective. In the first SOE act developed in the mid-1980s in New Zealand the objective was described as “being successful,” which was defined as “being as profitable as comparable businesses not owned by the State.”<sup>36</sup> In more recent SOE legislation, the objective sometimes has been equated with the SOE achieving a return sufficient to meet its risk-adjusted cost of capital.

## **Selection Process and Duties of Directors**

**Only candidates who have demonstrated the most relevant skills, knowledge, and experience to help the SOE achieve its primary**

**objective should be appointed directors.** In some countries the SOE director selection and appointment processes are codified as part of the SOE act and regulations, or through a cabinet directive. In the case of SOEs listed on stock exchanges, there is a formal process to appoint the directors, usually through election at the annual general shareholders meeting. However, this does not guarantee that those directors nominated and appointed by the government as shareholder are selected on merit. The quality of board decisions is very much a function of the quality and independence of the individual directors.

**The roles, responsibilities, and duties of directors—and how they will be held accountable—should be clearly defined.** If the SOE is not registered as a company, and subject to the duties set out in the relevant company legislation, then it may be necessary to have comparable duties codified in either the SOEs' rules or establishing legislation. Whether the State manages its SOEs through a centralized or decentralized ownership model, there is merit in ensuring that the duties and responsibilities of SOE directors are set at a consistently high standard across the full SOE portfolio. The State should use its ownership role in its SOE portfolio to demonstrate best practices in setting director duties and responsibilities, and in corporate governance generally.

**It is also important that there is a clear separation between the board and management.** Having management sit as directors adds little or no value to the organization's governance—management is still required to submit reports and recommendations for the board's consideration even if managers sit on the board, but their presence can complicate the board's function. It is more difficult to hold a chief executive accountable who is also a director. Also the practice of having an executive chair, as has been the case in many corporations in the United States, may create an environment where the chair is all-powerful and the board is unable to exercise the required level of oversight.

**Ministers and other public sector servants should not sit on the boards of commercially focused SOEs.** In the case of non-commercial SOEs, where the enterprise is undertaking State functions and is fully or heavily funded directly from the State budget, it may be justifiable to have the sector minister or public servants sitting on the board. However, in the case of commercially-focused SOEs, ministers and public servants carry irreconcilable conflicts of interest between their roles as ministers and public servants and their role as SOE directors. Further, having political appointees on boards, rather than those who are best qualified, erodes the independence and autonomy of the SOE boards.<sup>37</sup>

**Assuring the independence of SOE board members has several requirements.** For example, as reported by the IFC,<sup>38</sup> an “independent director” is a person who, among other things, has no personal service contracts with the SOE or with related parties, including its major shareholders and senior management members; has not been employed by the SOE or its related parties in the past five years; is not affiliated with a significant customer or supplier of the SOE; and is not affiliated with a company serving as adviser or consultant of the SOE.

**New directors should receive effective induction training.** It may take two to three years for a newly appointed director to be able to fully contribute to board discussions. It is in all stakeholders’ best interests if a director can fully contribute in the shortest time period and this can be achieved if a newly appointed director is provided with induction training. The OECD guidelines on boards of directors of SOEs<sup>39</sup> observe: *Induction programs should match the needs of each board. They should serve as a way to improve the effectiveness of board members.* Ideally, induction training should be undertaken both by the agency appointing the director and by the SOE on whose board the director is about to serve.

## **Accountability and Transparency**

**The foundation of any effective SOE governance model is the accountability framework, supported by an appropriate level of transparency.** SOE boards are the stewards of public funds and should be subject to an accountability framework at least comparable to that which applies to private sector directors. Furthermore, recognizing that SOEs are responsible for public funds, their transparency requirements should be higher than those usually adopted in the private sector.

**The board should ensure that the SOE has adequate internal controls and effective internal and external audit.** SOE boards should be accountable for the oversight and publishing of a set of audited annual accounts of the immediately preceding financial year, preferably within 3 months of that financial year ending. The existence of an audit committee, comprised of board members selected to focus on auditing requirements, is considered a good practice. The audit committee is usually in charge of the oversight of the SOE financial reporting, and (in some cases) of the evaluation of corporate risks. Board-revised financial reports should then be subject to independent external audit.

**Board accountability requires the use of forward-looking business plans—or performance agreements—covering a meaningful term such**

**as three to five years.** It is impossible to fulfill the minimum requirements of an SOE director if there is uncertainty about the enterprises' current financial position or what the board and management are planning—financially and operationally. In some cases, the SOE legislation requires the board to develop an overall guidance for the forward-looking business plan—often called “statement of corporate intent” or “statement of corporate objectives”—which must be made available to the public at no cost. In order to enhance SOE accountability, forward-looking SOE documents should contain a mix of relevant financial and non-financial performance indicators and associated targets. Model SOE legislation requires the SOE to publish summaries of their annual reports and actual performance measures against targets.

**In some cases, partial listing can be used to launch SOEs into a more robust and transparent governance framework.** The State may allow a partial listing of shares in its SOEs on international stock exchanges and its own domestic share market—large SOEs in Brazil are a good example. This practice has a number of direct benefits, such as increasing the ability to raise capital. But it also can strengthen the governance framework under which these SOEs operate; for instance, by increasing the accountability and transparency of the SOE board and management. Partially listed SOEs must abide by the rules set by the exchange on which their shares are listed. They also are subject to a high level of scrutiny by brokers and other market observers.

## **I.4.2 Recent Trends and Findings in Latin America**

**SOE board and management practices in Latin American vary from country to country.** Table I.4 summarizes current practices in six Latin American countries. It is based on information gathered by the World Bank and provided by government representatives from the SOE sector for each country.

**However, there are some practices common to all or several of the countries studied.** First, in almost all analyzed countries, the board of the SOEs has the authority to designate the management team, and also participates in the approval of the company's financial reports prior to their dissemination. Laws and other norms that establish functions and minimum characteristics of SOE boards of directors are common. Also, three of the six selected countries—Brazil, Chile, and Peru—appoint directors based on merit and qualifications. Finally, two practices that seem to be relatively



uncommon are (i) involving labor unions in the SOE boards and (ii) the use of sanctions—in monetary or other form—when SOE performance falls short of pre-established indicators and goals.

**Table I.4 compares specific SOE management practices among different countries.** For example, in Paraguay only a few companies have a board of directors, so SOEs are usually led by CEOs appointed by the President of the Republic, even though the CEP can recommend nominations. Also, the CEP can recommend that the President remove the CEO of an SOE that underperforms. On the other hand, in Peru under the lead of FONAFE, the role of the “Executive President” has recently been eliminated in most SOEs. This has helped enforce the separation of roles between the board and the management of SOEs. In contrast, in Uruguay board intervention in operational issues remains frequent. Finally, as mentioned earlier, the performance measurement of SOEs in Uruguay, and hence the use of sanctions against boards for poor performance, are still in an early stage and are limited to some companies that receive subsidies from the national treasury.

**TABLE I.4: Board and Management Practices in SOEs in 6 Latin American Countries**

Concept	Brazil	Chile	Colombia	Paraguay	Peru	Uruguay
Board appoints the management team	Yes	Yes	Yes	Some cases	Yes	Yes
Ownership entity (ministry, centralized agency, etc.) or other institution (presidency, ministerial cabinet, etc.) appoints management team	No	No	No	Yes	No	No
Clear separation of roles between board and management	Yes	Yes	Yes	No	Yes	No
Selection of the directors based on merit and qualifications	Yes	Yes	No	No	Yes	No
Board formally involved in approving SOE financial reports before dissemination	Yes	Yes	Yes	Some cases	Yes	Yes
Norms/laws establish minimum board functions	Yes	Yes	Yes	No	Yes	Yes
Legislation involves union representatives in board	Yes	Some cases	No	No	No	No
Board may be sanctioned for poor SOE performance	No	Yes	No	No	No	Some cases

Source: Report authors, in coordination with government staff from the SOE sector of the respective countries.

### I.4.3 Examples of Good Practices

**Examples reported by the OECD and by the World Bank illustrate some best current SOE management practices.**<sup>40</sup> OECD governments have increasingly addressed the role of boards to improve SOE governance and performance, and also to strengthen the State's ownership function. At the same time, the World Bank has been increasingly paying attention to SOE corporate governance issues, including board procedures, and has reviewed practices from several countries around the world. The following reviews some of what the OECD and the Bank have learned.

#### **Board Member Selection and Appointment**

**Some OECD countries now base selection and appointment of SOE directors on skills.** Overall, a relatively small number of countries have imposed minimum formal qualifications for individuals to be eligible for SOE board nomination. In the United Kingdom, board member selection and appointment is regulated jointly at several stages by the SOE board and the Shareholder Executive (the government coordination entity). New Zealand, through its centralized SOE monitoring unit,<sup>41</sup> has adopted a comprehensive approach to board appointments, from soliciting, vetting, and recommending candidates through conducting induction training after an appointment has been made. Also ministers, when making appointments to SOE boards, must certify that they have followed the mandated process. In Canada, when a board vacancy arises, the minister responsible for nominating a candidate—and the minister's staff, with support from the department—are guided by the profile developed by the board of directors to screen potential director candidates.<sup>42</sup>

#### **BOX I.14**

### **SOE Board Members Selection and Appointment Process in New Zealand**

In New Zealand the appointment process may vary for specific boards, but the following steps detail the general process that the CCMAU—the Crown Company Management Advisory Unit follows for all appointments.

**Skills profiling:** In conjunction with ministers and the chair of each company board where a vacancy arises, CCMAU analyzes the board's makeup to determine the general skills and

*(box continues on next page)*

**BOX I.14** *continued*

experience required and those that would be ideal in any new appointees. A position specification is then prepared.

**Candidate identification:** CCMAU’s primary tool for identifying candidates is its appointments database. Candidates may also apply directly for specific positions or register in the system to be considered for future opportunities. Ministers generally consult government colleagues for suitable candidates. Nominations from other agencies are also requested.

**Short-listing:** Ministers consider all applicants for each role and short-list possible preferred candidates who appear to match the skill needs for each board.

**Due diligence and identification of conflicts of interest:** Short-listed candidates have the opportunity to undertake a due diligence process before final decisions are made. This is a chance for the candidates to assess whether they will accept a role if offered. It also allows CCMAU and the board chair to form a view about each candidate’s suitability. The process allows both candidate and CCMAU to identify possible conflicts of interest (such as family connections, personal or professional links with the SOE or its management, or a directorship or ownership in another company that undertakes work for the SOE). When a conflict is identified, a decision is made as to whether that conflict renders the appointment unmanageable or whether the appointment can proceed with appropriate conflict-of-interest management regimes in place.

**Appointment:** After a preferred candidate has confirmed his or her availability to serve on a board, the shareholding or responsible ministers advise the cabinet appointment and honors committee and the cabinet accordingly. The appointment is then confirmed by a notice of appointment to the successful candidate. For most candidates, the shareholding or responsible minister makes the appointment and the entity and successful candidate are advised accordingly.

*Source:* World Bank, 2014, adapted from CCMAU, “Appointment Process,” at <http://www.treasury.govt.nz/commercial/board-appointments/process/>.

## **Definition of Board’s Key Responsibilities**

**The definition of the role and key responsibilities of SOE boards can often be found in laws, decrees, corporate governance codes, and so forth.** However, it is not always clear in practice what the board is required to do to perform its functions effectively. As noted earlier, it is helpful for the SOE legislative framework to provide a clear definition of the SOE “primary” or “principal” objective—whether by an overarching law or by SOE-specific legislation. The objective should be precise, unambiguous, and capable of measurement, and directors’ performance should be assessed against how the objective is achieved over time.

**BOX I.15****Empowering SOE Boards in South Africa and India**

*In South Africa* SOE boards have been given explicit responsibility through the 2002 *Protocol on Corporate Governance in the Public Sector*. The protocol is to be used in conjunction with South Africa's corporate governance code, the King Code, which applies to a range of enterprises, including listed companies. The protocol assigns clear responsibilities to SOE boards. According to the protocol, "the board of the SOE has absolute responsibility for the performance of the SOE." The protocol also clarifies when the government shares power with the board. For example, it notes that the board should consult with the "shareholder" (relevant minister) on the choice of CEO and that the shareholder should approve the pay of executive board members. It further specifies that the objectives of the shareholder compact—a performance agreement between the shareholder and the SOE—are to be the benchmark for measuring the performance of the company, the board, the chair, and the CEO.

*In India* board responsibilities are outlined by the corporate governance code that applies to all central public sector enterprises (CPSEs), which is similar to the requirements for listed companies. In addition, a formal system of delegation based on company performance determines which decisions are in the exclusive purview of the board and which must be shared with the relevant ministry. Under this system each SOE is classified on by its size, profitability, and governance. Maharatnas and Navratnas—which include some of the largest companies in India—have the most freedom. Miniratnas (smaller enterprises) have somewhat less latitude. And some additional powers are delegated to all profit-making SOEs. A threshold is set for such actions as capital expenditures, forming joint ventures or subsidiaries, and mergers and acquisitions. Actions below the threshold require no approval by the ministry; those above the threshold do require its approval.

*Source:* World Bank, 2014.

**In South Africa and India, SOE boards have been explicitly delegated certain powers in relation to their respective ownership entity.** In South Africa, board responsibilities are based on the national private sector corporate governance code followed by listed companies, with additional guidance provided for SOEs and their relevant ministries. In India, the span of authority delegated to the board is linked to the SOE's size and performance, with the boards of better-performing SOEs given more power. Also, a number of OECD countries recently have implemented policies that empower SOE boards and clarify their responsibilities, often in line with OECD guidelines and corporate practices of private sector companies.<sup>43</sup>

## Notes

35. OECD, 2013.

36. *New Zealand State-Owned Enterprise Act, 1986.*

37. World Bank, 2006.

38. International Finance Corporation (IFC), 2012.

39. OECD, 2013.

40. OECD, 2013; World Bank, 2014.

41. Crown Company Management Advisory Unit—CCMAU.

42. OECD, 2013.

43. World Bank, 2014.

## CHAPTER I.5

# Fiscal Risk<sup>44</sup>

### **I.5.1 Potential Fiscal Risks Posed by State-Owned Enterprises**

**Various factors can generate SOE-related fiscal risks.** Uncompensated quasi-fiscal activities, political interference in SOE operations, excessive SOE borrowing, weak SOE reporting and insufficient Government oversight are considered as some of the main potential sources of SOE-related fiscal risks. Experience shows that such risks can be substantial. Significant SOE losses and debts have resulted in costly government financial support, with associated unforeseen bailouts and increases in government debt.

**Sound management of SOE-related fiscal risks is essential.** It involves key elements of SOE corporate governance; strong government oversight, fiscal reporting, and disclosure of fiscal risks; and risk-mitigation strategies. Several World Bank studies of SOE performance highlight the need for sound corporate governance practices to help address avoidable fiscal risks.<sup>45</sup> The IMF has suggested criteria for fiscal transparency and for assessing the fiscal risks posed by SOEs. It also has made recommendations for the oversight, disclosure, and management of fiscal risks, including those posed by SOEs.<sup>46</sup> Similarly, the OECD's guidelines on SOE corporate governance also emphasize the need for transparency and disclosure of information.<sup>47</sup>

**TABLE I.5: SOEs as Sources of Fiscal Risks**

Potential Sources of SOE-Related Fiscal Risk	Selected Examples
Uncompensated quasi-fiscal activities and contingent liabilities	<ul style="list-style-type: none"> <li>• Mandated SOE pricing below market or cost recovery that generates losses not compensated by the budget</li> <li>• Requirements to undertake activities unrelated to business objectives, including substituting for government expenditure</li> </ul>
Macroeconomic and other broad sources	<ul style="list-style-type: none"> <li>• Variations in growth, inflation, exchange rates, and interest rates, affecting SOE operations and the value of assets and liabilities</li> <li>• Volatility and uncertainty of commodity prices</li> <li>• Natural disasters</li> </ul>
Sectorial and specific sources	<ul style="list-style-type: none"> <li>• Variations in demand for SOE output</li> <li>• SOE provision of essential services</li> <li>• “Too big to fail”</li> <li>• Changes in SOE production costs</li> <li>• SOE debt and contingent liabilities</li> <li>• Volatility in weather conditions</li> </ul>
Weaknesses related to SOE corporate governance, government oversight, reporting, and risk management	<ul style="list-style-type: none"> <li>• Inadequate SOE managerial, control, accounting, audit, and reporting systems</li> <li>• Lax government monitoring and oversight of SOEs; narrow fiscal reporting; shortcomings in the disclosure and management of fiscal risks</li> </ul>

### Quasi-Fiscal Activities

**Quasi-fiscal activities (QFAs) are activities carried out by nongovernment public entities on behalf of the government to achieve policy goals.**<sup>48</sup> Governments use QFAs to achieve various social, economic, and political objectives. In the case of SOEs, examples of QFAs include: the mandated supplying of goods and services at subsidized or below-market prices, the required delivery of free services or universal service, activities imposed by the government that are unrelated to the enterprise’s business, or activities driven by political interference in SOE operations. Fiscal risks may arise when the financial consequences of these QFAs are not properly compensated.

**Some QFAs can be justified.** QFAs properly and transparently compensated from the budget may be an efficient way of carrying out certain government policies to achieve legitimate objectives, particularly when fiscal alternatives are operationally unavailable or more costly.

**SOEs may be mandated to charge prices below costs or relevant international benchmark prices.** Examples include SOEs in sectors such as electricity, water and sanitation, transportation, and telecommunications that are required to set tariffs below cost-recovery levels. These subsidies are often provided without adequate transfers from the budget to cover the ensuing losses. In some cases, however, subsidized prices may not require transfers from the budget to preserve the SOE's viability. For example, in many oil-exporting countries, national oil companies (NOCs) are mandated to supply petroleum products to domestic consumers at prices that are less than opportunity cost, but above the NOC's costs. Even in such cases, however, open-ended subsidies raise fiscal risks for the public sector as a whole.

**SOEs may be required to undertake activities unrelated to their business objectives.** For example, fiscal rules that target the government's deficit and debt may provide incentives to shift activities to SOEs without compensation. This may also occur in the absence of formal fiscal rules. That is the case, for example, when there is a deliberate intention to reduce the government's reported deficit and debt.<sup>49</sup> If SOE operations are not covered by fiscal reporting, there is an incentive to induce SOEs to undertake uncompensated spending—this can make fiscal results at the government level look better, but at the cost of generating contingent liabilities.

**Political interference in SOE operations can generate inefficiencies and fiscal risks.** For example, explicit or implicit directed employment policies may lead to SOE overstaffing. The excess personnel generate added operating costs. Overstaffing also presents financial and social risks in the event SOEs are restructured or privatized in the future. Requirements to buy goods and services from domestic suppliers entail price and availability risks.

**QFAs can also arise from “soft budget constraints.”** Subsidies can be given by the government through SOEs in the form of low collection rates and tolerance of arrears. SOEs may sometimes not have enough power (from legal procedures or political support), willingness, or capability to ensure the full and timely collection of fees. Payment arrears and nonpayment operate as an implicit subsidy because they result in a nontransparent transfer of resources to some users and revenue losses for the SOEs. Difficulty in suspending services to customers with overdue bills, in the case of public utilities, is a related and commonly observed problem.

**Uncompensated QFAs are one of the main sources of contingent liabilities.**<sup>50</sup> If QFAs are compensated by budget transfers, the fiscal balance of the general government includes the costs associated with the pursuit of policy objectives through the SOEs. However, in many countries, SOEs carry out QFAs without adequate and transparent compensation from the budget.



When budget transfers are insufficient to cover operating losses and adequate investment, SOEs may be forced to borrow, often with government guarantees, or to run arrears. This in turn leads to the build-up of government contingent liabilities, which could affect fiscal debt sustainability. Contingent liabilities may be explicit, as in the case of government guarantees, or implicit, if there are expectations that distressed SOEs will eventually be rescued by the government. These problems can become particularly acute when SOE reporting and government oversight are inadequate.

**Uncompensated QFAs can be financed by “borrowing from the future” in the form of postponement of necessary SOE expenditures.** SOEs that are unable to secure adequate revenues or are in financial distress may resort to cutting down necessary expenditures on operations, maintenance, and capital investment. This practice often entails deteriorating service coverage and quality and other associated risks, such as reduced operational safety and lost output. Negative impacts may extend to the medium and long term: Depleting the SOE capital stock and generating fiscal risks will require future spending to improve or restore service viability.

#### BOX I.16

### SOE Fiscal Risk: Country Examples

- In *El Salvador*, tariffs charged by the water and sanitation public utility (ANDA) have been about 50 percent below cost. The enterprise’s budget has been insufficient to pay for inputs. As a result, ANDA has run recurrent arrears to the State-owned power generator (CEL) for power supply, and has been unable to fully cover its debt service, imposing repeated contingent liabilities on the government.<sup>51</sup>
- In *Ghana*, QFAs in the form of subsidized energy prices not compensated from the budget led to substantial losses at the State oil refinery and in the electricity sector. Delays in adjusting petroleum prices and electricity tariffs in the early 2000s inflicted large accumulated losses, on the order of 7 percent of GDP in the case of the refinery alone.<sup>52</sup>
- In Dubai, *United Arab Emirates*, several government-related enterprises ran up liabilities equivalent to 79 percent of GDP. As the global financial crisis unfolded, these liabilities proved unsustainable and led to a financial rescue by Abu Dhabi in 2010.<sup>53</sup>

## Macroeconomic and Other Broad Factors

**Sudden and unexpected changes in exchange rates and interest rates can affect SOE finances and government budgets.** SOEs that rely on revenues in domestic currency may borrow in foreign currency. This leads to currency mismatches between revenues and debt service, which raises fiscal risks should the domestic currency depreciate. While it is perhaps less widely realized, NOCs and other State-owned, resource-exporting companies also face fiscal risks stemming from domestic currency appreciations. This is because their foreign balance—exports and any return on foreign assets minus imports and foreign debt service—is almost invariably positive. Then, if the domestic currency appreciates in real terms, the domestic purchasing power of the net foreign resources accruing to the company diminishes. SOEs’ investment and debt management may also be vulnerable to increases in interest rates, both domestic and international.

### BOX I.17

#### **A Framework for Analyzing SOE Fiscal Risks: Application to Jamaica<sup>54</sup>**

**Analysis of SOE fiscal risk can be undertaken using forecasting techniques.** First, a baseline outlook for financial performance of each relevant SOE is constructed. Then, two scenarios (optimistic and pessimistic) are developed to demonstrate the impact of favorable or unfavorable shocks on the operations of the selected entities. The next step is a stress test analysis to show how macroeconomic risks could affect the overall SOE sector. Changes in, say, oil prices and exchange rates could affect some SOEs favorably and others unfavorably—stress testing answers the question of the aggregate effect of such factors on the aggregate financial outcomes and fiscal impact of the SOE sector.

**This fiscal risk analysis was applied to eight entities in Jamaica.** The focus was on those public bodies (PBs—the national definition of SOEs and similar off-budget entities) that posed most significant fiscal risk. The selected eight PBs together account for 2 percent of GDP (measured as total earnings before interest, taxes, depreciation and amortization). Of the eight PBs, three recorded losses in FY2011/12 and

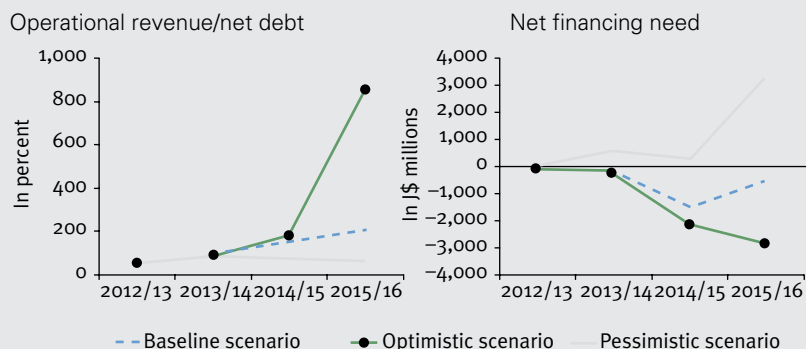
*(box continues on next page)*

**BOX I.17** *continued*

transfers from central government to support these entities amounted to J\$15.1 billion (1 percent of GDP) in FY2013/14. Under baseline assumptions, operational performance and fiscal risk of the key eight PBs deteriorates in FY2013/14, to then improve over the medium term.

**Scenario analysis was done for each PB, including public transport company JUTC** (Chart 1). In the pessimistic scenario with higher fuel prices, a depreciated exchange rate, higher interest rates, and government-set bus fares unchanged, JUTC would have substantial borrowing requirements in the medium term, about J\$3.5 billion or 0.2 percent of GDP in FY2015/16.

**JUTC Scenario Analysis**



**Stress testing shows vulnerability to macroeconomic shocks for SOE financial performance and their fiscal impact.** SOE performance is most susceptible to exchange rate risk. A depreciation of 20 percent in FY2013/14 would increase net debt by 1.7 percent of GDP for the eight PBs by FY2015/16 and increase their financing need by 0.6 percent of GDP over the medium term. The combined effect of a modest combined exchange rate, oil price and interest rate shock would add 2 percent of GDP to the financing need of the 8 key PBs over the medium term. This may seem modest, but given present tight fiscal conditions in Jamaica, such risks would be difficult to manage.

Source: Longmore, et al.

**The volatility and uncertainty of international commodity prices can generate fiscal risks for SOEs and overall government finances.**

Power generators that rely on fossil fuels face significant input price risks, which are compounded if tariffs are not allowed to respond adequately to changes in costs. Resource-exporting SOEs face significant revenue risks. The distribution of those risks between the SOE and the government depends on the fiscal regime applied to the resource sector. For example, the export receipts of PEMEX, Mexico's NOC, fell significantly in 2009 when the average international price of oil tumbled—receipts declined from 5.3 percent of GDP in 2008 to 4.0 percent in 2009,<sup>55</sup> and this decline was then passed on to the government in the form of lower tax payments.

## **I.5.2 Managing SOE Fiscal Risks**

**Sound management of SOE fiscal risks depends on key elements of SOE corporate governance, adequate government oversight, the disclosure of potential risks, and effective risk mitigation strategies.**

Appropriate and timely SOE financial planning, budgeting, and reporting provide information to the government about developments in the SOE sector, existing and potential financial stress areas that need attention, and future prospects. Government oversight should allow for the identification of SOE-related risks and their disclosure and scrutiny. It should also provide the basis for risk mitigation measures, if needed.

### **SOE Financial Planning, Budgeting, and Reporting**

**SOEs should clearly define both their commercial and non-commercial objectives, and include the costs of QFAs in their budgets and *ex post* financial reports.**

There is a growing emphasis on the provision of nonfinancial information by SOEs, which often combine commercial and public policy (non-commercial) objectives.<sup>56</sup> In particular, any QFA mandated or motivated by government policy objectives should be reported. Tordo (2011) notes that transparency with respect to the SOE's responsibilities and various objectives, and the relative importance of those objectives, may reduce perceptions of risk. As a good practice, SOE budgets should spell out QFAs and specify clearly how they are to be financed. Then, SOE financial statements and annual reports should include the actual costs of QFAs and related transfers from the budget.

**Setting explicit financial objectives is important to SOE transparency, accountability, and risk management.**<sup>57</sup> The targets and outcomes can be compared to industry and regional standards. They can be stress tested to identify downside risks and to assess the financial robustness of the SOE.

**Effective government oversight and risk management require timely and comprehensive SOE reporting to the government.** Reporting and monitoring are vital to help manage fiscal risks, including the ability to identify looming problems or the prospect of future liabilities early on and to adopt corrective actions. SOEs should submit relevant data to the government periodically. The government should be prepared to consolidate and analyze this information, and thereby to detect possible fiscal risks that might arise from SOE operations.

**The six Latin American countries studied demonstrate SOE use of adequate accounting standards, financial reports, and external audit.** In particular, the majority of the countries are using accounting standards similar to the ones used in the private sector and are increasingly adjusting them with the International Financial Reporting Standard (IFRS). In all analyzed countries, SOEs prepare and disclose their respective financial reports at least once a year. Furthermore, in some cases, these reports are presented in a consolidated form for the SOE sector: for example, the *Memoria Anual Consolidada* (Annual Consolidated Memorandum) which is published by SEP in Chile, or the *Informe Anual* (Annual Report) prepared by FONAFE in Peru. Finally, the accounting and financial statements of the SOEs are annually audited by a public external control organ or a professional audit firm—in some cases by both, as is the case for some SOEs in Brazil, Peru, Paraguay, and Uruguay. Despite of these achievements, further progress is still needed in some cases to increase the quality of audits to international standards, in particular with respect to the selection process of private sector audit firms and the role of Supreme Audit Institutions.

**Evaluation of fiscal risk and contingent liability linked to SOEs and other public entities is becoming more common.** Chile, Colombia, and Peru are most advanced and regulated in this area. In Chile, the Budget Directorate (*Dirección de Presupuesto* DIPRES) publishes an annual report on the government's contingent liabilities.<sup>58</sup> In Colombia, the medium-term fiscal framework, which is an annex of the budget law, contains estimates of contingent liabilities related to natural disasters, public/private joint ventures, lawsuits against the State, and debt guarantees issued by public entities (including SOEs). In Peru, since 2012 the Fiscal Responsibility and Transparency Law mandates the estimation of contingent liabilities by the Ministry of Finance.<sup>59</sup> Similarly, the budget law in Brazil includes an annex

on fiscal risk, which analyzes debt guarantees and judicial processes related to the SOE sector, among others.

## **Government's Oversight, Reporting, and Disclosure**

**The government should continuously monitor SOE operations accurately and comprehensively.** Oversight involves a number of functions, including review of SOE strategic plans, financial forecasts, and financial performance; identification of SOEs that pose high risks (such as vulnerable and money-losing enterprises); and management of a comprehensive database on SOEs. Detailed and transparent information on SOE operations should be provided to the legislature and the public. Reporting helps establish accountability and proper evaluation of fiscal risks.

**Fiscal coverage and fiscal indicators should be extended beyond the general government to encompass all SOEs.** Lack of coverage of SOE operations in the fiscal accounts and fiscal statistics can lead to problems, including obscuring their macroeconomic impact and the fiscal risks they may generate. Fiscal transparency and risk management demand reporting of all activities of a fiscal nature—that is, of the consolidated nonfinancial public sector—and related fiscal risks. SOE operations should be included in any wide-ranging analysis of public finances given their potential impact on fiscal policy and contingent liabilities. Broad fiscal coverage has a number of advantages:

- It permits a more accurate analysis of the fiscal stance.
- It reduces incentives for shifting activities to the SOEs.
- It reduces the likelihood of unrecorded and contingent liabilities appearing unexpectedly.
- It enhances awareness of fiscal risks.
- It promotes governance and can improve market confidence.

**Disclosure of fiscal risks aids risk management and can help make the allocation of public resources more efficient.** Cebotari and others (2009) emphasize that publicly disclosing information about fiscal risks subjects risk analysis to additional scrutiny; promotes earlier and smoother policy responses; strengthens accountability; and improves the quality of decisions and the assessment of the cost-effectiveness of taking on certain risks. Several countries have enacted legislation on the disclosure of fiscal risks or contingent liabilities. The trend in government practices has included growing awareness of the importance of the fiscal-risk issue, increasingly sophisticated and demanding international accounting and statistical standards, the introduction of fiscal responsibility and transparency

legislation in some countries, and international transparency initiatives. Countries typically have broadened the scope of estimated and disclosed fiscal risks gradually.

**Ideally, disclosure of SOE fiscal risks should be an integral part of the government's broad disclosure of fiscal risks.** Fiscal risks and contingent liabilities posed by SOEs are potentially important components of overall fiscal risk faced by a government. A holistic approach to risk analysis is needed, since a specific fiscal risk may actually act as insurance against other potential risks.

**SOE fiscal risks can be included in a single, comprehensive fiscal risk statement produced annually and presented with the budget.** Some countries do this now. Depending on country circumstances and the relative significance of various risks, the fiscal risk statement can include the analysis of general economic risks as well as specific risks, including public debt, contingent liabilities, SOEs, subnational governments and public/private partnerships (PPPs).

### **Risk Mitigation Strategies**

**Risk mitigation strategies aim to identify and reduce potential fiscal risks before they are taken on or materialize; or to minimize the cost once a risk has materialized.**<sup>60</sup> For identified fiscal risks, the priorities of risk mitigation policies should be based on the likelihood that a particular risk will materialize and on the resulting fiscal impact if it does. But costs also come into play: It is important to assess whether the expected benefits from mitigating risks outweigh the costs of doing so.<sup>61</sup> In this context, relevant risk mitigation policies for SOEs depend on the specific risks faced and posed by the SOE sector, and the eventual benefits and costs of risk mitigation measures.

**Proper budget compensation of the costs of QFAs is essential to reducing fiscal risks.** When the government fully compensates SOEs for QFAs, the costs and risks generated by the pursuit of government policy objectives are incorporated explicitly in the budget balance and the government's debt. Besides significantly reducing SOE risks, full budget com-

pensation of QFAs can foster a more efficient allocation of resources and greater appreciation of risks. It forces QFAs to compete fairly for scarce public resources in the budget process, and it forces the government to explicitly internalize fiscal risks.

**The granting of guarantees of SOE debts, which can be a significant source of fiscal risk, should be strictly controlled.**<sup>62</sup> Government debt guarantees issued to SOEs and other relevant decentralized entities should in all cases be analyzed and approved by the ministry of finance. Requiring legislative approval emphasizes that guarantees pose risks that can burden future budgets.

**Biases in favor of granting excessive debt guarantees may be remedied by setting quantitative limits and requiring legislative approval for changing them.** There may be biases toward granting excessive and wasteful guarantees: The guarantees may not be subject to the same degree of inspection as spending appropriated in the budget, and, unlike cash spending, they may not have to compete for fiscal space in the budget process. Setting limits on the granting of guarantees would foster competition for approval and focus priorities.

**Exogenous risks can sometimes be mitigated through the use of market instruments.** For example, currency, interest rate, price, and weather-related risks can be hedged—transferring risk to financial markets better able to bear them, at a cost. However, the use of market instruments to reduce risk requires considerable technical capacity and strong governance, and should not be attempted if those elements are not in place.

**In some cases diversification can reduce risks.** For instance, the diversification of energy sources of State-owned power utilities that rely largely or exclusively on one energy source can mitigate cost volatility and associated fiscal risks.<sup>63</sup>

**Strengthening SOE investment procedures reduces long-term risks.** The quality of SOE investment is a determining factor for the sustainability of the enterprise and depends on the strength of the investment mechanisms in place. Weaknesses in project appraisal, selection, implementation, and evaluation can be significant sources of fiscal risk since they can impair the enterprise's sustainability. These deficiencies should be addressed as needed.



**TABLE I.6: Financial Reports and External Audit in Six Latin American Countries**

<b>Country</b>	<b>Accounting Standards</b>	<b>Financial Reports</b>	<b>Reports on Fiscal Risk and Contingent Liabilities</b>	<b>Independent External Auditor</b>
<b>Brazil</b>	Application of own standards and IFRS complimentary	Yes; annually; publicly accessible	Annex on fiscal risk in the Budget Law	Yes (Comptroller General and external audit companies)
<b>Chile</b>	Similar standards to those used by the private sector; mainly IFRS	Yes; quarterly and annually; publicly accessible <i>Memoria Anual Consolidada</i> (SEP)	Report on contingent liabilities published annually by DIPRES	Yes (international audit companies)
<b>Colombia</b>	In process of harmonizing own standard with IFRS	Yes, annually; publicly accessible	Estimates of contingent liabilities in the medium-term fiscal framework under the budget law	Yes (private audit companies)
<b>Paraguay</b>	Own accounting and auditing standard, based on international standards Introduction of IFRS in process	Yes, annually; publicly accessible	No	Yes (Comptroller General and private audit companies)
<b>Peru</b>	Similar accounting rules to those of the private sector, including IFRS 2003	Yes, annually; publicly accessible Annual consolidated Report (FONAFE)	Estimate of contingent liabilities is a requirement of the Fiscal Responsibility and Transparency Law	Yes (private audit companies selected through a call for proposals, coordinated by the Comptroller General)
<b>Uruguay</b>	Similar accounting rules to those of the private sector, including IFRS 2003	Yes, annually; publicly accessible	Financial statements of SOEs contain footnotes and remark on fiscal risk; there is no general systematization	Yes (Supreme Audit Institution and international audit companies)

Source: Report authors, based on Part II and through consultation with staff from the SOE sector of the respective countries.

## Notes

44. This chapter draws heavily on previous studies of fiscal risks (IMF, 2005; Cebotari, 2008; Cebotari and others, 2009; Petrie, 2013) and of SOEs (Allen and Vani, 2013).
45. World Bank, 1995 and 2006; Polackova and Schick, 2002; Tordo, 2011.
46. IMF, 2005, 2007 and 2012; Cebotari and others, 2009; and Kopits and Craig, 1998.
47. OECD, 2005.
48. IMF, 2007; Tommasi, 2013.
49. Irwin, 2012.
50. IMF, 2005; and Cebotari and others, 2009.
51. IMF, 2011.
52. Chivakul and York, 2006; IMF, 2007a.
53. IMF, 2012.
54. This box draws on a fiscal risk assessment tool developed by Verhoeven et al. (2008) and the application to Jamaica by Longmore, Reveira Cazorla and Verhoeven (2014).
55. Export revenue expressed in domestic currency in PEMEX's statements (PEMEX, 2009) as a ratio to nominal GDP as reported in the IMF's World Economic Outlook.
56. World Bank, 2006.
57. Allen and Vani, 2013.
58. At the end of 2012, the total amount of contingent liabilities of the Government in Chile (assuming complete risk materialization) represented 3.7 percent of GDP, of which about a third (1.1 percent of GDP) was from debt guarantees for SOEs.
59. Government guarantees for issued debt of SOEs reached 0.6 percent of GDP in 2012.
60. Petrie, 2013.
61. Hardy, 2010.
62. IMF, 2005a; Cebotari, 2008.
63. Yépez-García and Dana, 2012.





PART II

**COUNTRY CASES**



## CHAPTER II.1

# The Case of Brazil



### II.1.1 State-Owned Enterprises Portfolio

**Despite a recent history of privatizations, federal State-Owned Enterprises (SOEs) in Brazil remain important actors.**<sup>64</sup> A number of key statistics confirms their relevance in Brazil's economy. For instance, they employ around 500,000 people (0.7 percentage of total employment); the aggregate budget for SOEs is approximately 30 percent of GDP<sup>65</sup> and total investment by SOEs amounts to roughly 2.3 percent of GDP. At the same time, they pay dividends and contribute to government finances by paying taxes and fees that amount to almost 3 percent of the GDP or 9 percent of total government revenue.<sup>66</sup>

**The universe of SOEs in Brazil includes 147 linked to the Federal Government.** Of this set of companies, 38 are wholly owned by the government, and 25 are directly controlled by the state due to their being fully financed by the state budget. The rest of the companies finance their activities with their own resources or through the market, and are indirectly controlled by the state.

**SOEs in Brazil operate in both competitive and non-competitive markets.** Their activities are concentrated in the oil and natural gas, finance, electricity, and service sectors. A few large SOEs play a leading role in their respective sectors: Brazilian Oil Company S.A. (*Petróleo Brasileiro S.A.—PETROBRAS*) is the largest company in oil and natural gas with a budget that represents almost 7 percent of Brazil’s GDP—*Banco do Brasil, Caixa Econômica*, and the Brazilian National Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social—BNDES*) are the most important actors in the finance sector with an aggregate budget equal to approximately 4.3 percent of GDP. The budget of the postal service company, *Empresa Brasileira de Correios e Telégrafos* (ECT), is 0.33 percent of GDP; and the Brazilian Energy Company (*Centrais Elétricas Brasileiras S.A.—ELETROBRAS*) leads the electricity sector with a budget of 0.3 percent of GDP. In terms of distribution of firms across sectors, the table below shows that 43 percent of Brazilian SOEs operate in the oil and natural gas sector, and 37 percent in the electricity, finance, and service sectors.

**SOEs have an important presence in the Brazilian stock exchange.** Eight companies are listed on the BM&F BOVESPA exchange, accounting for approximately 25 percent of its total market capitalization; PETROBRAS alone represents 17 percent of market capitalization.<sup>67</sup>

**TABLE II.1: Distribution of SOEs across Sectors**

Sector	Number of SOEs
Oil and Natural Gas	63
Electricity	19
Finance	19
Services	16
Infrastructure	9
Transport	3
Research	4
Industry	4
Others	10
<b>Total</b>	<b>147</b>

Source: Ministry of Planning.

## II.1.2 Ownership Function: Institutional Framework and Organization

**Brazil's government follows a hybrid model for SOE oversight.** While the Ministry of Finance (MF) takes the lead on rate-setting, the Ministry of Planning focuses on budgeting and is also responsible for strategic planning, investment programs, and SOE organization and performance oversight, through the Department of Coordination and Control of State Enterprises (*Departamento de Coordenação e Controle das Empresas Estatais*—DEST), its coordinating agency for SOE oversight. The DEST reports to the Executive Secretariat of the Ministry of Planning and is responsible for overseeing 122 SOEs.<sup>68</sup> Among its duties, the agency coordinates SOE budget preparation and monitors its execution (including the fiscal goals and investments), compiles SOE economic and financial data, and promotes good practices of corporate governance. Several sector ministries (listed in Annex A) also play a significant role, both in sector planning and technical aspects, such as defining benchmarks and targets for performance in that sector, and for service delivery. Finally, regulatory agencies are responsible for sector regulation, consumer protection, and guarding against anti-competitive behavior by SOEs.

**The oversight of most SOEs in Brazil has been technically strengthened and balanced by the role of DEST, and institutionally consolidated through the SOE Governance Committee.** On one hand, and playing a particular role, DEST is a technical department within the Ministry of Planning in charge of the direct oversight of SOEs. On the other, the SOE Governance Committee is a political body composed of three permanent members (Minister of Finance, the Minister of Planning, and the Executive Office of the President) and upon special request, other representatives from sector ministers. The SOE governance committee is charged with coordinating the main institutional actors involved in SOE oversight, and plays a leading role in strategic decisions regarding the SOE portfolio, such as in the case of merger and acquisitions or privatizations. DEST is responsible for providing the Governance Committee with support on technical issues.

**The Ministry of Planning assumes the leading role in defining the general framework for SOE staffing policies.** The Minister of Planning is empowered (by means of Decree 3.735) to approve or reject staffing plans and ceilings; labor collective agreements; profit-sharing programs for



employees; incentivized resignation programs; and other personnel policies. Some personnel policies are outside the immediate purview of the Minister of Planning; for example, Law 3.255 establishes limits to SOE staff benefits.

## II.1.3 Accountability and Oversight Mechanisms

### Statements of Objectives & Planning Documents

**Management/performance contracts.** In the last decade DEST has piloted performance contracts with four SOEs.<sup>69</sup> These companies' contracts included clearly defined results, which had been agreed upon between DEST (or in certain cases the company's board of directors) and the SOE: financial targets (e.g. return on liquid assets), service delivery targets, and some indicators on internal management (e.g. human resources, internal control, technical aspects, etc). The performance contracts impose financial penalties (partial or complete elimination of bonus/dividends) for failure to achieve these targets. However, according to DEST, the impact of these accountability tools on improving performance has not been significant so far. It should be pointed out, that DEST signed annual programs with about 20 SOEs, which link the salary payment with the achievement of the pre-defined goals.<sup>70</sup>

**SOEs budgets and investment plans.** Those are approved by the executive and by the legislative, respectively, as stipulated in the Constitution and Budget Guidelines Law. The Budget Guidelines Law (*Lei de Diretrizes Orçamentárias*) assigns responsibility for approving SOEs' current expenditure budget to the Presidency. However, SOEs investment plans are to be approved by national Congress, within the framework of the government's general investment plan for the year. In the particular case of fully State-Owned Enterprises, the Fiscal Responsibility Law (LC-101) imposes expenditure limits and constraints. DEST is in charge of preparing the Comprehensive Plan of Expenditures (*Programa de Dispêndios Globais*—PDG) for SOEs using the integrated information system, SIEST.

**Budget formulation and approval.** SOEs in Brazil prepare and submit their budgets annually, jointly with the rest of government entities. Results-based budgeting is common for SOEs distributing dividends/bonuses to employees, while the rest usually practice simple program budgeting. The proposed budget of each SOE is cleared by the shareholders' assembly, and then submitted for approval to the Ministry of Finance, or the corresponding line ministry, which works toward a consensus decision with the advice of the Ministry of Planning. Once these steps are cleared, SOEs' budgets are

submitted to the legislature for approval. SOEs' approved budgets are published jointly with the national budget, which is made available to the public.

## **Reporting: Monitoring of Performance & *Ex post* Disclosure**

**Budget Execution Reports.** DEST oversees the budget execution and financial operations of SOEs using the SIEST information system. SOE expenditures are monitored monthly and reconciled with the budget accounts on a cash basis. Every two months, DEST publishes online reports covering budget execution for each SOE based on their respective investment plans.<sup>71</sup>

**Other SOE key reports.** On a regular basis, the CEOs of SOEs prepare reports containing financial information, as well as complementary information on performance and other technical details on the company's status. These reports are submitted to the board and retained for internal audit. The board of each SOE is responsible for submitting to several government control entities (internal and external) an annual financial report containing aggregate information. Additionally, the SOE boards disclose their annual reports and financial statements, both internally, to the relevant control bodies in the executive and legislative, and externally, via online publication.<sup>72</sup> Also, as per the annual budget law of the federal government (*Lei de Diretrizes Orçamentárias*), SOEs receiving transfers from the treasury are required to prepare an annex containing an estimation of fiscal risk.

## **Auditing of SOEs**

**SOEs are required to undergo external audits.** The Accounting Court and the Office of the Comptroller General (*Controladoria Geral da União—CGU*) are both entitled to perform external audits on SOEs. In addition, the respective SOE's board of directors selects external firms to audit the company. This external audit, performed annually, covers financial and accounting aspects of SOE management. The results of these audits are published online and submitted to the executive's and the legislature's control bodies.<sup>73</sup>

**However, independent external auditors are frequently selected through a public procurement process that does not necessarily consider the relevance of technical qualification.** Brazil's Public Tender Law<sup>74</sup> sets forth different specifications for public tenders, which may include technical qualification and cost, or cost only. Some independent auditors have been selected using the "lowest bid" modality. For tenders in

which technical competence is considered, proficiency is still not always the most heavily weighted factor in the final decision; instead, cost is considered the leading factor under consideration, which has the potential to jeopardize audit quality standards.

## **SOEs Boards of Directors and Management**

**Boards of directors oversee all SOEs linked to the federal government, either directly or through a holding company.** Each of these boards is composed of several members, including a specialized technical representative from the Ministry of Planning, several representatives from the respective sector ministry, also with a strong technical background; since 2010, a representative of the SOE's staff has also been part of the board. Each board is then further structured, with a president, a vice-president, and a variable number of directors. Usually, area experts also participate regularly in board meetings as advisors. In some specific cases, the board also relies on a technical advisory body, independent from the SOE staff.

**Although board members are selected on a discretionary basis, they have a fixed term mandate, unrelated to the government's mandate.** The supervisory ministries select their respective board members according to technical criteria, but not systematically on a competitive basis. Appointments must be further vetted and approved by the *Casa Civil* (Executive Office of the President) to ensure technical soundness in the selection. The duration of their mandate is fixed, and generally unrelated to the government's mandate.

**There is a clear division of roles between the board and the SOE director.** Whereas the director's area of responsibility is focused on the SOE's business management, the board is in charge of the following oversight responsibilities:

- Providing general guidelines for the SOE's business activities;
- Assessing the performance of the SOE's director;
- Organizing the shareholders' general assembly;
- Evaluating the firm's annual management report;
- Deciding on public offerings or stock warrants;
- Authorizing the lease or sale of fixed assets; and
- Selecting and dismissing independent auditing firms.

**Board meetings are frequent and mainly treat technical issues.** Executive board meetings take place on a weekly basis, with content usually related to routine decisions and procedures. The meetings of the Fiscal

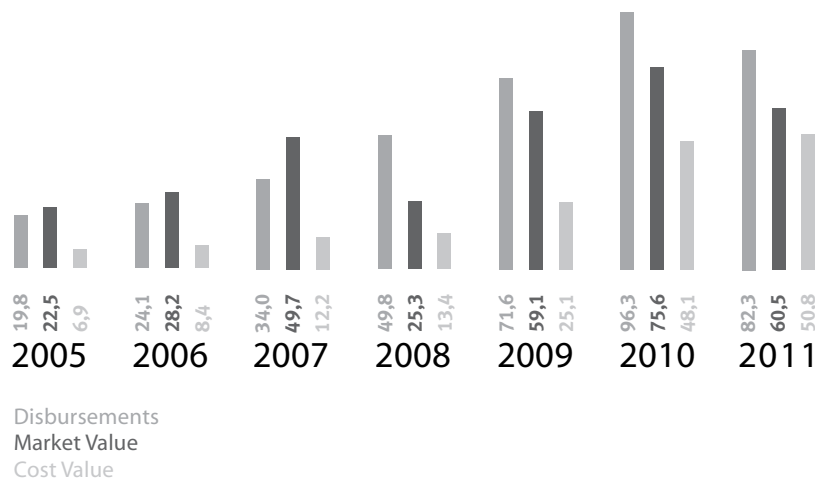
Council and the Management Council take place on a monthly basis. At these meetings, the agenda for discussion adopt a more strategic dimension.

**However, selection mechanisms for SOE directors remain discretionary.** SOE directors are appointed to fixed-term contracts by the National Treasury General Attorney’s Office (*Procuradoria Geral da Fazenda*, under the Ministry of Finance), by the suggestion of sector ministries. The *Casa Civil* reviews the candidates’ background, but in only a few cases are there clear regulations indicating a minimum experience. Informally, political affiliation has played a role in some selection processes.

## II.1.4 BNDES: A Key Player in the Brazilian Economy

**Since its creation in the 1950s, the Brazilian Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social*—BNDES) has provided most long-term financing for investments in all segments of the Brazilian economy.** The actual relevance of BNDES can be illustrated through several different indicators. In 2011, BNDES had 2,500 employees and provided approximately half of the total credit in Brazil (total credit and BNDES credit as a proportion of GDP were, respectively, 46 percent and 21 percent in 2011). Total disbursements by BNDES totaled US\$82.3 billion and reached a market value of approximately US\$60.5 billion in 2011.

**TABLE II.2: BNDES Disbursements and Equity Portfolio (in US\$ billion)**



Source: BNDES.

**TABLE II.3: BNDES Compared to Multilateral Banks (in US\$ million)**

	<b>BNDES</b>	<b>IDB</b>	<b>IBRD</b>	<b>CAF</b>	<b>CDB</b>
	<b>Dec 31 2009</b>	<b>Dec 31 2009</b>	<b>Jun 30 2009<sup>(*)</sup></b>	<b>Dec 31 2009</b>	<b>Dec 31 2009</b>
Total Assets	222,050	84,006	275,420	15,887	665,168
Shareholders' Equity	15,867	20,674	40,037	5,287	55,471
Net Income	3,868	794	3,114	235	4,673
Loan Disbursements	78,910	11,424	18,564	4,584	92,998
Total Loans	162,917	58,049	105,698	11,687	543,196
Capitalization	7.10%	24.60%	14.50%	31.90%	8.30%
ROA	2.30%	1.00%	2.40%	2.40%	0.80%
ROE	29.00%	4.00%	8.00%	4.70%	8.80%
Founded	1952	1959	1945	1968	1994

Note: IDB = Inter-American Development Bank, IBRD = The International Bank for Reconstruction and Development (World Bank), CAF = Corporación Andina de Fomento, CDB = China Development Bank, Capitalization = Shareholders' Equity/Total Assets, ROA = Return On average Assets, ROE = Return On average Equity.

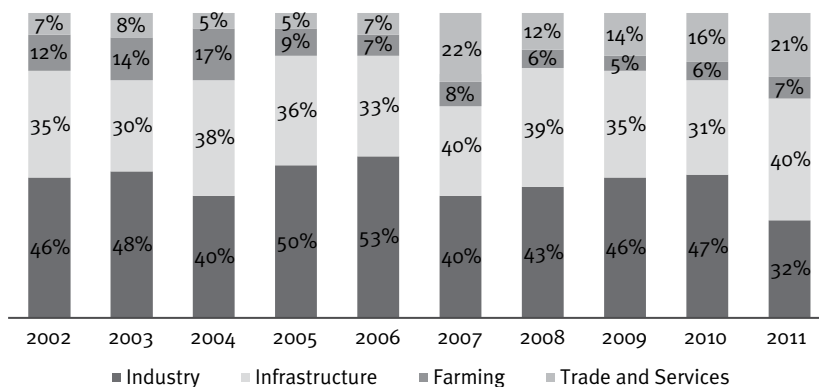
(\*) Unlike other institutions, 12-month fiscal year ends June 30th.

**BNDES was established on June 20, 1952, under Law 1628, as a government agency, with the aim of developing and carrying out national economic development policies.** Subsequently, according to Law 5662, of June 21, 1971, BNDES was converted into a state-owned company under private law, which both reduced political interference, and gave the bank greater flexibility to raise and invest funds.

**The size of BNDES' loan portfolio and equity is comparable to those from other well-known financial institutions.** In order to assess its size and relevance, the following table shows several indicators that compare BNDES to other international development banks. In terms of total assets and loan disbursements, BNDES ranks second after China's Development Bank (CDB). Relative to the size of their respective economies, however, loan disbursements by BNDES amount to 5 percent of GDP, while loans by the CDB are 2 percent. Additionally, BNDES's return on average equity (ROE) is the highest among international development banks considered in this sample.

**The presence of BNDES is significant throughout the Brazilian economy.** BNDES provides support by financing projects including investments, equipment acquisition and exports of goods and services. In addition, BNDES strengthens the capital structure of private companies and devotes

**FIGURE II.1: BNDES Disbursements by Sector**



Source: BNDES.

non-reimbursable financing to projects that contribute to social, cultural and technological development.

## Corporate Governance

**BNDES's policies are set by the Minister of State for Development, Industry, and Foreign Trade.** However, the company still reports to DEST, within the Ministry of Planning, on its financial and economic performance. As mentioned above, DEST is in charge of preparing the Comprehensive Plan of Expenditures (PDG) for all SOEs under its oversight, including BNDES.<sup>75</sup>

**BNDES' corporate governance practices are based on the principles of transparency, fair treatment of all stakeholders, and accountability.** The implementation of these practices is meant not only to optimize BNDES' performance, but also to protect its sole shareholder, the central government, and other stakeholders, such as employees, creditors, workers, and Brazilian society in general. Within the organization, the corporate governance practices are scrutinized at different stages by: (i) the Advisory Board, (ii) the Audit Committee, (iii) the Fiscal Council and the Management Council, and (iv) the Ombudsperson's Office.

## Advisory Board

**The Advisory Board is the highest guidance body.** It has eleven members, including the Chairman of the Board; four selected by the Ministers of State for Planning, Budget and Management; Labor and Employment, Finance,

and Foreign Affairs, respectively, and the other by the Minister of State for Development, Industry and Foreign Trade. The President of the BNDES is the Vice-President of the Board. Members of the Advisory Board are appointed by the President of the Republic to a three year term, effective from the date the appointment is published and renewable for one additional term. Prospective candidates should have outstanding knowledge and experience in the area, moral integrity and unblemished reputation. The Advisory Board meets every quarter, and for extraordinary sessions, called by the President at his/her discretion, or at the request of at least two of its members. The board only takes decisions in the presence of at least six of its members. The Advisory Board's duties include:

- Provide opinions and analysis, when requested by the Minister of Development, Industry and Foreign Trade, on issues pertaining to the economic and social development of the country and directly related to BNDES' efforts;
- Advise BNDES' President on general guidelines for the Bank's efforts and to promote disclosure of objectives, programs and results of BNDES' operations to the main institutions in the economic and social sector;
- Examine and approve proposals of BNDES' President, to ensure that general policies and long-term programs of the bank remain consonant with the economic and financial policy of the central government.

### **Auditing Committee**

**BNDES' Audit Committee acts as an auxiliary agency to the Advisory Board, to whom it must report.** This relationship is stipulated by statutory provision and is in keeping with the guidelines of the Code of Best Corporate Governance Practices of the Brazilian Institute of Corporate Governance (*Instituto Brasileiro de Governança Corporativa—IBGC*). The Committee can consist of up to six members (at the time of writing, there are three) appointed by the Advisory Board. Members are appointed for an indefinite term, which may end at any time by resolution of the Advisory Board. The duties of the Auditing Committee include:

- Nomination of an independent auditor to be contracted by the administration;
- Reviewing BNDES' financial statements every six months prior to publication;
- Assessing the effectiveness of internal and independent audits;
- Recommending changes to correct or improve policies, practices, and procedures which fall within the ambit of the Board of Directors;

- Preparing a report of its own activities and assessing the effectiveness of internal control systems.

### **Fiscal Council**

**Brazilian legislation establishes a fiscal council to oversee limited liability companies and corporations.** The fiscal council is essentially a supervisory and inspection body which reports directly to the shareholders. In the case of BNDES, the Brazil's Corporations Act Law defines the responsibilities of the Fiscal Council and of the Management Council, and appointment rules governing the appointment of their members. The fiscal council of BNDES is formed by three members and three alternates; all serve a two-year term, renewable for an equal period. Two members and their alternates are appointed by the Minister of Development, Industry and Foreign Trade, and one member and his/her alternate are appointed by the Minister of Finance, as representatives of the National Treasury; lines of responsibility are considered to run to the President of the Republic, in the sense that he or she appoints these ministers. The Fiscal Council's duties include:

- Examining and providing opinions on the balance sheets, other financial statements, and the half-yearly accounts of the BNDES' directors;
- Performing other duties established in the Stock Corporation Act. For instance, administrative agencies are required to provide the current members of the Fiscal Council with a copy of the minutes of their meetings, by means of formal communication, within ten days. Within fifteen days of their completion, copies of balance sheets and other periodically prepared financial statements, as well as reports on budget implementation, must also be supplied to the Fiscal Council.

### **Ombudsperson's Office**

**The Ombudsperson's office is charged with mediating issues between citizens and the institution.** It provides clarification on items of contention, and seeks to strengthen ties between the BNDES, its clients, and the general public. To that end, it encourages decentralized, voluntary initiatives to effectively improve the services provided, in the process playing a role as an instrument of social inclusion. This office contributes to enhancing the democratic process by acting independently and impartially to confidentially convey demands and concerns from the public and clients to the BNDES. The Ombudsperson is appointed by the BNDES' President and remains in office indefinitely, ending his/her term at any time at the discretion of the President.



## II.1.5 Reform Initiatives

**After the 1980s debt crisis, the Brazilian Government began to shed an extensive SOE portfolio, which played a major role in the economy, with the initiation of a large-scale privatization plan.** Before 1990, a limited privatization scheme was launched, and the central government privatized 38 enterprises. Between 1990 and 1992, 15 more SOEs were privatized, yielding about US\$3.5 billion in total proceeds. Another 18 SOEs were sold afterwards, yielding over US\$5 billion. By 1994, 25 State-Owned Enterprises had been sold, mostly in exchange for debt certificates and a little hard cash.

**This second wave of SOE privatizations under the Cardoso administration, beginning in 1994, focused on SOEs responsible for the major part of Brazil's economic infrastructure, including, enterprises in the energy, transportation, and communications sectors.** However, Brazil's largest State-Owned Enterprises, PETROBRAS, remained outside the program because of constitutional restrictions.

**The government has taken some steps toward strengthening and centralizing SOEs oversight in the past few decades.** Departing from a fully-decentralized oversight in which sector ministries played a key role, the central government initiated the centralization of oversight functions by creating in 1978 the Secretary of Coordination of State-Owned Enterprises (*Secretaria de Controle de Empresas Estatais*—SEST), under the Ministry of Planning. Regulatory agencies were also created after 1994 to reinforce the technical oversight and legal framework of strategic sectors.

**Following privatization reforms throughout the 90s, the government opted for further centralization of the oversight function.** In 2007, the central government created the Inter-Ministerial Commission of Corporate Governance and Administration of State participation (*Comisión Interministerial de Gobernanza Corporativa y de Administración de Participaciones Societárias del Estado*—CGPAR) as a centerpiece of the centralization of oversight functions. The committee's permanent members are the Minister of Planning, the Minister of Finance, and the Executive Office of the President, while other sector ministries may participate by request of permanent members. DEST exercises the role of Executive Secretariat for the Committee, which focuses on the strategic oversight and planning of the SOE portfolio, and on improving management of SOEs, with an emphasis on public financial management of these firms.

**The main three actors driving this gradual oversight reform process have been the Ministry of Planning, DEST (within the Ministry of Planning), and the Ministry of Finance.** While the privatization process caused political turmoil and was mainly undertaken in response to distressed public

**TABLE II.4: Legal Framework**

	Legal Protection			
	Constitution	Law	Decree	Lower Norm
<b>Division of Responsibilities between Ministries</b> in the ownership function of the SOEs Portfolio	X	X	X	
<b>Creation of SOEs Monitoring Unit</b>			X	
<b>SOEs Board/CEO's</b> appointment & dismissal rules	Not established			
<b>Reporting Requirements</b> from SOEs, if any		X	X	
<b>Auditing Requirements</b> from SOEs, if any		X	X	
Assessment Mechanisms of SOEs Performance			X	X

finances, reform of SOE oversight was a gradual process initiated by the creation of SEST, and by the progressive consolidation of the institutional oversight structure. The resulting oversight structure, far from being completely centralized, distributes responsibilities between the oversight coordination agency (DEST), the SOE Governance Committee, regulatory agencies, and several sector ministries.

In 2010, the legal framework was modified to introduce mandatory participation of a staff representative in every SOE Board.

### Challenges Ahead

**The main challenges in the area of corporate governance in Brazil concern the relationship between the state as the main shareholder and other shareholders.** Specifically, the rules regulating this relationship have been subject to several modifications, and the current legal framework is still questioned. Keeping in mind the significant share of Brazilian SOEs that participate in capital markets, it is commonly argued, on the one hand, that government control of publicly-traded corporations can have unintended consequences, due primarily to the conflict of interest that may arise when the state is simultaneously a shareholder and a regulator. It is also generally assumed that corporate law could influence the behavior of the state as shareholder.

**There are other specific areas of corporate governance that present concrete challenges to SOEs.** In particular, it is important to continue implementing measures that ensures an appropriate functioning of the board of directors. Some of the issues that would require attentions are those related to the definition of roles and responsibilities between boards; independence of external directors; and, in some cases, remuneration of board members.

## Notes

64. This work focuses on SOEs linked to the Federal Government.
65. It is important to note that the combined budget of the ten largest SOEs in Brazil (*PETROBRAS, BR, Banco do Brasil, Caixa Econômica, BNDES, Empresa de Brasileira de Correios e Telégrafos (ECT), ELETROBRAS, Banco do Nordeste do Brasil, Empresa Brasileira de Infra-Estrutura Aeroportuária (INFRAERO), and Casa da Moeda do Brasil*) added up to almost 13 percent of GDP and contributed 86 percent of SOE employment in 2010.
66. The figures are for 2010 and were calculated using official data obtained from the Ministry of Planning and the Ministry of Finance.
67. The Governance of Mixed-Ownership Enterprises in Latin America: Discussion Paper, OECD 2012.
68. Conceptually, the fiscal budget in Brazil differentiates between two types of SOEs: (a) those companies that finance their activities with their own resources or market earnings; and (b) those that depend on the fiscal budget to pay for their current expenditures. Only the first group of companies is under DEST oversight and are being discussed in this chapter (Annex A shows a complete list of state companies under DEST).
69. The State Electric Energy Company (*Companhia Estatal de Energia Elétrica—CEEE*) and the Water Company of the Federal District of Brazil (*Companhia de Saneamento Ambiental do Distrito Federal—CAESB*) signed performance contracts with the authorities that formulate their respective sectoral policies. These authorities are also in charge of monitoring and enforcing the contracts. The Sanitation Company of Rio Grande also signed a performance agreement, but in this case a committee was specially created to oversee the contract.
70. These programs are referred to as the Program for Participation on Profit and Results (*Programa de Participação nos Lucros e Resultados—PLR*).
71. All this information is made publicly available at <http://www.planejamento.gov.br/secretaria.asp?cat=20&sec=4>.
72. Please refer to <http://www.planejamento.gov.br/secretaria.asp?cat=20&sec=4>.
73. Audited reports are publicly available at the companies' website. For example, in the case of PETROBRAS, the independent auditors' report can be found at <http://www.petrobras.com.br/rs2010/en/>.
74. Law No. 8666/93.
75. The information collected by DEST about the company is publicly available and can be consulted at <http://www.planejamento.gov.br/secretaria.asp?cat=310&sub=189&sec=4>.



## CHAPTER II.2

# The Case of Chile

### II.2.1 State-Owned Enterprises Portfolio

**Even though the State-Owned Enterprise (SOE) sector is relatively small in Chile, some state-owned companies play an important role in strategic sectors of the Chilean economy.**<sup>76</sup> Overall SOEs employ around 49,000 people (0.7 percent of overall employment); their aggregate expenditures account for approximately 9.4 percent of GDP; revenues generated by all SOEs amount to 12.8 percent of GDP;<sup>77</sup> and total investment 1.2 percent. At the same time, they contribute to government finances through taxes, fees, royalties, and dividends in an amount that reaches almost 2.5 percent of the GDP or 6 percent of total government revenue.<sup>78</sup>

The universe of SOEs in Chile comprises 33 SOEs linked to the central government. Twenty-seven of the 33 are entirely state-owned, and the rest have some private participation. They operate in both competitive and non-competitive markets, and their activities are spread across different sectors. However, SOEs are particularly important in the mining and financial sectors, where SOE revenues represent 11 and 1.1 percent of Chile's GDP, respectively.<sup>79</sup> They also actively participate in transportation, harbor infrastructure, communications, defense, water and sanitation, and services, but

**TABLE II.5: Distribution of SOEs across Sectors**

Sector	Revenue (as % of GDP)	Number of SOEs
Mining	11.0	4
Transportation	0.2	2
Harbor Operators	0.1	10
Communications	0.2	6
Water and Sanitation	Less than 0.1	2
Service	0.2	8
Financial	1.1	1
<b>Total</b>	<b>12.8</b>	<b>33</b>

Source: Budget Directorate (Dirección Nacional de Presupuesto—DIPRES).

the revenues generated by SOEs in each one of these sectors represent less than 0.2 percent of GDP.

## II.2.2 Ownership Function: Institutional Framework and Organization

**Chile currently has a hybrid structure ownership function.** Ownership representation and responsibilities regarding the control and supervision of the majority of SOEs (23 out of 33 SOEs) reside in the State-Owned Enterprises System (*Sistema de Empresas Públicas*—SEP). The SEP is a technical advisory body, with authority to centrally oversee management of State-Owned Enterprises.<sup>80</sup> However, the largest Chilean SOEs are not under SEP control and supervision, but operate in a decentralized and autonomous way. They are linked to the government through the sector ministries of their line of competency. In particular, the National Copper Corporation (*Corporación Nacional de Cobre*—CODELCO), the national oil company (*Empresa Nacional del Petróleo*—ENAP), the Chilean State Bank, the companies active in the communications sector, and all defense-related state companies are subject to separate institutional arrangements. Many of these companies have a regulatory framework specifically developed for their operations and approved by special laws.

**The SEP is overseen by a 9-member governing council,<sup>81</sup> and managed by an Executive Director who reports to the Council.** Under the Executive Director’s supervision, three offices execute the SEP’s functions: the Corporate Management Office, the Legal Office, and the Administrative

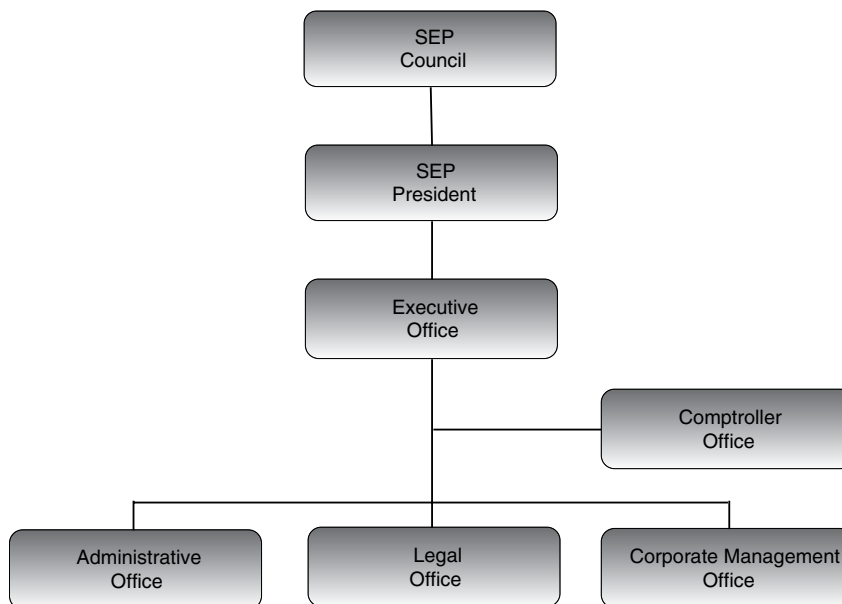
Office. In addition, a Comptroller's Office also reports to the Executive Director. In total, the SEP's staff is composed of twenty-six officials.

**The SEP's main functions include nominating and appointing SOEs' directors, approving strategic plans, establishing annual goals and controlling the management of the SOEs under its supervision.** The Ministry of Finance approves SOEs' annual budgets and investment projects, authorizes borrowing, and approves fiscal contributions. The SEP verifies that SOE budgets are reasonable and that their management, strategic initiatives and investment projects are aligned with the strategic planning. The management control function of the SEP is to evaluate the outputs it receives from the SOEs and to provide them with the necessary inputs with the aim of improving their functioning.

**The SEP informs the Ministry of Finance of the investment projects and budgets of the SOEs.** The Ministry of Finance in turn determines the approval or rejection of proposed projects and budgets. The SEP is also required to present an annual report on SOEs performance to Congress and the President of the Republic.

**Enterprises that take on loans with the guarantee of the state have to sign a contract with the SEP in which the objectives and expected**

**FIGURE II.2: SEP's Organizational Chart**



**results of the operation and investment program are laid out.** The annual compliance rate of these contracts is specifically reported to the President of the Republic and the National Congress.

## **II.2.3 Accountability and Oversight Mechanisms**

### **Statements of Objectives & Planning Documents**

**Management/Performance Agreements.** SOEs' directors and managers are accountable to the SEP, which establishes annual goals through performance agreements. The SEP evaluates SOEs' performance through specific instruments: annual management plans for harbor companies; programming contracts; and performance agreements. The performance contracts include: financial indicators; performance indicators to measure service delivery; and internal management indicators (human resources, internal control, and technical issues). In general, SOE leadership and management are subject to penalties for not reaching the established goals.<sup>82</sup>

**Budget formulation and approval. The Budget Office of the Ministry of Finance is in charge of assigning public resources to SOEs.** Annually, in October, SOEs have to submit a budget proposal to the Budget Office (*Dirección de Presupuestos*), which finalizes the budgets in December based on a report developed by the SEP. Executed budgets and on-going budget execution are reported on the Budget Office website.<sup>83</sup>

### **Reporting: Monitoring of Performance & Ex post Disclosure**

**Budget execution reports. SOEs are required to provide monthly reports to the SEP indicating any deviations from the original budget.** These reports are subsequently submitted to the Budget Office.

**Chile has made significant progress in the harmonization of standards across SOEs in the areas of information disclosure, accounting provisions, and auditing.** The Transparency Act, enacted in April 2009, requires all SOEs to disclose the same information and comply with the same accounting standards as private enterprises, mostly International Financial Reporting Standards (IFRS). SEP has established a list of criteria, systematized in the SEP Code, that intends to formalize and unify practices of corporate governance<sup>84</sup> across all SOEs. The policies to be harmonized include policies on internal management, internal audit, risk management, and board, CEO, and personnel supervision.

**Each SOE has the obligation to elaborate quarterly Management Reports.** The reports have to be issued within a month following the end of the quarter, and are submitted to the SEP Council for review.

**Each SOE submits an Annual Report.** They are not standardized, resulting in different formats and differences in the content of the report between SOEs. The length of these reports varies,<sup>85</sup> and their content can be divided into two topic areas. In the first, the company reviews the values and missions of the SOE, the statutes and the internal organization. The second usually covers areas of transparency and accountability, and it includes management reviews, external audit reports, and financial statements.

**Since its creation in 2001, SEP has centralized all information from SOEs under its control, using this information to compile a consolidated Annual Report (*Memoria Anual*).** This report is submitted to the President of the Republic and to the presidents of both chambers of Congress. The Annual Report contains a brief overview of the SEP (administration, history, Council officials, mission, etc.) focusing on the projects, investments, and results of the SOEs under its control. The rest of the report reviews the performance of each SOE in turn. In that respect, it is not a self-evaluation of the SEP, but rather an evaluation of the results and achievements of the each SOE in a given year. The reports are made available online at the corresponding SOEs' websites, and at the SEP website.<sup>86</sup> Since some of the largest SOEs are not under SEP oversight, however, the report does not fully represent the entire situation of the SOE sector in Chile.

## **Auditing of SOEs**

**In Chile all SOEs are required to have internal auditors.** The SEP Code stipulates the establishment of internal audit procedures monitored by the board. Internal auditors focus on risk management following the guidelines of the Government General Internal Audit Council using the Committee of Sponsoring Organizations methodology. The results are examined by the board and SEP. Non-SEP SOEs also have internal audit functions.

**All SOEs are subject to an annual external audit by independent auditing firms.** In the case of those SOEs that are limited liability companies, audits and audit firms are assigned at the shareholder meeting. For the remaining companies, the companies assigned to perform audits are selected by the board and approved by the SEP. An audit company cannot remain the auditor of a particular SOE for more than four years. These audits focus on financial statements, and the results are later included in the Annual Report. In 2011, for example, the harbor company *Empresa Portuaria de Iquique* was



audited by KPMG and *ENAMI* (*Empresa Nacional de Minería*) by PWC. Listed SOEs are also subject to the oversight of the Chilean Securities and Insurance Supervisor (*Superintendencia de Valores y Seguros de Chile—SVS*).

**In addition, SOEs are audited by the Office of the Comptroller General, the agency that supervises compliance with administrative regulations.** These audits are publicly available on the Office of the Comptroller General website.<sup>87</sup>

## **SOE Boards of Directors and Management**

**All SOEs are headed by a board of directors.** The board's responsibilities and duties are similar to those found in the private sector: appointment and dismissal of the CEO, appointment of the internal comptroller, proposal or appointment of an external auditor, definition of the SOE's strategic plan, determination of the compensation systems for CEOs, and supervision of SOE management.

**In the case of entirely publicly-owned companies, the SEP Council is in charge of appointing the SOE's board of directors** (see Box II.1 on the next page for details). These appointments are subject to the approval of the General Comptroller's Office. In SOEs organized as corporations, board's members are also nominated and selected by the SEP Council in the respective SOE's general shareholders' meeting and then ratified. Ministers, politicians and high-level civil servants may serve on some SOE boards. The duration of the appointments is between one and three years, and this period does not follow the government's mandate. It is not common to appoint alternate directors. In those SOEs that are not under SEP supervision, the appointment of board members follows their own legal or corporate regulations.

**In general, SOE boards meet once a month.** In some cases, meetings take place twice a month, as in the case of harbor companies. It is common among SOEs to establish different committees in charge of supervising specific areas (audit, purchasing, remunerations, and risk management), and these committees convene monthly. The SEP Code provides for annual board evaluations, which are complemented by a self-evaluation.

**There is a clear definition and division of the roles played by the SOE Board and the CEO.** The CEO cannot chair the board of the same company, and its area of responsibility focuses on the SOE business management. Selection mechanisms for CEOs are the responsibility of the respective SOE's board.

#### BOX II.1

### **SOEs: Rules and Standards for the Nomination of Board Directors**

The President of the Republic of Chile, with the co-signature of the Ministers of Finance, Public Works and Reconstruction, issued decree N° 113, 2001, in September 2001. This act authorized the SEP to advise the President of the Republic and cabinet ministers on the designation and removal of SOE Board Directors. There are four main criteria regarding the nomination of Directors:

- (a) Candidates should be able to comply with high ethical standards; they should be sufficient with respect to integrity, character, common sense, competence and capacities to learn from the organization;
- (b) Candidates should have experience and knowledge in the respective area;
- (c) Candidates must be capable of carrying out cooperative team work in which there is mutual gain (complementarity); and
- (d) Candidates should look after the best interest of the company with independence of who designated them.

A nominating committee proposes to the SEP Council a list of prospective candidates for the positions at the SOE's board. This committee is composed of the President and Vice-president of the SEP Council, four additional council members, and another individual is designated by the SEP Council. The Executive Director of SEP serves as the Secretary of the Committee. In line with good practice, an independent recruitment firm or "head hunter" selects the five candidates who will be evaluated by the nominating committee to choose the SOE Board Director.

## II.2.4 Reform Initiatives

**Until 1997, Chilean public enterprises were managed by the Production Development Corporation (*Corporación de Fomento de la Producción—CORFO*).** Created in 1939 to foster industrial development and economic growth, CORFO promoted a wide variety of industries in the Chilean economy, most notably oil (*Empresa Nacional del Petróleo*), sugar (*Industria Azucarera Nacional*) and steel (*Compañía de Acero del Pacífico*). CORFO was and still is the main shareholder in many SOEs and as such, controls the ownership of SOEs. The number of these enterprises rose from 46 in 1970 to over 500 in 1973. Then, Chile initiated an important privatization process, including large companies such as energy and telecommunications. CORFO's main goal in the 1990s was to restructure and write off SOEs high deficits. Since then, CORFO has focused on fostering technological research and development (R&D), promoting the development of private enterprise and the modernization of management practices, and facilitating business access to loans.

**The first step in reforming the SOE ownership function in Chile was the creation of the Enterprises Management System (*Sistema Administrador de Empresas—SAE*) in 1997.** The creation of this new entity served to separate the ownership function from industrial development policy, with the latter continuing to be exercised by CORFO. CORFO's governing council<sup>88</sup> delegated to SAE the administration of rights and shares of SOEs. In addition, the SAE was empowered to appoint and remove its own representatives in the shareholder's meetings of SOEs placed under its control. In parallel to this reorganization process, another privatization reform was enacted, which involved two steps: first, the transformation of many enterprises into joint corporations; and second, the introduction of private capital in public enterprises in the water sector, such as EMOS S.A. (today *Aguas Andinas* S.A.), ESVAL S.A., ESSBIO S.A., and ESSAL S.A.

**The next move toward SOE reform was the creation of the *Sistema de Empresas (SEP)*, seeking to attain a more clear ownership function.** As a result of a consensual review process that concluded with recommendations<sup>89</sup> to strengthen the state's ownership function, the SAE was replaced in 2001 by a new entity, the System of Public Enterprises (*Sistema de Empresas—SEP*). Soon after its creation, SEP was granted an important role in nominating and removing SOE directors of all SOEs under state control (except for CODELCO, *Banco Estado*, *Televisión Nacional*, *ENAMI*, and defense enterprises).

**TABLE II.6: Evolution of the Governmental Organization Supervising the SOEs**

Until 1997	1997–2001	Since 2001
<p><i>Corporación de Fomento de la Producción</i> (CORFO)</p> <p>Controlled a large number of key SOEs, with some exceptions</p>	<p><i>Sistema Administrador de Empresas</i> (SAE)</p> <p>Exercised the ownership function of SOEs at behest of main shareholder (CORFO)</p>	<p><i>Sistema de Empresas</i> (SEP)</p> <p>Replaces SAE in exercising the ownership function at behest of main shareholder (CORFO)</p>

**Chile has been focused for several years on incorporating good corporate governance practices in the management of SOEs.** As a result of this decision, the performance of SOEs has substantially improved. Some of the most relevant measures are listed below:

- SOEs have been granted greater autonomy. Measures have been taken to shield enterprises from government “instructions” and to ensure that SOEs do not receive preferential treatment. At the same time, SOEs have also been allowed greater operational autonomy. The SEP’s management practices strive not to “duplicate the work” of SOE boards.
- There have been noticeable improvements in transparency and information disclosure. Financial statements and other reporting of SOEs are generally made publicly available on trimestral basis. Consolidated annual reports are compiled by the SEP, and subsequently sent to the executive power and/or parliament, and publicly disclosed. The Transparency Act (April 2009) requires all SOEs to disclose the same information as corporations are required to provide to the SVS.
- Significant steps have been taken to strengthen the quality of financial and non-financial disclosure, including the adoption of International Reporting Standards.
- The SEP Code establishes an ethics standard that individual SOEs are required to implement, if necessary adapted to their specific situation and regulations.
- Chile is well advanced in assuring equal treatment of shareholders in SOEs with minority non-state participation. Minority shareholders are guaranteed, by law, nondiscrimination, access to information and access to vote in shareholder meetings. The state is not legally entitled to obtain information in preference over other shareholders in SOEs.

## Challenges Ahead

**The main challenge faced by the reforms implemented in Chile concerns the legal status granted so far to the new institutional arrangement in SOEs management.** Certain new functions have been extended to the SEP by specific laws and decrees. Recently, new legislation has been drafted to strengthen the current institutional framework. The draft law currently under consideration would grant the SEP legal status as an autonomous public agency.

## Notes

76. This work only focuses on SOEs linked to the central government.
77. It is important to note that CODELCO, the National Copper Corporation, and ENAP, the National Oil Company, combined contribute to almost 90 percent of total expenditures and total revenues generated by all SOEs in 2010. In addition, CODELCO is responsible for nearly 95 percent of all fiscal transfers from the SOEs to the State.
78. These figures are for 2010 and were calculated using official data obtained from the Budget Office.
79. *Banco del Estado de Chile* is the only SOE in the financial sector.
80. Legally, SEP is a committee of CORFO (Chile's Production Development Corporation) but is commonly referred to as a holding of SOEs. Annex B shows the full list of companies under SEP oversight.
81. From the members of the Council, 3 are appointed by the President of the Republic; two are appointed by the Ministry of Finance; one is appointed by the Ministry of Economy, Development and Tourism; and three are appointed by the Vice-president of CORFO—out of these three, one is proposed by the Ministry of Mining and one by the Ministry of Transportation and Telecommunications.
82. For example, in the case of harbor companies, board members do not receive a bonus in their stipends if they fail to meet targets specified in their management plans.
83. More information at <http://www.dipres.gob.cl/572/channel.html>.
84. These practices focus on three objectives: Board of Directors, Integrated Risk Management and Organizational Culture. For each of them, SEP has developed guidelines called "*Guías de Gobierno Corporativo Empresas—SEP*" that establishes the standards which the enterprises should comply with. They define the relation with topics such as external audit, code of conducts, complaint mechanisms, fraud prevention and replacement of key staff.
85. E.g., ranging from 14 pages (Coquimbo) to over 100 pages (Antofagasta and Metro S.A).
86. The reports can be found at <http://www.sepchile.cl/en/documentacion/memorias>.

87. Audited can be searched at <http://www.contraloria.cl/appinf/basesdocumentales/bifaPortalCGR.nsf>.
88. The governing council of CORFO is composed of 7 individuals: the Minister of Economy, Development and Tourism; the Executive Vice-president; the Minister of Foreign Affairs; the Minister of Social Development; the Minister of Finance; the Minister of Agriculture and a member appointed by the President of the Republic. For further details, see [http://www.corfo.cl/acerca\\_de\\_corfo/estructura\\_corporativa/consejo\\_directivo](http://www.corfo.cl/acerca_de_corfo/estructura_corporativa/consejo_directivo).
89. *Institucionalidad y Criterios de Gestión para las Empresas Públicas* (2001).



## CHAPTER II.3

# The Case of Colombia



### II.3.1 State-Owned Enterprises Portfolio

**As in many other Latin American countries, national State-Owned Enterprises (SOEs) in Colombia remain important actors despite a recent history of intense privatization.**<sup>90</sup> The aggregate budget of SOEs linked to the central government in Colombia represents approximately 8 percent of GDP and 24.5 percent of the government budget;<sup>91</sup> total investment by SOEs amounts to roughly 5 percent of GDP; and SOEs contribute to the national government finances via dividends equal to almost 1.3 percent of GDP or 4 percent of total government revenue.<sup>92</sup> Three SOEs (ECOPETROL, ISAGEN and ISA) are listed on the national stock exchange; they constitute 15 percent of the National Stock Market and 50 percent of the total value of SOEs.<sup>93</sup>

**The universe of SOEs in Colombia is made up of 37 SOEs linked to the central government.**<sup>94</sup> This number includes state industrial and commercial companies, and mixed-capital corporations (MCC), as recognized by the current legal framework. SOEs in Colombia operate in both competitive and non-competitive markets. Their activities are widespread across sectors, but they play a significant role in the oil, financial, and electricity



**TABLE II.7: Distribution of SOEs across Sectors**

Sector	Expenditures		Number of SOEs
	% of Gov. Budget	% of GDP	
Oil and Natural Gas	19.70	6.81	1
Financial	3.18	0.87	15
Electricity	1.53	0.44	7
Postal Services	0.04	0.01	1
Telecommunications	0.02	Less than 0.01	4
Transportation	Less than 0.01	Less than 0.01	3
Others	0.02	Less than 0.01	6
<b>Total</b>	<b>8.13</b>	<b>24.50</b>	<b>37</b>

Source: DNP, MF.

sectors. The Colombian Oil State Company (*Empresa Colombiana de Petróleos—ECOPETROL*), a mixed-capital corporation with majority state participation,<sup>95</sup> is dominant in the oil sector with a budget that amounts to almost 7 percent of Colombia’s GDP (or 20 percent of the government’s budget). In the financial sector, SOEs’ aggregate budget is 0.87 percent of GDP (3.18 percent of the government’s budget), and 0.44 percent of GDP (1.53 percent of the government’s budget) in the electricity sector.

**There are 15 SOEs in the financial sector, six of which provide agricultural financial services.** Another seven SOEs operate in the energy sector, providing public home utilities. Rounding out the list, four SOEs focus their activities in telecommunications, three in transportation, and the rest in areas such as veterinary products (VECOL S.A.), tourism (*Sociedad Hotelera*), and crafts (*Artesanías de Colombia*).

### **II.3.2 Ownership Function: Institutional Framework and Organization**

**The SOE ownership function in Colombia is decentralized and exercised by several government units simultaneously or sequentially.** In general, sector ministries or similar agencies are in charge of executing ownership rights. However, for some companies ownership rests entirely with the MF. Complementing these institutional arrangements, other relevant public sector entities may play key roles, intervening at different stages of the budgeting and oversight processes. For example, the National Planning

Department (*Departamento Nacional de Planeación*—DNP) takes significant responsibility for, oversight of SOEs and control of royalties, and the National Council of Economic and Social Policy (*Consejo Nacional de Política Económica y Social*—CONPES) is responsible for financial programming of some enterprises.

**In most cases, the sector ministry exercises ownership rights with another ministry or agency.** These SOEs follow sector-specific policies and articulate their plans according to the sector planning process. For instance, companies in the telecommunication sector implement the sector policies dictated by the Ministry of IT and Communications or the National Television Commission. In a few other cases the Ministry of Finance exercises SOEs ownership rights along with the sector ministry. In this latter case, while the MF monitors financial indicators, the sector ministry focuses on performance indicators. For example, strategic and operational decisions taken by ECOPETROL are subject to the approval of the Ministry of Mining and Energy. However, the MF exercises the ownership function as the main shareholder of the company.<sup>96</sup>

**Colombia's National Planning Department (DNP) is one of the main government entities in charge of supervising SOEs.** DNP is a highly technical executive administrative agency that reports directly to the Presidency, and whose main objectives are the preparation, implementation, monitoring and evaluation of the activities performed by the entire public sector. DNP evaluates all public investment projects developed by the SOEs which are financed through the national government's budget, and monitors their results. SOEs are required to send their financial statements to DNP annually, but DNP may also request specific information at any time. DNP keeps centralized records of the information submitted by SOEs on potential financial surpluses and, in some cases, on their investment budget. It also receives financial information from other government agencies, and coordinates the formulation of the National Development Plan for the entire public sector. In 2010, DNP elaborated a methodology to monitor SOE performance.<sup>97</sup> The main objective of such methodology is to “create an integrated information system to monitor the management of SOEs in order to adopt policy strategies towards the optimization of SOEs performance.” This methodology includes three dimensions: financial, internal organization, and performance.

**The National Council of Economic and Social Policy (CONPES) is in charge of determining the amount of money from financial surpluses and profits of industrial and commercial enterprises and MCCs to be assigned to the national treasury.**<sup>98</sup> At least 20 percent of these surpluses

remain in the respective SOEs that generated them. CONPES informs SOE boards about the distribution of the surpluses generated by their company.

**The Water and Sanitation, Energy, and Communications regulatory commissions also exercise oversight functions on SOEs.** The regulatory commissions are administrative units within their respective sector ministries (Ministry of Economic Development, Ministry of Mining and Energy, or Ministry of Communications) with technical, financial, and administrative autonomy. The responsibilities of these commissions include setting tariffs and fees, ensuring compliance with contracts and acts, and collecting and analyzing all relevant information provided by public utility companies.

**Various superintendencies oversee the performance of SOEs.** The Public Utility Superintendence (*Superintendencia de Servicios Públicos Domiciliarios*), an agency that is part of the DNP hierarchy, oversees compliance with Law N° 142/1994 (Public Domiciliary Utilities Law); rules, and performance indicators established by regulatory commissions (water and sewage, energy, and telecommunication); and contracts between users and public utilities, technical requirements established by sector ministries regarding procedures, equipment and public works. Commercial SOEs are controlled by the Superintendence of Mercantile Companies (*Superintendencia de Sociedades*), and the Financial Superintendence (*Superintendencia Financiera*) supervises those SOEs that provide financial services and those that trade in the stock market.<sup>99</sup>

**The Office of the Comptroller General, in accordance with the Colombian Constitution, oversees the execution of the budget of all SOEs.** This supervising function extends to all entities that receive or execute public funds.

### **II.3.3 Accountability and Oversight Mechanisms**

#### **Statements of Objectives & Planning Documents**

**Management/Performance contracts.** Financial and performance objectives in service delivery are defined by the SOE Boards. These objectives must be aligned with national goals, as codified in the National Development Plan, and have to be approved by shareholders. However, often the objectives derived from national plans are too broad to concretely inform the management of SOEs. For this reason, each SOE tends to elaborate its own corporate plans, taking into consideration the strategic sector plans (e.g., the National Energy Plan) and their own objectives.

**Budget formulation and approval.** The National Budgeting Office (*Oficina del Presupuesto Nacional*—OPN) of the MF monitors the budgets of industrial and commercial SOEs, and MCCs operating in non-financial activities. The OPN gathers all relevant information about the budget planning processes of these SOEs through a financial information system which operates independently from the integrated financial information system (SIIF) that includes all other resources of the national government’s budget. It also establishes rules and procedures for the disclosure of information. Annual budgets of non-financial SOEs with a majority of shares held by the central government are supervised by the Superior Council of Fiscal Policy<sup>100</sup> (*Consejo Superior de Política Fiscal*); the corresponding sector ministries also participate in the process. The Colombian legal framework provides for the approval and modification of the SOEs’ budgets. This applies to industrial and commercial SOEs, as well as the division of CONFIS that functions as a mixed-capital corporation, CONFIS, an institution attached to the Ministry of Finance and Public Credit and in charge of fiscal policy and the coordination of the budget system.

## **Reporting: Monitoring of Performance & Ex post Disclosure**

**Budget execution reports.** The MF and the DNP supervise budget execution by SOEs with a majority of shares held by the national government. Monthly reports on budget execution are elaborated and published in the MF website.<sup>101</sup> These reports are based on the information collected by the ONP through a financial information system.

**The DNP is in charge of collecting and disseminating information about the execution of the companies’ investment plans, and the progress of the National Development Plan.** The DNP also reports regularly to the President regarding the execution of public investments and the implementation of the development plan, and advises on the preparation of an annual report on these issues to Congress.<sup>102</sup>

**Additional information disclosure and reporting requirements for SOEs.** In general, there are no specific rules for citizens to access financial information of SOEs. However, SOEs are required to prepare and disclose the following information:

- *Financial Reports.* Financial statements are presented to the Investment and Public Finance Office of the DNP and are made available at the SOEs’ websites.<sup>103</sup>
- *General Directors’ or Corporate Governance reports.* The Chairman, on behalf of the board of directors, provides a report on the performance of the SOE to the general shareholder meeting.

- *Performance (Results in Service Delivery) reports.* Annual and quarterly management reports are produced. The CEO is responsible for officially submitting quarterly management reports.
- *Other specific reports required from SOEs.* Financial reports are submitted to the Financial Superintendence or Public Utilities Superintendence, depending on the type of SOE.
- *Disclosure of ex post reporting.* Financial and management reports are publicly available and usually posted on the company's website.

**Additionally, superintendences collect and publish information about SOE performance.** The Public Utility Superintendence, for instance, publishes management performance and quality indicators for the year under review. The indicators made available include information on claims, customer satisfaction, and sanctions placed on companies that do not comply with specified standards.<sup>104</sup>

## **Auditing of SOEs**

**SOEs are subject to internal and external audits.** The table below describes the audit arrangements that serve to exercise control on SOEs.

## **SOEs Boards of Directors and Management**

**Boards of directors and CEOs.** At the national level, the sector ministers and the directors of administrative departments coordinate and guide the activities of the industrial and commercial SOEs and MCCs in their respective sectors. Typically a board, with the director, president, or CEO of the company, is in charge of the direction and management of these SOEs.

**There are no specific rules guiding the appointment of board members, directors, or presidents of SOEs.** Law N° 489/1998 only establishes generic guidelines. The President of the Republic or the respective Board of Directors selects CEOs or presidents of SOEs and can remove the appointees at any time. The designation of board members is established in the law or norm that creates the corresponding SOE. Members of the board must follow the sector policy guidelines and uphold the interests of the SOE. Members who come from the private sector are not considered public officials, although they execute a public service. In general, in appointing these positions SOEs must draw guidance from both Law N° 489/1998 and their own governing statutes.

**TABLE II.8: Types of Audit**

Type		Who Is Responsible	Audit Scope	Frequency
Internal	Inside SOE	Auditor ( <i>fiscal supervisor</i> )	Oversees financial statements and accounting processes.	Permanent
		Audit committee (formed by members of the board of directors)	Oversees internal control management.	
		Internal control office	Ensures that proper procedures are followed, improvement plans are implemented, and that the company complies with ISO norms.	
	Gov.	General Comptroller Office	Responsible for financial, legal and management control, auditing and evaluation of internal control processes, and verifying the results of these processes.	Annual
External		Private auditing firms	May be engaged to conduct an audit upon request of shareholders with more than 5% of shares.	Annual

**In practice, the selection criteria have not followed a standard procedure.** In some cases, the CEO is required to have a specific background consistent with the type of business developed by the SOE or the ministry that exercises the ownership rights. For example, the CEO of the *Sociedad Hotelera Tequendama* must be an official of the military since the Ministry of Defense is the major shareholder in this SOE.

**The DNP stated in its 2003 National Development Plan that the appointment, term duration, and promotion of directors and managers are to be decided by merit-based criteria or performance, but in practice this is not always the case.** In some cases, directors and managers are appointed, retained, and promoted based on their political allegiance, which can generate uncertainty within the organization. This may also create

perverse incentives for appointees, as in such cases, directors and managers tend to devote a significant amount of resources to goals determined by political expediency, sometimes at the expense of sound long-term policies for the companies they guide.

**The following characteristics define the functioning of SOE boards in Colombia:**

- *Frequency of meetings:* Ordinary shareholder meetings are held annually, while the boards of the companies meet monthly or bi-monthly (depending on the company).
- *Record-keeping of meeting minutes:* In accordance with the Commercial Code a secretary is designated to keep minutes, which must be approved by the respective meeting participants.
- *Rules or code of ethics informing the board's behavior and composition:* Many SOEs have code of ethics approved for the entire enterprise, but these do not apply specifically to the board.
- *Rules for board members' appointment and dismissal:* Regulations regarding the composition of the board are stated in the law that creating the SOE in question.
- *Length/duration of appointment:* One year.
- *Board responsibilities:* Interaction with the CEO (supervision, dismissal) and with the Ministry/SOE Management Unit.
- *Mechanism of Board's performance appraisal:* Self assessments are presented by the Chairman of the Board in the shareholders meeting.

**Salaries of managers, members of the board and other employees are not in all cases based on performance.** There is a fixed salary scale which limits the incorporation of salary incentives or bonuses for good performance. One attempt at reform in this area was the creation of an additional “technical bonus,” which was applied to those SOEs operating under public law. In practice, however, this bonus was incorporated into the regular salary for employees at these SOEs, negating its original purpose. In the case of companies operating under private law, bonus payments based on results are more firmly established.

**SOEs that operate in the financial sector must comply with additional rules and guidelines.** In 2005, Congress passed the Securities Market Law (*Ley del Mercado de Valores-964*). The law established mandatory corporate governance practices for issuing institutions.<sup>105</sup> Among other things, it established a minimum mandatory percentage (25 percent) of directors on the board that must be independent, and established the requirement for an audit committee, to be formed by independent board

members. Additionally, in 2006, a working group led by the Financial Superintendent elaborated a code to promote good governance practices. The code enumerates recommendations for the functioning of the board of directors, setting best-practice standards for the number of directors, their desired qualifications and degree of independence, responsibilities of the board, and frequency of board meetings.

### **II.3.4 Reform Initiatives**

**As in many other countries, in Colombia improving corporate governance is seen as an opportunity for SOEs to advance their access to international markets, and their ability to compete openly in those markets.** Companies see transparency, probity, good enterprise practices, and effective control as key to achieving their mandated objectives in an effective and efficient manner.

**Two types of reforms in the area of corporate governance of SOEs should be highlighted.** First, the creation and proliferation of MCCs and the subsequent incorporation of private shareholders to SOEs have contributed to improving the performance and transparency of the companies. Moreover, some SOEs have introduced a code of ethics for their firm. It should be noted, however, that no general guidelines have been provided for the creation of such codes.

#### **Challenges Ahead**

**The efficient management of SOEs in Colombia is still a significant challenge for the public sector administration.** The government has focused on reinforcing good practices of corporate governance in several areas. Some of the issues that present specific challenges are the lack of a centralized ownership structure; the existence of reporting standards based on local norms instead of international requirements (International Financial Reporting Standards—IFRS); and, for some SOEs, insufficient separation between commercial and political objectives.

#### **Notes**

90. This work only focuses on SOEs linked to the central government. Counting SOEs that involve the participation of sub-national governments, however, there are a total of 105 SOEs in Colombia, representing 16.7 percent of GDP and 0.7 percent of employment (OECD).



91. It should be noted that expenditures by ECOPETROL, the state-owned oil company, represent almost 7 percent of GDP and 20 percent of the government budget.
92. The figures are for 2010 and were calculated using official data obtained from the National Planning Department and the Ministry of Finance.
93. OECD 2013b. Corporate Governance Working Paper No. 12, *Colombian SOEs: A review against the OECD Guidelines on Corporate Governance of State-Owned Enterprises*, written by Hector Lehuéde.
94. Annex C provides a complete list of SOEs linked to the central government.
95. The Republic of Colombia owns 89 percent of the shares of ECOPETROL.
96. The last column of the table in Annex C shows the main sector ministry in charge of supervising the corresponding SOE.
97. DNP acknowledged in the 2003 National Development Plan the importance of clearly defining the concept of autonomy in the organizational policies applicable to SOEs. The DNP emphasized the need to clarify responsibilities and roles of sector ministries, MF, and DNP regarding SOE management (*Departamento Nacional de Planeación, Colombia, 2003*). It also highlighted the importance of implementing good corporate governance practices to improve the performance of SOEs.
98. This is applied to SOEs once their budget has been approved.
99. In a country report issued by the Financial Superintendent (2007), this institution argued that the Corporate Governance Code (*Código País*) “(. . .) will be used as a standard for issuers to provide the market with relevant and adequate information regarding their corporate governance. This information would become an important tool for the decision-making process leading to investments.” Among the SOEs that have adopted this Corporate Governance Code are ECOPETROL, *Banco Agrario S.A.*, *FINAGRO* (Colombian Credit Fund for Agriculture & Livestock) and *Fondo Nacional de Garantías*.
100. SCFP is formed by the MF, the Director of the Administrative Department of the DNP, the Economic Advisor for the Presidency, the Vice Ministries of Finance, and the National Directors of the OPN, Office of Public Debt, Office of Taxes and Customs, and the Treasury.
101. This information is published at the MF website: <http://www.pte.gov.co/>.
102. The information can be found at <http://www.dnp.gov.co/Default.aspx>.
103. To cite a couple of examples, in the case of ECOPETROL, this information can be consulted at <http://www.ecopetrol.com.co/english/contenido.aspx?catID=305&conID=41397>, and in the case of the electricity company DISPAC, at <http://dispac.com.co/nuestra-empresa/informes-empresariales/>.
104. Refer to <http://www.superservicios.gov.co/home/web/guest/inicio>.
105. Issuing institutions are companies with registered securities in the National Registry of Securities and Issuers.

## CHAPTER II.4

# The Case of Paraguay

### II.4.1 State-Owned Enterprises Portfolio

**Despite a recent history of privatizations, State-Owned Enterprises (SOEs) in Paraguay remain important actors.**<sup>106</sup> A number of key items of information confirm their relevance in economy. For instance, they employ around 17,000 people in total; the aggregate budget for all SOEs is equal to 14.5 percent of GDP, and accounts for 32 percent of the national budget (*Presupuesto General de la Nación*—PGN). Moreover, total investment by SOEs amounts to roughly 1.3 percent of GDP (3.3 percent of the national budget).<sup>107</sup>

**The universe of SOEs in Paraguay includes 13 SOEs linked to the central government.** Five of the companies are directly controlled by the state; the operation of these enterprises is regulated by *Cartas Orgánicas* and four are mixed corporations with majority state participation.<sup>108</sup> Of the remaining four, which are not included in this chapter, three are public financial entities and one is the postal company. SOEs in Paraguay operate in both competitive and non-competitive markets. The participation of SOEs is widespread across sectors, but concentrated in oil, electricity, and telecommunications. Typically the important SOEs play a strategic role in their respective sectors. For instance, in the oil sector, the state-owned company *Petróleos Paraguayos* (PETROPAR), has a budget that amounts to

**TABLE II.9: List of National SOEs in Paraguay**

Sector	SOE	SOE Budget	
		As % of Gov. Budget	As % of GDP
Oil	Petróleos Paraguayos (PETROPAR)	13.8%	6.3%
Electricity	Administración Nacional de Electricidad (ANDE)	11.4%	5.2%
Telecommunications	Compañía Paraguaya de Comunicaciones S.A. (COPACO)	3.6%	1.5%
Construction	Industria Nacional del Cemento (INC)	1.7%	0.7%
Water and Sanitation	Empresa de Servicios Sanitarios del Paraguay S.A. (ESSAP)	0.8%	0.4%
Transportation	Dirección Nacional de Aeronáutica Civil (DINAC)	0.5%	0.2%
	Administración Nacional de Navegación y Puertos (ANNP)	0.3%	0.1%
	Ferrocarriles del Paraguay S.A. (FEPASA)	0.0%	0.0%
Beverages	Cañas Paraguayas S.A. (CAPASA)	0.1%	0.0%
<b>TOTAL</b>		<b>31.8%</b>	<b>14.4%</b>

Source: MF.

almost 6.2 percent of Paraguay’s GDP (13.8 percent of the PGN); in the electricity sector, the Paraguayan Power & Electricity Company (*Administración Nacional de Electricidad*—ANDE) has a budget that reaches 5.1 percent of the GDP (12.8 percent of the PGN); and in the telecommunication sector, the Paraguayan Telecom Company’s (*Compañía Paraguaya de Comunicaciones*—COPACO) budget is 1.4 percent of the GDP (3.6 percent of the PGN). Other relevant sectors include transportation, water and sanitation, and beverages production.

## **II.4.2 Ownership Function: Institutional Framework and Organization**

**Paraguay’s government has recently taken a series of measures aimed at establishing a centralized model for the ownership function of SOEs.** These measures have been addressed to gradually leaving behind the

traditional decentralized model, where sector ministries supervise SOEs and implement a more centralized model, whereby a single entity acts as the SOE shareholder on behalf of the state. Most of these initiatives have been promoted by the Ministry of Finance (MF), as an attempt to reduce fiscal and social undesired effects related to poor management and sub-optimal service delivery of SOEs.

**The introduction of a Governing Council of SOEs (*Consejo Nacional de Empresas Públicas*—CNEP) in 2008 constituted the basis of the current organization of the SOEs ownership function in Paraguay.** The CNEP is formed by representatives of the Ministry of Finance, Ministry of Public Works and Communications, Ministry of Industry, and the Office of the State Attorney General. The Minister of Finance holds the presidency of the CNEP. Its main objective is to administer, coordinate, and execute the plans, programs and modernization strategies of SOEs delivering public services, while also providing supervision and oversight of these companies.

**To better exercise its management and oversight functions, the CEP has created the Monitoring Unit for SOEs (*Unidad de Monitoreo de las Empresas Públicas*—UMEP) as its internal decision-making and implementing body.**<sup>109</sup> UMEP is situated within the organizational structure of the State Sub-Secretariat of Economics and Integration (SEE), one of the main sub-secretariats of the MF which has recently been granted the status of a Directorate. The unit is staffed by a director and department heads (*Jefatura de Departamento*) who oversee departments of management control, research and planning, and regulation. It also has a multidisciplinary professional team, organized into working groups to supervise each of the SOEs.

**The CNEP is currently working on its multi-annual strategic plan within the policy guidelines formulated by the National Government.** The UMEP professional team has been progressively assuming a leading role in the elaboration of this plan, which is intended to provide greater predictability to sector policies, and lays out specific actions that the national government intends to take in policy implementation over the next few years. The plan is designed on the basis of the following five strategic objectives: (i) strengthening the institutional framework for SOE supervision; (ii) further developing the CNEP's capacity to monitor and supervise SOEs; (iii) regularizing payment arrears for public utilities by the government's central administration; (iv) strengthening the regulatory framework for the provision of public services; and (v) implementing rules for corporate governance of SOEs.

**At the same time, the CNEP intends to develop inter-institutional relationships that may also impact favorably on SOE oversight.** In this

case, it has an agreement on inter-institutional cooperation with the State Audit Office (*Contraloría General de la República*—CGR). Currently, UMEP is also in discussions with the National Directorate for Public Procurement (*Dirección Nacional de Contrataciones Públicas* (DNCP)) on signing a similar agreement on inter-institutional cooperation.

**The creation of the CNEP and UMEP has contributed to significant improvement in SOE oversight from an institutional standpoint.** The CEP contributes inter-institutional agility in decision-making with professional and technical monitoring by UMEP. The CNEP meets regularly, to discuss priority topics concerning SOEs with an agenda prepared by UMEP; and based on discussions following the agenda, executive decisions are taken. The progress and impact of these decisions are regularly monitored and followed-up by specialists.

### **II.4.3 Accountability and Oversight Mechanisms**

#### **Statements of Objectives & Planning Documents**

**Management/performance contracts.** Between 2009 and 2010, the UMEP defined a standardized model for SOE management contracts. These contracts have a time span of 3 years and are based on standardized indicators that measure qualitative and quantitative goals. These goals, and the indicators used to measure progress toward them, are agreed upon between the SOEs and UMEP, and based on the SOEs' medium-term strategic objectives. These include indicators and goals in the financial, commercial, and economic areas, as well as technical and public services. The provisions of each management contract also include monthly and quarterly reporting requirements, as well as external audit reports. In addition, the UMEP is currently establishing an automated system to access SOEs' data in order to enhance the effectiveness of this monitoring process.

**Five of the main Paraguayan SOEs (ANDE, COPACO, ESSAP, INC, and PETROPAR)<sup>110</sup> signed their respective management contracts in 2010.** In 2011, a sixth SOE, the National Administration of Navigation and Ports (*Administración Nacional de Navegación y Puertos*—ANNP) signed its management contract. These contracts contemplate the systematic compliance of a series of performance indicators on both quantitative and qualitative dimensions by the SOE and the UMEP. As a result, the CNEP now uses a standardized monitoring mechanism, with the results displayed on an online “dashboard,” which allows access to a database of performance indicators, and to the results of the periodic systematic evaluations of SOEs.

**Budget formulation and approval.** SOEs in Paraguay submit their budgets annually, jointly with the rest of government entities. Diverging from current practice in most countries, Paraguayan SOEs' budgets are consolidated and approved as part of the overall budget PGN, which also incorporates the budget of the central administration and of other decentralized (non-commercial) entities. The national budget with all of its components is annually consolidated by the MF's General Directorate of Budget and submitted to Congress for approval.

**For SOEs constituted as corporations,** the National Budget Law states that starting in 2011 corporations with shares held by the state must submit their budgets to the Ministry of Finance once they have been approved by their respective ordinary shareholder meetings.

### **Reporting: Monitoring of Performance & *Ex post* Disclosure**

**Budget execution reports.** The Directorate General of Public Accountancy (*Dirección General de Contabilidad Pública*) is the body responsible for compiling an annual report of the financial statements prepared by SOEs and the rest of governmental entities and agencies. These consolidated financial statements include complete information on revenue, expenditure and financial assets and liabilities, in accordance with the provisions of the financial administration law, and are submitted each year to the CGR, and subsequently submitted to Congress for review.

**Other key reports for SOEs.** Since 2010, UMEP has collected and processed quarterly information on various indicators established in the performance contracts. Although this information is not yet available to the public, the results of the evaluations carried out by CNEP in its session on SOE management are occasionally published. On the other hand, UMEP's multi-annual strategic plan, which is currently under execution, is available on the website of the Ministry of Finance.<sup>111</sup> Finally, despite the relatively large size of SOEs, and their strategic role in the Paraguayan economy, no evaluation of their aggregate fiscal risk has been carried out.

### **Auditing of SOEs**

**Following a period of low compliance, external audits were successfully implemented in 2009 for most SOEs, and have continued regularly since.** For the audit of the 2009 financial statements, the UMEP required SOEs to improve their procedures for external auditing, and expand the scope of external audits, to accord with international good practices. By May

2010, three large-scale SOEs (ANDE, COPACO, and ESSAP) signed contracts for the preparation of external audits with independent audit firms, following the procedures established by the National Public Procurement Law (No. 2051/03). As part of the effort to improve the transparency of SOEs, the results of those external audits were made publicly available on MF's official website.<sup>112</sup>

**The main oversight body for economic and financial activities of the state in Paraguay is the Comptroller General (CGR).** The CGR is empowered to perform financial, administrative, operational, and management audits on SOEs. The CGR bases its selection of SOEs to be audited on an audit risk assessment. For instance, the 2009 annual financial statements of the Paraguayan telecom enterprise (COPACO S.A.) were audited by CGR in 2010.

**UMEP receives and reviews the external audit reports.** In addition, UMEP makes all the necessary arrangements for their publication at the MF's website,<sup>113</sup> and monitors SOE compliance with the recommendations of the external audit.

## **SOE Boards of Directors and Management**

**Boards of directors and CEOs.** SOEs constituted as corporations have started to form boards of directors that are generally composed of a president, two board members, and one trustee. The responsibilities of the board generally include: to execute, comply with, and enforce the company's bylaws, national laws, and resolutions of shareholder meetings; to prepare and submit aggregate reports to the meeting; to perform financial operations; sign contracts; and propose to the meeting the distribution of dividends and creation of cash reserves. Those SOEs entirely owned by the government only have a CEO, who jointly with the line minister is in charge of the decision making process.

**There are currently no specific rules or guidelines in place to govern the appointment of SOE authorities and the functioning of the board.** The President of the Republic has the ability to appoint and remove SOE directors through a presidential decree. Board members and CEOs are accountable to the President of the Republic through the CEP. There are no specific criteria in place to guide the selection of candidates. Appointments to the board do not have a specific duration, but in general, they tend to coincide with presidential terms. There is no specific requirement for frequency of board meetings, but boards generally meet once a week.

## II.4.4 Reform Initiatives

**From the 1950s to the present, the largest companies of Paraguay have been under state ownership.** Some of these companies were privatized in a public administration modernization process that was initiated in 1991 and that developed in several different stages. However, the number and economic and strategic relevance of companies under state control remains very important.

**The government of Fernando Lugo, which took office in 2008, introduced significant reforms in the supervision framework for SOEs in Paraguay.** Establishing effective state oversight of SOEs and improving their performance was a major part of the plan introduced by the government. The reforms focused on the establishment of an effective State oversight of SOEs through the creation of the *Consejo de Empresas Públicas* (CNEP). However, it also included specific actions to improve business management and even, increase private sector participation in SOEs. The government sought to fashion a new institutional framework in order to: (i) create an adequate structure for supervision of SOEs and the exercise of the ownership function; (ii) ensure transparent reporting of financial management by SOEs; and (iii) promote an effective regulatory framework for public utility services.

**Since the last quarter of 2008, the organization of the ownership function within the state administration has made important progress.** After the creation of the CNEP and the regularization of the mandate of UMEP, progress has been observed in at least three areas: in terms of institutional development; in the measurement and monitoring of SOE performance; and in the level of transparency in financial management of SOEs.

**Instruments supporting the transparency of SOE finances and operations, and enabling more effective oversight, are being progressively implemented.** In particular, procedures for the annual publication and dissemination of SOEs' audited financial statements are already in place, as well as the elaboration of new rules that require the contracting of independent audit firms, in line with international best practices. Also, by mid-2010 elaboration and definition of medium-term financial and performance targets were advanced for at least five SOEs, representing almost 80 percent of total SOE-consolidated expenditures.

**The government has also initiated actions to regularize public utilities payment arrears from the central administration.** By the end of 2009, three main Paraguayan SOEs, responsible for the delivery of utilities



and basic goods (ESSAP, ANDE, and COPACO) claimed accumulated payment arrears to the central administration in the consolidated amount of US\$ 110 million.<sup>114</sup> As a response, the CNEP formally designated representatives from the Ministry of Finance, the Comptroller General, and the respective SOEs to create an inter-institutional technical commission (*Comisión Técnica Inter-institucional*—CTI) responsible for calculating and verifying the legitimacy of accrued debits and credits that were maintained between the SOEs and the central administration over time.

## Challenges Ahead

**Despite significant progress achieved over the last few years, Paraguay still faces several challenges.** In September 2013, the CNEP was institutionalized by law. One main challenge is to strengthen the institutional framework for supervision of SOEs. To this end, a key hurdle is to ensure the sustainability of the reform effort by approving the draft law for the legal establishment of the CEP, which was submitted to Congress in 2011. While this strengthens the institutional framework for the supervision of SOEs and ensures sustainability of recent reform efforts, another important challenge in the medium term is to create a consolidated regulatory framework. Among other measures, this would involve the creation of an independent regulatory body for the energy sector, as well as further progress towards the effective implementation of the water and telecommunication regulators and the eventual harmonization of standards governing these bodies.

**Recent achievements represent the initial phase of a more ambitious medium-term plan.** Next steps would include, inter alia, the implementation of strategic plans in five SOEs, the repayment of debt held by several SOEs and public sector entities, and to carry out accounting, financial and tax audits on five SOEs which have not yet been subjected to this level of scrutiny.

## Notes

106. This work only focuses on SOEs linked to the central government.
107. The figures are for 2010 and were calculated using official data obtained from the Ministry of Finance.
108. A complete list of SOEs is provided in the Annex. The companies considered here are those listed in the National General Budget of Paraguay as state companies and corporations with government participation. Not included are public financial entities such as *Banco Nacional de Fomento*, *Fondo Ganadero*, *Crédito Agrícola de Habilitación* and the *Agencia Financiera de Desarrollo*. The

postal company, *Correo Paraguayo*, operates as a decentralized entity within the structure of the Ministry of Public Works and Communications.

109. Decree no 955 from November 26, 2008, defining the role and mandate of the UMEP.
110. These companies jointly represent around 80 percent of 2010 SOEs' consolidated total expenditures.
111. [http://www.economia.gov.py/umep/\\_admin/uploads/umep\\_plan\\_estrategico.pdf](http://www.economia.gov.py/umep/_admin/uploads/umep_plan_estrategico.pdf).
112. <http://www.economia.gov.py/umep/empresas.php>.
113. Published at <http://www.hacienda.gov.py/web-sseei/index.php?c=322>.
114. According to SOEs reported data collected by the UMEP.



## CHAPTER II.5



# The Case of Peru

## II.5.1 State-Owned Enterprises Portfolio

**Despite an intense wave of privatization in the 1990s, State-Owned Enterprises (SOEs) in Peru remain important actors in the national economy.**<sup>115</sup> For instance, in 2012 SOEs employ around 22,000 people (0.3 percent of total employment in the country);<sup>116</sup> SOE aggregate (operating) expenditures are nearly 3.1 percent of GDP; and total investment by SOEs amounts to roughly 0.33 percent of GDP. At the same time they contribute to the government finances through taxes and direct transfers in an amount that reaches almost 2.4 percent of the GDP.<sup>117</sup>

**The universe of SOEs in Peru includes 31 companies overseen by the centralized ownership agency National Fund for Financing State Business Activity (*Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado—FONAFE*).** The central government of Peru is owner of at least 87 percent of each SOE, and owns 24 SOEs in full.<sup>118</sup> Moreover, the Peruvian state holds a small percentage of another 13 companies (with state participation up to 10 percent), and 13 companies are in process of liquidation due to bankruptcy.

**TABLE II.10: Distribution of SOEs across Sectors**

Sector	Budget as % of GDP	Number of SOEs
Electricity	1.3%	16
Environmental remediation and oil and gas	0.6%	2
Financial services	0.6%	4
Water and Sanitation	0.4%	1
Transportation and Communications	0.2%	4
Other Sectors	0.1%	4
<b>TOTAL</b>	<b>3.2%</b>	<b>31</b>

Source: FONAFE.

**SOEs in Peru operate in both competitive and non-competitive markets.** Their activities are concentrated in the electricity sector (generation and distribution), the financial sector, the oil and gas sectors, and in environmental rehabilitation. Aggregate expenditures by SOEs that operate in the electricity sector are nearly 1.3 percent of GDP; aggregate expenditures in the financial sector are 0.6 percent, and in oil and gas and environmental rehabilitation 0.6 percent. SOEs are also active in sectors such as transportation and communications, and in sewage sanitation and port infrastructure, but, as indicated in Table II.10, their contribution is relatively less significant. The category “Other Sectors” includes companies in the defense sector (weapons production, maintenance, and engineering), in trade, and companies engaged in shipbuilding and metalworking. In terms of distribution of firms across sectors, the table above indicates that half of Peru’s SOEs operate in the electricity sector. In fact, almost 27 percent of the energy distributed through the National Interconnected Electrical System (*Sistema de Electricidad Interconectado*—SEIN) is generated by national SOEs, and state-owned electric distribution companies satisfy 60 percent of total demand.

## **II.5.2 Ownership Function: Institutional Framework and Organization**

**The main actors in the Peruvian model of SOE ownership are the sector ministries, the National Fund for Financing State Business Activity (FONAFE), and the SOE management (boards of directors and CEOs).** Other institutions play a key role in ensuring the accountability of SOEs: the

Comptroller General's Office, the National Congress, and regulatory bodies, such as the Institutional Control Office.

**The ownership function for SOE management and oversight in Peru has been centralized since the creation of FONAFE in 1999.** The creation of FONAFE established legal separation between SOE ownership and other state functions,<sup>119</sup> as the agency functions as a public holding company, responsible to the Ministry of Finance (MF), and charged with regulation of all state enterprises (except PETROPERU S.A.) linked to the national government, including oversight of SOE budgets.

**Among other duties, FONAFE is responsible for:**

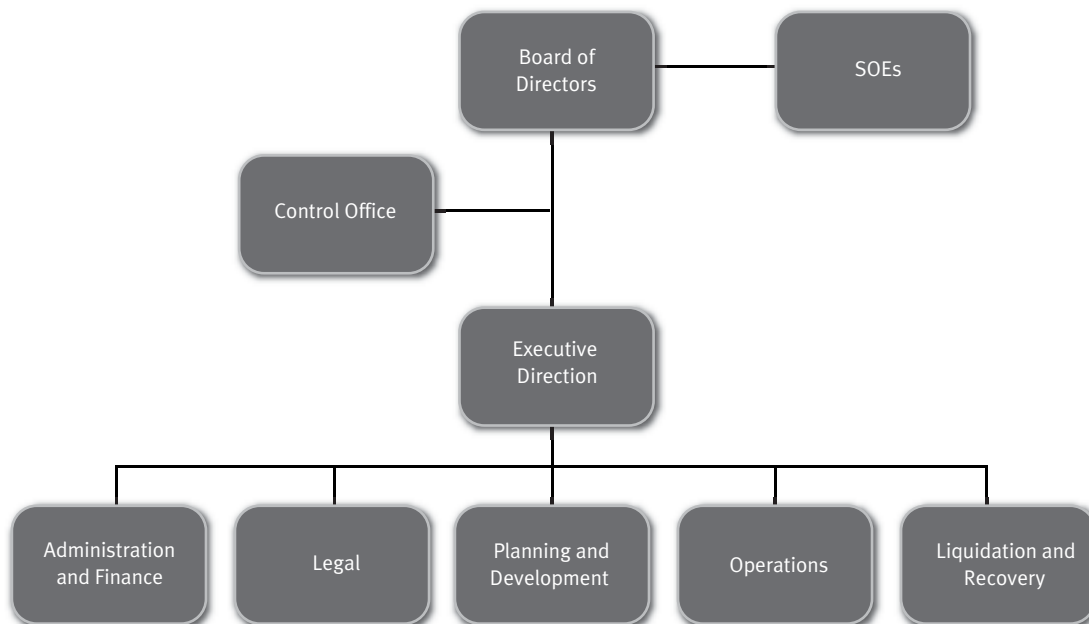
- Regulating and supervising the state's business activity;
- Exercising ownership of the shares of SOEs (under any legal form) and the rights over any company under public law;
- Approving the consolidated budget of SOEs;
- Establishing corporate governance regulations for all SOEs;
- Managing resources generated by the exercise of the ownership function; and
- Designating members for SOEs' shareholders meetings and boards.

**FONAFE is also in charge of ensuring that SOEs comply with applicable administrative systems in the execution of their activities.** These norms include budgetary, procurement of goods and services, acquisitions, investment, recruiting of new staff, and accounting and auditing norms. General corporate law and civil law may also be applicable and may supplement administrative guidelines.

**FONAFE's institutional structure reflects the inter-ministerial coordinating role of the holding.** FONAFE is led by a board of directors composed of the following ministers: (i) Minister of Economy and Finance, who presides; (ii) President of the Council of Ministers; (iii) Minister of Transport and Communications; (iv) Minister of Housing, Construction and Sanitation; and (v) Minister of Energy and Mines. FONAFE's executive director is appointed by the Minister of Economy and Finance. Figure II.3 shows its organizational structure.

**In the past few years, FONAFE has begun to put into practice a new approach for the management of SOEs, which involves the creation of business networks.** Each business network is formed by CEOs of different companies, who collaborate to identify common projects (or strategies) that would increase the value of the participating companies. By encouraging the creation of these networks, FONAFE aims to optimize the use of resources, enhance corporate integration and collaboration, and strengthen good practices of corporate governance across the companies of the holding.<sup>120</sup>

**FIGURE II.3: FONAFE's Organizational Structure**



**FONAFE has also been leading reforms in areas such as human resources and IT.** FONAFE has introduced higher standards in the selection of board members and CEOs, and taken steps to make the process more transparent. In IT, FONAFE has implemented a System for Electronic Documentation Interchange (*Sistema para Intercambio de Documentación Electrónica*—SIED), a software package that connects SOEs to FONAFE, and allows them to share documents and improve communications through electronic signatures. Recently, a data sharing system and paper recycling were also introduced.

**In 2006, FONAFE approved a Good Governance Code to foster the implementation of business best practices across SOEs.** This code is a guide of principles that SOEs are supposed to implement progressively. By 2011, the level of implementation was low and it seemed that the importance and relevance of the code had yet to be internalized by board members. Implementation of the code's provisions is also not closely monitored, with the exception of the electricity sector; in 2012, a consulting company performed an inventory of the code's implementation in the 16 SOEs of this sector.

## II.5.3 Accountability and Oversight Mechanisms

### Statements of Objectives & Planning Documents

**Management/performance contracts.** FONAFE is entitled to sign management performance agreements and other management tools with SOEs. These management agreements should include quotas, measuring tools, and performance indicators that accord with SOEs' objectives, as outlined in their strategic plans, corporate policies and corporate governance plans. FONAFE first implemented management agreements with specific sets of goals and indicators in 1999. However, their impact on SOE management could not be assessed, since no follow-up evaluation was conducted. FONAFE stopped signing new management agreements from 2006 to 2010.

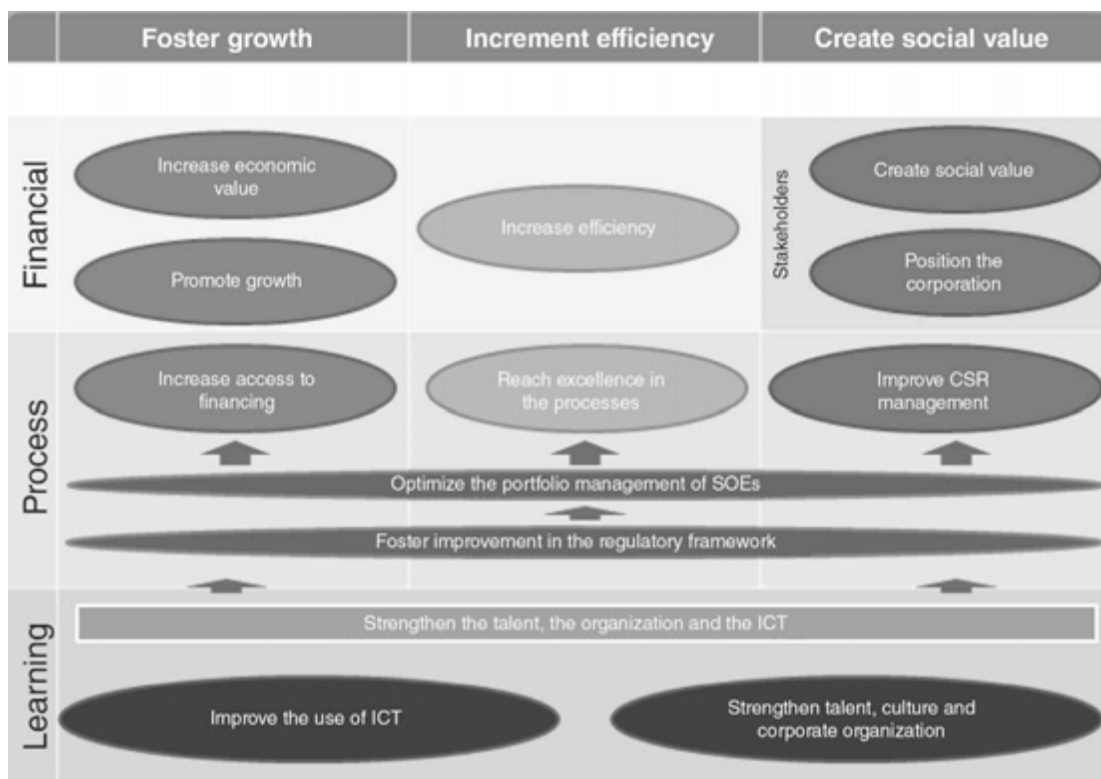
**SOEs' 5-year strategic plans.** Peruvian SOEs are required to produce a 5-year strategic plan with specific objectives, as well as to explicitly outline how they plan to achieve these objectives, which in turn, as mentioned above, have to be aligned with the Strategic Corporate Plan approved by FONAFE. For the period 2012–2016, FONAFE has established the following general strategic objectives: (i) foster dynamic SOE growth to contribute to the country's development; (ii) increase efficiency through operational excellence; (iii) foster the creation of social value; (iv) strengthen human resources and develop talent, corporate organization, and the use of information and communication technology in FONAFE.

**SOEs' Institutional Strategic Plans.** These plans provide a management instrument defining the institution's short-, medium-, and long-term objectives. They are formulated by each SOE in accordance with FONAFE's directives, corporate policies, and strategic plan, and are required to be aligned with their sector's policy plans. They should also be put in place for a 5-year period, and incorporate a diagnostic description of a company's current state of health, along with the company's strategic objectives, performance indicators and goals. These plans are first approved by the board of the company, the sector ministry and then by FONAFE's board. Upon approval, they must be ratified by the General Meeting of Shareholders of each company and published online.<sup>121</sup> The strategic plans are updated frequently, and approved changes are also published on the corresponding websites.

**Budget formulation and approval.** The budgetary process of SOEs is governed by the National Budgetary Law, which regulates this process for the entire Peruvian state apparatus. However, the annual national budget is not applicable to FONAFE and its SOEs unless stated explicitly in the law.



**FIGURE II.4: General Strategic Objectives**



Source: FONAFE.

Typically, FONAFE consolidates all SOEs’ budgets following the guiding principles of the National Budgetary System and submits them for approval to FONAFE’s board.

**FONAFE has developed several guidelines to inform SOEs about planning instruments, including their strategic plans and budgets.** As stated above, FONAFE is the main entity in charge of managing SOE budget processes. In 2008 FONAFE approved *Directives to formulate a SOE Strategic Plan*<sup>122</sup> and, in 2010, *Directives of Programming, Formulation and Approval of Operational Plan and Budget*.<sup>123</sup> These directives establish a set of guidelines, rules and principles to foster enhanced planning of SOEs’ activities in accordance with their objectives. Also, they contain detailed forms that allow FONAFE to gather information from all SOEs in a standardized way.

## Reporting: Monitoring of Performance & *Ex post* Disclosure

**FONAFE’s electronic document exchange system, SIED.** This system is used by FONAFE to centralize the submission of SOEs’ reports. It also facilitates exchange of documents between SOEs. Table II.11 outlines the reports required by FONAFE to individual SOEs.

**TABLE II.11: SOE Reports Required by FONAFE**

Type of Information	Documents	Frequency	Specifications
Strategic management	Operational Plan’s Control Report	Quarterly	
	Evaluation of compliance with goals and objectives established in the Operational Plan and the Strategic Plan	Annually	
Budgetary information	Financial statements	Monthly, Quarterly, Annually	
	Executive report	Monthly, Quarterly, Annually	Financial and budgetary analysis in comparison with the same period under evaluation from previous year
Audit information	Short- and long-form audit reports	Annually	Short- and long-form audit reports on financial statements as of 31 December
Corporate governance	Executive report on the implementation of good corporate governance	Annually	

**In general, all information regarding the management of SOEs is available to the public and published at both FONAFE’s and SOEs’ websites.**<sup>124</sup> FONAFE has issued a specific resolution regarding transparency regulations with which SOEs must comply, entitled “*Transparency in the Management of State Owned Enterprises under FONAFE*,”<sup>125</sup> and closely monitors compliance with it. Table II.12 contains the information that SOEs must publish on their websites.

**TABLE II.12: SOE Reports Available Online**

Type of Information	Documents
Budgetary information	Budgetary information: Initial budget of income and expenditures; Modification to the initial budget of income and expenditures; Implementation of the budget of income and expenditures.
Financial information	Initial budget of Income Statement, Balance sheet and Cash Flow forecast; Modifications to the Income statement, Balance sheet and Cash Flow forecast; Budget execution of the Income Statement, Balance sheet and Cash Flow forecast; Financial statements, including notes to these Financial Statements and the auditors' opinion.
Public investment projects in execution	List of projects
Performance indicators	Compliance report on Operational Plan's indicators; Compliance report on Strategic Institutional Plan's indicators.

**According to the provisions of the Transparency and Public Information Law SOEs can classify certain information as “restricted access.”**

This information can be classified as secret, reserved or confidential, e.g. in areas related to national security, or to banking, trade, or industrial secrecy.<sup>126</sup>

**An annual report is prepared by FONAFE, and publicly disseminated.** The report aggregates fiscal and financial SOE-related information, and it is submitted to the ministries, the Presidency of the Republic, the cabinet, and the Comptroller General, among other institutions.

**The Budget Law establishes that once a year FONAFE has to report to Congress’ Budget Commission.** During the session FONAFE presents, and may be required to explain or justify, the results of the previous fiscal year, and introduces the consolidated budget of SOEs for the following fiscal year. The Congress has the authority to request information from FONAFE, or from any SOE at any time.

### **Auditing of SOEs**

**In 2006, FONAFE approved the Code of Internal Control for all SOEs under its supervision.** The code was developed accordingly to the National

Control Law and its objective is to provide guidelines for the implementation of measures regarding the internal control of the enterprises. This code proposes a standard system and internal control structure to support the implementation of internal control processes, in turn fostering an ethical environment, preventing risks and promoting the permanent improvement of SOE management. In 2008, the Comptroller General approved guidelines for the implementation of the internal control system and FONAFE instructed the SOEs to comply with the guidelines for implementation of internal control.

**Internal control measures implemented by SOEs are supervised by the Institutional Control Office (ICO).** Each SOE has an ICO unit within its organizational structure. It reports directly to the board of directors, and it is responsible for monitoring administrative, financial and economic resources and assets of SOEs, in line with the National System of Controlled by the National General Comptroller (CGR). The CEO of the ICO is appointed by the CGR, and reports to and is remunerated by this institution.

**SOEs' annual financial statements are audited by external independent auditors selected through an open "request for proposal" process.** This process is managed by the CGR and includes technical requirements proposed by the SOEs. Furthermore, additional external audits may be requested by a general shareholders meeting at any time. Audit results are required to be submitted to FONAFE and the CGR, and must report on the following topics: (i) achievement of objectives and goals outlined in the Strategic and Operational Plans; (ii) execution of budget process and procedures; (iii) compliance with tax obligations; and (iv) the financial state of the company.

## **SOEs Boards of Directors and Management**

**All SOEs in Peru are governed by a board of directors, while CEOs are responsible for the daily operations of the companies.** After the general shareholder meeting, the SOE Board of Directors is the highest authority of the company, with the responsibility to oversee the company and establish its strategies, plans and objectives, as well as ensure compliance with these. The companies' bylaws determine the number of board members. In no case, however, is this number less than three or larger than seven. For the majority of SOEs, directors are appointed by FONAFE (through its board). The line ministry and/or MF proposes a candidate or candidates to FONAFE, which then makes an official nomination to the General Assembly of the Shareholders, which then confirms the candidate. The board regularly convenes twice a month.

**In general, professional requirements and the appointment/selection procedure for board members are established by law.**<sup>127</sup> According to the *Decreto Legislativo 1031*, board members must be professionals with strong ethics, be familiar with the business of the SOE, and have extensive experience in strategic and business management. However, FONAFE defines additional rules for companies under its supervision,<sup>128</sup> establishing detailed procedures for the designation and dismissal of board members. This includes strengthening the professional requirements established by the law; for instance, the candidate must hold a university degree, and between five and 10 years of professional experience or 10 years of professional experience in the sector in which the SOE operates. FONAFE also sets several restrictions on individuals becoming board members; for example, on-going judicial process involving the SOE, having been sanctioned or dismissed due to an administrative fault from any public institution or public enterprise, or being in a commercial relationship with the SOE.

**In August 2010, a decree supported by FONAFE established that at least one of the board members shall be selected through a public, competitive search.** This search is conducted by the National Authority for Civil Service (*Autoridad Nacional de Servicio Civil—SERVIR*) or by a private recruitment firm or “head hunter.” When the selection is the result of such an open search, candidates are required to meet higher professional standards (such as holding a master’s degree in a field related to the SOE sector) and additional qualifications.<sup>129</sup>

**Board members do not have a contractual relationship with the SOE.** Therefore, they are not considered employees in legal terms and do not have the benefits or protections provided by private or public labor regulations. Members of SOE boards may have their SOEs appointments revoked by FONAFE at any time without cause. Board members receive an honorarium for attending board meetings. The regulations specify that these payments should be set at a level appropriate to create incentives for improved productivity and performance, but in practice they are lower than those received in the private sector.<sup>130</sup> The duration of the appointment is effectively indefinite since it has not been established in any regulation. However, usually at the end of a presidential term, several changes take place in public administration and tend also to affect SOE boards.

**FONAFE establishes certain guidelines to evaluate board members.**<sup>131</sup> However, the guidelines focus on SOE performance rather than on the specific contributions of the board. In 2006, FONAFE approved the *Code of Ethics for State Owned Enterprises’ Workers*, which also applies to board members<sup>132</sup> and the *Directive on Neutrality and Transparency of State Owned*

*Enterprises during electoral processes*<sup>133</sup> which regulates the behavior of SOE boards during electoral campaigns.

**CEOs are selected through a public, competitive job search conducted by private head hunters, and appointed by the SOE board.** In 2009, FONAFE established a general policy to select CEO and other managerial positions using private recruitment agencies or “head hunters,” and develops guidelines for this purpose.<sup>134</sup> CEOs are accountable to the SOE’s board and to FONAFE. Since 2010 administrative regulations mandate that FONAFE develop mechanisms to evaluate the performance of CEOs, but these mechanisms have not yet been approved.<sup>135</sup> In general, managerial personnel in the SOEs are hired under private labor laws. This practice grants SOEs more flexibility in managing human resources compared to other public entities. There are no specific rules for dismissing CEOs since they are hired “at will” by the SOE boards.

**In Peru, the mandate of an SOE CEO is supposedly not tied to the government’s mandate.** However, political interference in bureaucratic institutions is still high in the country, so changes in ministerial positions may affect SOEs’ management stability, in particular in the nomination of the boards.

## II.5.4 Reform Initiatives

**The SOE ownership framework in force in Peru until 1990 did not deliver good results.** The supervision and accountability mechanisms were inadequate and unclear. In practice, the sector ministries exercised the ownership function: they were in charge of appointing board members, and deciding and implementing sector-specific policies. However, these decisions were generally driven by political motives and there was no coordination across sectors. MF intervened in budgetary issues or salary policy, but it did not effectively control the companies. All this led to poor performance by SOEs, an inefficient provision of goods and services, and consequently, low investment levels in the sector.

**In 1990, an aggressive privatization process led by the MF began in Peru.** This wave of privatization transformed Peru’s SOE portfolio from over 300 companies owned by the central government to the 31 currently under FONAFE’s oversight. The main sectors that participated in the privatization process were energy (hydrocarbon and electricity transmission) and infrastructure (ports and airports). The main purpose of this process was not to separate the ownership functions from regulatory or public policy functions, but was mostly aimed at downsizing and reorganizing SOEs to privatize them.

**A new constitution, approved in 1993, established that state business activities must be authorized by law, must be complementary to private activities, and must serve the public interest.** To organize and carry out the privatization process of SOEs, the Peruvian government created the *Oficina de Instituciones y Organismos del Estado* (OIOE), an office with financial autonomy, under the MF. All supervision and control functions pertaining to public enterprises were transferred to this new office which had absolute control over SOE management (procurement, investment, salaries) and budget. In 1998, when the privatization process came to an end with some SOEs still under state control, the OIOE adopted measures to improve SOE management at three levels: budget, personnel costs, and management agreements.

**In 1999, FONAFE was created as the holder of all state shares and as the governing body for state business activities.** All public entities that held shares in a SOE transferred them to FONAFE. The creation of FONAFE as a governing body of state business activity effected a separation of the ownership function from public policies.

**The following table summarizes the level of legal protection granted to the new institutional arrangement in SOE ownership and oversight in force since the creation of FONAFE in 1998.**

**TABLE II.13: Legal Protection of the Reforms**

	Level of Legal Protection			
	Constitution Protection	Law	Decree	Lower-rank Norm
Division of Responsibilities between Ministries in the ownership function		X		
Creation of SOEs Monitoring Unit		X		
SOEs Board/CEO's appointment & dismissal rules		X	X	X
Reporting Requirements from SOEs		X	X	
Auditing Requirements from SOEs		X	X	X
Assessment Mechanisms of SOEs Performance		X	X	X

## Notes

115. This work only focuses on SOEs linked to the central government and overseen by FONAFE, which includes 31 companies. The national oil company *Petróleos del Perú*—PETROPERU S.A. is overseen by the Ministry of Energy and Mining. It is also important to note that the social and health insurance company (*Seguro Social de Salud* (ESSALUD)), the maintenance company *Servicios Integrados de Limpieza S.A.* (SILSA), and the security company *Empresa de Seguridad, Vigilancia y Control S.A.C.* (ESVICISAC) are not included in this work; these were incorporated under FONAFE's budgetary oversight through the 2011 Budget Law. (*Ley N° 29626, Ley de Presupuesto del Sector Público*).
116. Press Release N° 064-30 Abril 2013, *Instituto Nacional de Estadística e Informática*.
117. The figures are for 2012 and were calculated using official data obtained from FONAFE.
118. Annex D shows a complete list of SOEs.
119. FONAFE's legal framework is Law N° 27170, and Legislative Decree N° 1031. These rules were enacted through Supreme Decree 072-2000-EF and Supreme Decree N° 176-2010-EF, respectively.
120. One example is the “Business Portfolio Network,” formed by CEOs from electric generation and distribution, financial, and non-electrical infrastructure companies, among others. Another example is the “Cross-Corporate Business Processes Network,” which integrates a series of different key processes, including those related to budget, investment, information technologies and communication, and corporate acquisitions.
121. For instance, the strategic institutional plan of CORPAC S.A. can be found at <http://www.corpac.gob.pe/Main.asp?T=4529>.
122. *Directiva de Formulación del Plan Estratégico de las Empresas bajo el ámbito de FONAFE*, approved by Board Agreement N° 001-2008/019-FONAFE.
123. *Directiva de Formulación del Plan Operativo y Presupuesto de las empresas bajo el ámbito de FONAFE*, approved by Board Agreement N° 001-2010/014-FONAFE.
124. Refer to <http://www.fonafe.gob.pe/portal>.
125. *Directiva de transparencia en la gestión de las empresas bajo el ámbito de FONAFE*, approved by Executive Direction's Resolution No. 010-2009/DE-FONAFE, published on February 11th, 2009.
126. This information may be technical, trade or business related, including secret processes, formulas, programs, marketing plans, research and development information, studies, special pricing plans or other information that may merit a reasonable effort at maintaining secrecy, particularly insofar as it derives commercial value from its secrecy.
127. The evaluation procedure is defined in the Supreme Decree 085-2006-EF. This decree establishes precise steps that should be followed in the evaluation process. It defines several categories and assigns scores to each categories that prospective candidates should meet.



128. The guidelines are entitled *Directivas aplicables a los directores de las Empresas públicas en las que FONAFE participa como accionista* (Directives applicable to Directors of the State-Owned Enterprises in which FONAFE participates as shareholder). The rules are also applicable to board members in companies where the state participates as a minority shareholder.
129. For instance, board members should not be related to SOE's personnel, management, board or shareholders; shall not be a public official or have had a direct or indirect contractual, commercial or labor relationship with the company for at least two years before the designation. See D.S. 126-2010-EF, art. 15.
130. This practice prevents FONAFE from attracting competitive professionals to the boards. Recently, in an attempt to foster directors' involvement in the SOEs, FONAFE included a variable amount in these payments. However, this measure has not yet been implemented.
131. No information, however, is available regarding the results of these evaluations.
132. Agreement No. 010-2006/004-FONAFE of the Board of Directors, published on February 3, 2006.
133. Agreement No. 001-2006/003-FONAFE of the Board of Directors, published on January 18, 2006.
134. Directive applicable to the selection of managers and equivalent positions in the SOEs under FONAFE. Approved by the Agreement of FONAFE's Board of Directors No. 006-2009/09-FONAFE on the 04.09.09 (Published on October 20, 2009).
135. In practice, FONAFE evaluates CEOs' performance through the performance of the SOE. This means that if SOEs objectives are achieved, it is assumed that the CEOs have performed well.

## CHAPTER II.6

# The Case of Spain



### II.6.1 State-Owned Enterprises Portfolio

**Overall, the size of the public enterprise sector in Spain is relatively small.**<sup>136</sup> Aggregate current expenditures of the entire sector amount to nearly 5 percent of GDP or 13 percent of the central administration's budget; and total investment is roughly 0.5 percent of GDP or 1.3 percent of the government's consolidated budget. At the same time SOEs contribute to the government finances through taxes, profits, and other transfers in an amount that reaches almost 1.3 percent of the GDP or 3.6 percent of total government revenue.<sup>137</sup>

**The public enterprise sector<sup>138</sup> in Spain is composed of approximately 260 State-Owned Enterprises (SOE).** This number includes companies directly controlled by the central administration through the Ministry of Finance and Public Administration (*Ministerio de Hacienda y Administraciones Públicas*—MHAP) and/or sector ministries (Industry, Agriculture, Development), and public companies under the supervision of the Public Holding for Industrial Participations (*Sociedad Estatal de Participaciones Industriales*—SEPI), a public entity attached to the MHAP.<sup>139</sup>

**SEPI is the biggest holding of the public sector.** As of December 31, 2012, SEPI had a direct and majority participation in 18 companies that together employ more than 80,000 workers. Under its economic and financial control are also the public radio and television company *Corporación de la Radio y Televisión Española* (CRTVE),<sup>140</sup> currently a public foundation. In addition, SEPI participates as a minority direct shareholder in seven companies (of which 5 are traded at the stock market), and indirectly in more than 100 companies. Total current expenditures of companies in the SEPI group add up to almost 0.4 percent of the GDP and 1 percent of the central administration's budget.<sup>141</sup>

**Table II.14 groups SOEs by percentage of state participation.** As indicated in the table, most of the SOEs are entirely owned by the government.

**TABLE II.14: State Participation in SOEs**

State Participation	Number of Entities	%
100%	192	73.28
≥90% and <100%	17	6.49
≥70% and <90%	10	3.82
≥60% and <70%	7	2.67
>50% and <60%	35	13.36
≤50%	1	0.38
<b>TOTAL</b>	<b>262</b>	<b>100.00</b>

Source: MF.

**SOEs in Spain operate in both competitive and non-competitive markets.** Their activities are spread across the economy. Table II.15 below describes SOE participation by sectors calculated by aggregating SOEs current expenditures by SOEs in each respective sector. As the table indicates, SOEs in Spain tend to concentrate their operations in trade, transportation, and tourism activities (SOE aggregate expenditures in this sectors are nearly 2.6 percent of the GDP and seven percent of the central administration's budget), artistic and recreational activities (one percent of GDP and almost three percent of the budget), and financial and insurance activities. SOE participation in other sectors is relatively minor.

**TABLE II.15: Participation of SOEs across Sectors**

Sector	SOE Sector Budget	
	As % of Budget	As % of GDP
Agriculture, Livestock, Forestry, Fishing	0.07%	0.02%
Artistic, Recreational	2.00%	0.74%
Construction	0.96%	0.35%
Defense, Education, Sanitary and Social Service Activities	0.24%	0.09%
Extractive Industries, Manufacturing, Energy, Water, Sanitation	2.06%	0.76%
Financial, Insurance	0.37%	0.14%
Information, Communications	0.20%	0.07%
Professional, Scientific, Technical, Administrative	0.79%	0.29%
Real Estate	0.18%	0.07%
Trade, Transportation, Hospitality	6.04%	2.22%
<b>TOTAL</b>	<b>12.92%</b>	<b>4.74%</b>

Source: MF.

## II.6.2 Ownership Function: Institutional Framework and Organization<sup>142</sup>

**SEPI centralizes the ownership function of the state as applied to the public companies under its control—that is, when it holds the majority of the shares.** SEPI was initially constituted by the Law 5/1996 for the creation of specific legal entities as a public corporation of the Central Administration, and under the responsibility of the Ministry of Industry. This responsibility was transferred to the Ministry of Finance in 2011.<sup>143</sup> The legal framework which regulates the current functioning of SEPI is based on the General Budget Law No. 47/2003.

**The law defines SEPI as a body, whose economic activities and contractual obligations are governed by the civil, mercantile and labor stipulations from the private-sector legal code.** However, in certain areas (such as recruitment of staff, procurement and budgeting), its activities are governed by public law and subject to the same control mechanisms (budget oversight, audits, public control, etc) as the rest of the public sector.

**SEPI acts as an instrument of government policy in the restructuring and modernization of public enterprises.** Furthermore, SEPI plays an important role in promoting economic development. According to its internal regulation and guiding norms, its main functions are:

- promoting and coordinating the activities of the entities it controls;
- setting strategy and supervising the planning processes of the enterprises in which it holds the majority share;
- managing the portfolio of its shares and SOEs in which it participates as a shareholder;
- carrying out all active and passive financial operations related to its own capital and the capital of the entities in which it directly and indirectly participates;<sup>144</sup>
- facilitating the process of privatization in SOEs it controls, as well as other processes delegated to it by the government.

**SEPI functions fundamentally as a financially autonomous corporation.** In order of significance, the main sources of SEPI's financing are: (i) management of its own assets; (ii) revenues from privatization proceeds; (iii) dividends from participation in enterprises (as majority or minority shareholder); (iv) borrowing from private financial markets, within the limits laid out by the annual general budget law. Also, since 2006, SEPI has had the option to receive, if necessary, transfers from the general budget; however, at the time of writing, fiscal year 13, this had not been necessary.

**To exercise the delegated supervisory and control functions for the enterprises of the SEPI Group, SEPI applies the following two management instruments:**

- i. **An integrated planning and oversight mechanism called the Integrated Planning, Follow-up, and Monitoring System.** This is a series of formal instruments through which SEPI exercises strategic economic and financial control of the management of the companies and foundations in its group. Through this system SEPI applies homogeneous guidelines to SOEs for accounting, fiscal, and financial issues. It is implemented in three stages: (i) oversight of the companies' budgetary process, (ii) periodic control (monthly or quarterly) of budget execution, and (iii) required reporting of companies' results and a final evaluation of the companies' performance.
- ii. **A series of regulations which govern the relationship between SEPI and its companies, which also establish functions and operations executed by the companies.** These regulations must be submitted for previous authorization by SEPI's governing bodies (Administrative Council and Directorate Committee).

## II.6.3 Accountability and Oversight Mechanisms

### Statements of Objectives & Planning Documents

**Management/performance contracts.** The General Budget Law assigns SEPI the responsibility of monitoring SOE performance. Generally, the companies are required to meet some minimum performance levels (in terms of rate of return, service provision, etc.) set by SEPI at the first stage of the Planning, Control and Monitoring System. The conditions are laid out in performance contracts between each company and SEPI. At the end of the year, SEPI reviews the information provided by the firm, evaluates each company's success in achieving these objectives, and, based on this performance, establishes the course of action for the following year. Detailed information about performance indicators is published in the companies' websites and frequently incorporated into the companies' annual reports. The General Comptroller and Accounting Directorate's (*Intervención General de la Administración del Estado*—IGAE) also includes information about the companies' performance in the report *Empresas Estatales: Informe Provisional*, but with some lag.<sup>145</sup>

**Annual and multi-annual budgeting formulation and approval.** At the beginning of each fiscal year, SOEs are required to prepare an Annual Operative Plan (*Plan Operativo Annual*—POA) and a four-year projected budget (*Plan a Largo*—PL) for SEPI's approval. The POA also lays out the objectives for each company, the basis for the application of the incentive system (this is a variable portion of the salary) for the managers of the companies, and submits these to the Directive Committee of SEPI for approval. Once the POAs and PLs of all companies have been compiled, the Multi-Annual Action Plan (*Plan de Actuación Plurianual*—PAP) of SEPI and its group is consolidated. It is then approved by the Administrative Council of SEPI and submitted to the Ministry of Finance for the preparation of the general budget. SEPI also prepares annually an operating and capital budget (for each company individually, and on a consolidated basis for the group as a whole), which is integrated into the general budget of the government in each budget cycle.

### Reporting: Monitoring of Performance & *Ex post* Disclosure

**SEPI's comprehensive "Integrated Planning, Follow-up and Monitoring System" constitutes the main reporting tool throughout the year, including ongoing and *ex post* reporting and review processes.** The type of reports and their frequency are described in the table below.

**TABLE II.16: Types of Reports and Frequency**

Type	Documents	Frequency
Ex Ante	POA (Annual Operative Plan), PL (Long Term Projected Budget, for 4 years)	Annually
Ongoing	POA and PL monthly and quarterly execution report	Monthly/Quarterly
Ex Post	Annual Comprehensive Report (business trends, performance, financial statements, proposed targets and actions for next year)	Annually

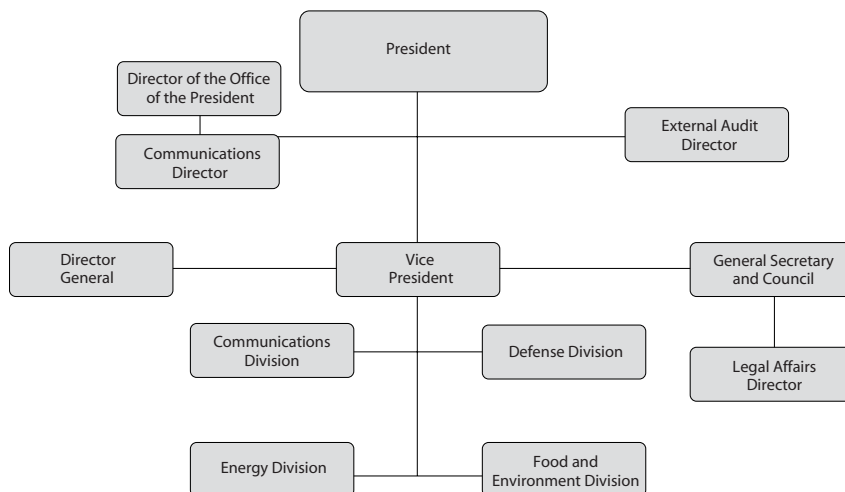
**Budget execution.** SEPI performs regular (monthly and quarterly) assessments regarding the level of POA-PL budget execution, sector trends, the level of progress in the implementation of planned activities, and monitoring of follow-up indicators. The type of oversight exerted by SEPI is less administrative and more managerial, focused on results and on increasing the competitiveness and profitability of the SOE portfolio. This approach facilitates significant management autonomy within the SOEs, and SEPI's role is more focused on supervision and authorization of strategic decisions and actions. SEPI also submits annually to Congress and publishes its Annual Report, which presents the consolidated budget execution of all SOEs under its supervision.

**Other key SOE reports.** At the end of the fiscal year, SOEs are required to provide a comprehensive annual report to SEPI. As part of this global evaluation, which is submitted for approval to the Directive Committee of SEPI, it is determined which proposals will be submitted for authorization to the Administrative Council of SEPI. This includes proposals on functions and operations of the companies, which subsequently will be submitted to the respective General Shareholder Meetings. Furthermore, SEPI evaluates the work of the management team of the enterprises during the past fiscal year. Specifically, the achievement of the objectives set for the companies in the POA-PL is used for the application of the incentive system (that is, the award of a variable portion of the salary to the management teams).

### **SOEs Boards of Directors and Management**

**As established in Law 5/1996 (Art. 15), SEPI is headed by a President and its Administrative Council (*Consejo de Administración*).** The President of SEPI is appointed by the government, as nominated by the Ministry of Finance and Public Administration, and is considered a high-level

**FIGURE II.5: SEPI's Organizational Structure**



position. His or her remuneration is set by the government. The board of directors is composed of the president and a maximum of 15 board members, who themselves nominate up to two vice-presidents from among their number.<sup>146</sup> The council members are nominated by the MHAP based on proposals by other ministries. Usually, the counsels are political designees holding high level public posts (State Secretaries, Undersecretaries and General Directors) and represent the ministries linked to the activity of the company. With the exception of the president and the vice president, the members of SEPI's board do not receive compensation for attending the board meetings.

**In general, the functioning of the boards of directors of public enterprises is regulated by public commercial law<sup>147</sup> and does not have a specific body of regulation that applies to it.** Some characteristics common to the boards of SOEs under SEPI are laid out below:

- **Board Composition:** State representation in the board of SOEs is proportional to the ownership of the SOE. The most common proportion of public participation is 100%, sometimes accumulated through different public institutions, e.g. participation by the Ministries of Industry or Agriculture. There are no independent board members, with the exception of some of the SOEs in the SEPI Group which have private minority shareholders represented at the board. Also, in some enterprises, unions have representation on the board by agreement with the particular enterprise.



In 2012, the government established by law a maximum number of board members for all SOES.

- **Nomination:** The members of the boards of public enterprises under SEPI are typically proposed by the relevant ministry, and then officially appointed to the respective boards by the Ministry of Finance and Public Administration. SEPI's board then communicates this appointment to the board of directors of the respective company.
- **Meetings and Regulation:** The legal framework governing commercial enterprises requires the boards to meet regularly and at least for the discussion of the annual statements.
- **Board Evaluation:** There is no formal board evaluation.
- **Remuneration:** Board members are not remunerated, except stipends to defray the cost of attendance. In the cases of high-ranking officials (General Director and above), the remuneration is not received by the member of the board, but transferred to the Treasury.

**In the case of very senior management staff (President, Vice President, and SEPI Executives), the government sets their maximum remuneration.** As explained above, the president of SEPI is the only manager directly appointed by the government. The directors of the SOEs are nominated by their respective boards, based on the proposal of SEPI's Board. SEPI and SOE management staff members are recruited through the same mechanisms as other private companies, and the lower-level employees of SEPI and its enterprises are hired through public recruitment processes.

## Auditing of SOEs

**SOEs are subject to the same auditing mechanisms as the rest of the public sector.** External audits on economic and financial issues are performed by the Office of the State Comptroller (IGAE) and the Court of Auditors (*Tribunal de Cuentas*); and audits on labor relations are performed by specific commissions (*Comisión de Seguimiento de la Negociación Colectiva* and *Comisión Interministerial de Retribuciones*—CECIR). As a result, the companies are subject to very stringent audit mechanisms.

**The legislative branch also exercises an oversight function in several different ways.** One the one hand through the legislative committees' *ad hoc* oversight. Both legislative chambers and/or any parliamentary group may request the presence of SEPI and SOE representatives to discuss issues related to their performance. Furthermore through financial oversight, SEPI and the SOEs are required to submit economic and financial information to the legislature on a regular basis. Finally, the European Union, through

specialized committees, controls SOEs' performance on issues concerning sector-specific policies and anti-competitive practices.

## II.6.4 Reform Initiatives

**Over the last two decades, the role and importance of SOEs in Spain decreased notably due to the privatization process that started in the early 1980s.** Between 1982 and 1996 public stakes in 70 enterprises were sold, and in some cases the state pulled out completely. The privatization process accelerated in 1996, when the government approved a cabinet agreement which organized and regulated the procedures for the selling of shares in public companies. Between 1996 and 2009, shares from 60 companies were sold, bringing in some 34 million euros. These sales included significant disinvestments in all major state monopolies and affected some of the largest national companies in Spain.<sup>148</sup>

**The creation of SEPI and the consolidation of results-based SOE oversight (1997–2004).** The reform of SOE oversight in the 1990s and 2000s has been led by both the Ministry of Industry and the Ministry of Finance. SEPI was created as a public-law entity by decree in 1995; its status was then protected by law in 1996. A notable event in the evolution of SEPI was the decision by the government to restructure the public enterprise sector through government agreements.<sup>149</sup> Since then, and through succeeding legal reforms, other enterprises and corporations were transferred to SEPI and given possession of minority participation in some companies in strategic sectors (electricity, gas).

**SEPI was put in charge of supervising a portfolio of SOEs that supposedly performed under competitive and unregulated markets.** To succeed in that environment, SEPI requested the firms to implement a results-based management focus. Within this framework, the industrial policies remained under the control of the line ministries, the regulating authority was implemented by technically savvy autonomous regulating agencies, and SEPI was in charge of supervising the financial management and performance of the supervised firms.

**The key legislation reforming SOE oversight in Spain was promoted by European Union directives which were in turn incorporated into the government's strategy.** Initiated by the Ministry of Finance and approved by Congress, the new legal framework for SOE oversight established lines of accountability, and mechanisms for enforcing these; both from SOEs to SEPI, and from SEPI to the rest of government, including the Ministry of Finance, the Wage Bill Inter-Ministerial Committee, the

Advisory Committee on Privatizations, Parliament, and the Court of Accounts/Auditors. The progressive reform of SOE oversight took almost two decades (1983–2001) to complete the transformation of the institutional regime into a results-based management framework governing SOEs in competitive markets.

**The European Union has played a fundamental role in pushing forward reform of SOE portfolio management.** During the 1980s and 1990s, European institutions and treaties transformed the role of the state in the economy. New directives and agencies were established to ensure the protection of the single market and guarantee fair competition within sectors, which forced EU members to adapt their national legislation. The resulting EU guidelines enacted in the last two decades promoted the restructuring (or privatization) of uncompetitive SOEs, the removal of subsidies for SOEs, the establishment of a results-based approach to SOE management, and the rationalization of regulatory frameworks. Finally, the EU also added an additional layer of public oversight of SOEs, by stipulating that SEPI, the public holding, would be accountable to EU agencies in charge of sector regulation and the guarantee of fair competition.

**The latest reforms of the public enterprise sector have been taken up by the government in 2010 and 2012.** These efforts have included the approval of regulation establishing the close-out of some companies and the sale of others, as well as the transfer of an important SOE to SEPI—the postal company *Grupo Correos y Telégrafos* in March 2012.

**The analysis here has focused on those companies under SEPI oversight.** However, an important number of SOEs in the Spanish public enterprise sector remain under direct ownership of the central administration, either through the MF or sector ministries. The main challenge for the government in the area of corporate governance is to continue developing and adopting measures that could benefit a much broader set of SOEs.

## Notes

136. This work only focuses on SOEs linked to the central administration.
137. The figures are for 2010 and were calculated using official data obtained from the Ministry of Finance.
138. The public enterprise sector is defined by the National General Budget Law 47/2003, art. 3.
139. See [www.igae.pap.minhap.gob.es/sitios/igae/es-ES/ClnInvespe/Paginas/invespe.aspx](http://www.igae.pap.minhap.gob.es/sitios/igae/es-ES/ClnInvespe/Paginas/invespe.aspx) for more information on the structure of the central administration.

140. In 2006, the public entity RTVE declared bankruptcy (under the supervision of SEPI) and the *Corporación de Radio y Televisión Española S.A.*, was founded.
141. A complete list of companies in the SEPI group is shown in Annex E.
142. The institutional framework and the oversight mechanisms described in the next sections are those that apply to SOEs under the supervision of SEPI.
143. This law was then partially modified by the following: Law 13/1996, on fiscal and administrative matter; Decree-Law 15/1997; Law 66/1997, on fiscal and administrative matters and social order; and Law 20/2006.
144. In some cases those operations require a previous administrative authorization. Also, the maximum debt level for SEPI is determined annually in the government's Budget Law.
145. <http://www.igae.pap.minhap.gob.es>.
146. In early 2013, there was only one vice president.
147. Through the *Ley de Sociedades de Capital (Real Decreto Legislativo 1/2012, July 2)* and *Normativa reguladora del Registro Mercantil*.
148. These companies remain large, and have grown to become large-scale multinationals such as Repsol (oil production and distribution), *Telefónica* (telecoms), Iberia (national airlines), ARCELOR-MITTAL (steel industries), Endesa (electricity production and commercialization), *Red Eléctrica de España* (electricity distribution), and ALTADIS (tobacco production and distribution).
149. Through the *Ley de Patrimonio de las Administraciones Públicas (Ley 33/2003, de 3 de noviembre)*.



## CHAPTER II.7

# The Case of Uruguay



### II.7.1 State-Owned Enterprises Portfolio

**State-Owned Enterprises (SOEs) play a major role in Uruguay.**<sup>150</sup> A few key items of information confirm their relevance in the economy. SOEs employ around 35,000 people (2.3 percent of total employment in Uruguay and 16.8 percent of public sector employment); SOE aggregate current expenditures are approximately 12 percent of GDP; and total capital expenditures amount to roughly 1.7 percent of GDP.<sup>151</sup>

**There are about 15 significant SOEs in Uruguay that operate in both competitive and non-competitive markets.** Their activities are concentrated in the oil, electricity, telecommunications, financial, water and sanitation, and infrastructure sectors. The six largest SOEs in Uruguay (measured in terms of employment and current expenditures) represent nearly 70 percent of the SOE sector. Table II.17 below shows several indicators that describe the relevance of these companies in the economy.<sup>152</sup> Current expenditures of the state-owned oil company *Administración Nacional de Combustibles, Alcoholes y Portland* (ANCAP) amount to 6 percent of Uruguay's GDP

**TABLE II.17: Significance of the Six Largest SOEs in Uruguay**

Name	Sector	Employment	SOE Current Expenditures As % of	
			GDP	Gov. Current Expend. (*)
Administración Nacional de Combustibles, Alcohol y Pórtland (ANCAP)	Oil	2353	6.0%	29%
Administración Nacional de Usinas y Transmisiones Eléctricas (UTE)	Electricity	6150	2.6%	16%
Administración Nacional de Telecomunicaciones (ANTEL)	Telecommunications	6034	1.7%	10%
Banco República (BROU)	Finance	4279	1.1%	5%
Obras Sanitarias del Estado (OSE)	Water and Sanitation	4605	0.6%	4%
Administración Nacional de Puertos (ANP)	Infrastructure (port administration)	1087	0.2%	1%
<b>TOTAL</b>		<b>24508</b>	<b>12.1%</b>	<b>65%</b>

(\*) Central government current expenditures.

and almost 30 percent of central government current spending; in the electricity sector, current expenditures of the State Power & Electricity Utility (*Administración Nacional de Usinas y Transmisiones Eléctricas—UTE*) are approximately 2.6 percent of GDP and 16 percent of government spending; and in the telecommunication sector, ANTEL's current expenditures represent 1.7 percent of GDP and 10 percent of government spending. Aggregate expenditures by SOEs operating in other sectors represent around 2 percent of GDP.

## II.7.2 Ownership Function: Institutional Framework and Organization

**The ownership function of SOEs<sup>153</sup> in Uruguay is based on a hybrid model, which combines several aspects of both the centralized and dual arrangements.** The Office of Budgeting and Planning (*Oficina de Planeamiento y Presupuesto*—OPP), along with the Ministry of Finance (MF), sector ministries, and, in some cases, other autonomous control agencies, are jointly responsible for SOE oversight.

**SOEs enjoy some budgetary and financial autonomy.** However, they still report all economic and financial decisions and ongoing SOE business documentation to the OPP, which is in charge of the public sector general planning system. The OPP is directly responsible to the President of the Republic; its director holds the same rank as a minister, and maintains direct communication with ministries and other government entities. Its director, however, in contrast to other ministers, is exempt from parliamentary questioning. OPP advises the president on various economic and technical issues, and jointly with the MF and the sector ministries is responsible for the national budget and assessing budget performance.

**OPP is directly linked to SOEs through its Department of Public Enterprises (*Departamento de Empresas Públicas, DEP*).**<sup>154</sup> The main tasks of this department include: (i) to generate budgetary and policy guidelines<sup>155</sup> that SOEs should follow in the preparation of their budgets; (ii) to examine and approve the budgets proposed by SOEs; (iii) to collaborate in the preparation and monitoring of management agreements signed between the Executive and SOEs; (iv) to examine SOEs' fee structures; (v) to modify and adjust SOEs' organizational and compensation structures; (vi) to examine SOEs' balance sheets; (vii) to assess SOEs' investment projects whose costs exceed a certain minimum threshold; and (viii) to collaborate in the preparation and monitoring of financial programs.

**The MF also plays a role in the supervision of SOEs.** MF sets, through its Macroeconomic Advising Unit, the macroeconomic guidelines that the OPP (and, consequently, SOEs) should follow in developing their investment plans. Given the significant fiscal impact of SOEs' aggregate operating results, and to ensure that SOEs work within the government's financial program established by both the five-year budget plan and the annual budget reviews (*Rendición de Cuentas*), MF along with OPP (through DEP), also monitors the financial position of SOEs on a monthly basis.



## II.7.3 Accountability and Oversight Mechanisms

### Statements of Objectives & Planning Documents

**Management/performance contracts.** The use of management and performance contracts in Uruguay is still in early stages of development. The Constitution of Uruguay (articles 221 and 231) establishes general guidelines for the use of performance indicators and performance agreements, and approves the use of a variable pay scale depending on performance. The government, through DEP, has been working in recent years on the implementation of performance agreements between the government and those SOEs<sup>156</sup> which receive subsidies to their general income. The contracts drafted by DEP specify a series of financial and non-financial or operating performance indicators, such as indicators that assess the provision of services, and indicators that evaluate internal management (human resources, control systems, technical aspects, etc.). These contracts also include penalties for poor performance: the board may be pressed to resign, board members may not be entitled to incentive payments, and the government may deny financial assistance and/or support for access to external financing. Furthermore, DEP is developing a variable compensation system which implies improved compensation subject to the achievement of global, sector, and individual goals.

**Budget formulation and approval.** Uruguay's National Constitution and its associated current legal framework allow for a multiplicity of budget formulation and approval mechanisms, depending on which entity is involved.<sup>157</sup> SOEs are considered "decentralized services," and as such, they prepare their own budget annually, which is then submitted for evaluation to OPP. Once the evaluation report has been prepared, the budget proposal is approved by the executive branch, which requires signatures from the appropriate sector ministry, the Ministry of Finance, and the President of the Republic. The Parliament intervenes only to resolve eventual disagreements that may arise in the course of this approval process. Those disagreements could stem from various interests of the executive branch or the legal mandate of the Court of Auditors. If within 40 days, the Parliament does not issue a statement, then it is presumed that observations of the Court of Auditors are lifted, and that any observations issued by the executive branch will prevail.

**Multi-annual investing and planning.** Every SOE is required by law<sup>158</sup> to prepare long-term investment and financing plans. These reports should contain an explanation of plans, goals, and projects, extending through the current government's mandate. However, OPP requests SOEs to prepare

five-year plans on a rolling annual basis. This information is submitted to OPP and the corresponding sector ministry for approval. A similar approval mechanism applies to ongoing investments, contracts, asset sales, and tariff structures.

## **Reporting: Monitoring of Performance & *Ex post* Disclosure**

**Budget execution reports.** All SOEs submit annual financial statements, including information on budgeted expenditures, revenues, assets and liabilities to the Accounting General Office (*Contaduría General de la Nación—CGN*), OPP, and the Court of Accounts (*Tribunal de Cuentas de la República—TCR*<sup>159</sup>), Uruguay's Supreme Audit Institution. Additionally, given the fiscal importance of SOEs operating results, there is continuous internal reporting on actual financial results between each SOE, the Ministry of Finance, and OPP.<sup>160</sup> SOEs publish at the companies' website their annual financial statements, net worth, and aide memoires.<sup>161</sup>

**SOEs are subject to a uniform accounting regime, essentially the same as that applied to private companies, including the requirement to report according to the 2003 version of IFRS.** SOEs in Uruguay enjoy special privileges under the Constitution, including operational autonomy *vis-à-vis* the government. They are governed by statutes or bylaws specific to each entity and also fall within the scope of the laws on public sector accounting and auditing. Article 211 F of the Constitution empowers the Court of Accounts with accounting standard-setting authority in relation to SOEs. In December 2002, the TCR issued Ordinance no. 81, *Preparation and Presentation of Financial Statements*, which mandates accounting standards. The upshot of this ordinance is that, with the exceptions already mentioned, in practice SOEs report under the 2003 version of IFRS.

**The 2006 Report on the Observance of Standards and Codes (ROSC) examines reporting practices followed by a sample of four SOEs.** The report focuses on financial statements audited under Ordinance 81. The report concludes that the overall presentation of SOEs' 2004 financial statements is good. The following detailed comments were also indicated:

- *Comparative information:* Unlike most private companies reviewed, Uruguayan SOE financial statements present comparative information and had a very user-friendly lay out.
- *Audit reports:* Two companies did not publish their audit reports even though such audits did take place.
- *A number of disclosures required by IFRS were missing:* cash and cash equivalents, employee benefits, details of foreign exchange gains and

losses, interest rate for borrowing costs capitalized, compensation for management, risk management policies (IAS 32), and relevant explanations on contingent liabilities.

- *Impairment of assets:* Except in one case, the financial statements did not indicate whether assets had been tested for impairment, and if loss of value had been recognized.
- *Other:* In one case, loans were not carried at amortized cost and other financial instruments were not measured at fair value, as required by IAS 39. Moreover, one company made no tax allocation (in equity) to a transaction recognized in equity.

## Auditing of SOEs

**Under Uruguay's Constitution, the body charged with the annual control over SOE financial management and reporting is the TCR.** TCR regulations mandate the use of international standards of accounting and audit.<sup>162</sup> Its role has traditionally focused on verifying the legal conformity of expenditures with budget appropriations made by the Congress. TCR does not have the ability to sanction SOEs or their auditors; its monitoring activity is limited to pointing out problems uncovered by the audit.

**Most SOEs in Uruguay hire independent professional firms to conduct an external and independent audit even though they are not required by the companies' bylaws.** The majority of SOEs choose to have their financial statements reviewed by one of the four largest international audit firms to assure better compliance of the audit with international standards.<sup>163</sup> More recently, the TCR has begun to conduct external audits of SOE financial statements as well. Although some level of coordination exists between the TCR and private auditing firms, there is much room for improving their coordination. One of the main issues has to do with the timing of TCR's audits, which usually end later than those of their private counterparts.<sup>164</sup> The independent external auditor's opinion and report are published by the SOEs at their websites, alongside the annual financial statements. Publication of audit reports in the official gazette, the "*Diario Oficial*," is mandated by law.<sup>165</sup>

## SOEs Boards of Directors and Management

**Article 185 of the Constitution establishes that state-owned industrial and commercial services are to be managed by boards.** The article

also states that board members shall be appointed by the President in consultation with the Council of Ministers, and approved by the Senate.<sup>166</sup> In practice, the appointment of SOE board members has usually been shaped by political concerns, hindering the implementation of effective accountability arrangements in these organizations.

**SOE boards were previously all composed of five members, but some companies have recently modified their bylaws to reduce this number to three.** Traditionally, the political arrangement is that the majority party in Parliament appoints 60 percent of members, and the opposition appoints the rest. Boards are majority or 100 percent executive, which has some shortcomings. First, top management is changed with each government election, and has a limited opportunity to specialize in the job. Second, it is not possible for the board to exercise the usual oversight function on management.

**Most SOE boards in Uruguay do not form specialized committees.** There are some exceptions, such as the Bank of the Republic (*Banco de la República Oriental del Uruguay*—BROU), whose board has planning, credit approval, and audit committees. In general, the respective sector ministries and government agencies wield considerable influence over decision-making by SOE boards. Boards do not seem to fully engage with, or benefit from, their relationship with auditors. For example, directors do not engage in regular contact with the external audit team, delegating instead such communication to the government audit agency, and do not actively monitor the accounting, audit, and control processes.

## II.7.4 Reform Initiatives

**Since 1992, a series of reforms were introduced in the Uruguayan public sector, including the privatization of several SOEs.** At the same time, other reforms were proposed to improve accountability and transparency in the public sector, including SOEs. These included the implementation of a program oriented budgeting including the definition of precise objectives and goals, and performance agreements, and variable remuneration scales depending on performance.

**However, most of these reforms have not addressed the fact that SOEs are subject to public sector law with the consequence that several SOEs have created corporations operating under private law to achieve their objectives.** Examples include the construction of a sanitation and

rainwater system in Ciudad de la Costa, a regasification plant, and an energy conversion project with Brazil. In the last few years, Uruguay has initiated a drive to boost SOE efficiency by introducing a few important changes:

- SOEs are now subject to international accounting and reporting standards;
- It is now mandatory that SOEs undergo an external audit;
- Some monopoly rights have been relaxed; and
- The DEP has started to design a model to systematically evaluate the performance of all SOEs.

### **Challenges Ahead**

**The level of professionalism of SOE board members and the follow-up of audit recommendations are two areas that require further attention.** The level of professionalism of SOE board members could be strengthened even further. Effective boards are difficult to achieve, even in the private sector, and require training, legally binding imposition of duties and liabilities, and business expertise. The Uruguayan government has recently begun to address this issue by supporting the appointment of SOE board members with a higher degree of technical formation. It is also extremely important to follow up on all significant issues reported by auditors, and monitor their timely resolution. Mechanisms should be introduced to ensure that observations raised by auditors (internal and external) are properly and promptly addressed by SOEs.

**Other more general issues related to SOE ownership structure present some challenges that would also need to be addressed.** SOEs' decisions are sometimes constrained by political factors; this undermines SOE governance, and may lead to sub-optimal outcomes in terms of performance and competitiveness. Additionally, the fact that several ministries or other government agencies exercise authority over SOEs may result in the issuance of conflicting objectives for these countries. As a result, SOE management may not receive a clear set of performance goals, and therefore may not be held accountable for the company's performance. Lastly, the government typically performs several roles *vis-à-vis* SOEs (owner, regulator, supplier, customer, financier, etc.). These roles need to be disentangled, and insulated from one another. Other countries have addressed this issue by creating a single government agency in which SOE oversight (and frequently

the ownership function as well) is consolidated. This agency is empowered to appoint the board of directors, as well as to exercise control over the SOE's business.

## Notes

150. This work only focuses on SOEs linked to the central government and regulated by public law (autonomous entities and decentralized services). There are no subnational public enterprises.
151. The figures are for 2010 and were calculated using official data obtained from the Ministry of Finance.
152. Additional information about these companies is shown in Annex E.
153. These entities are collectively referred to as *Entes Autónomos y Servicios Descentralizados del Dominio Comercial e Industrial del Estado*, Article 221 of the Constitution.
154. OPP's activities focus on five main areas: Public Budgeting, Public Enterprises, Regional Policies, Development Strategies and Investment Policies, and State Management and Performance Evaluation.
155. The policy guidelines are determined by the executive through sector ministries and MF.
156. Article 752, Law 18.719 requires of the use of performance agreements. The law also establishes that these contracts should be supervised by OPP and MF.
157. For example, the Constitution requires a 5-year budget for the central government and a yearly budget for SOEs and other decentralized entities. However, Law 16211, Art. 4, establishes that decentralized services and autonomous entities (with the exception of BROU, BCU and BPS) are responsible for preparing an "informative report" containing information about plans and goals for the following five years. For SOEs, Article 221 of the Constitution of the Republic is applied.
158. See previous footnote.
159. The TCR is the supreme audit institution and is independent of the executive branch of government. The President of the TCR is appointed by the legislative branch.
160. Budget execution is monitored using the information collected through an integrated financial information system (SIIF). SIIF allows OPP and MF to examine SOEs' financial situation and assess their compliance with the government financial program on a monthly basis.
161. For example, information on ANCAP can be found at <http://www.ancap.com.uy/>.
162. Ordenanza 81 of the Tribunal de Cuentas (TCR).

163. KPMG, Deloitte, PricewaterhouseCoopers, and Ernst & Young are the largest four audit firms. It should also be noted that, as in many other countries in the region, these international accounting firms tend to dominate the market for audit services in Uruguay. SOEs typically contract external auditors for two- to three-year engagements, with the option to renew.
164. TCR's monitoring activity is limited to pointing out problems they have uncovered in the course of conducting an audit; it lacks the ability to impose sanctions on SOEs.
165. <http://www.impo.com.uy>.
166. National Constitution article 187. Directors are appointed by the Executive Branch with 3/5ths approval by Parliament.

## CHAPTER II.8

# Leading SOEs: The Cases of the Panama Canal and PEMEX



### II.8.1 Introduction

**This chapter examines the models of corporate governance adopted by two large SOEs: the Panama Canal and PEMEX, the Mexican state-owned oil company.** Even though these two companies operate in completely different sectors, both play leading roles in their respective economies: the Panama Canal generates revenues that amount to 8 percent of the country's GDP and represent 10 percent of government's revenue, while PEMEX's sales are nearly 9 percent of Mexico's GDP and generate one third of government revenues.

**Given their economic significance, the performance of the companies is under permanent public scrutiny, and the assessment typically falls on the models of corporate governance chosen to organize their activities.** At the same time, and due to the characteristics of the markets where they operate, these companies also face significant global exposure, which obliges them to implement corporate governance practices consistent with international standards.

**The practices adopted by these two companies show some clear differences.** Moreover, each model presents a few novel features. For instance, the Panama Canal's management is supported by the expert opinion of an



Advisory Board. This Advisory Board complements the work of the Board of Directors, and is formed by highly recognized international professionals in the area of global maritime transportation. PEMEX, for its part, was legally authorized in 2008 to issue “citizen bonds,” which are debt securities that grant their holders a return linked to the entity’s performance. The implementation of this type of financial instrument is intended to, among other things, encourage citizens’ interest in the company, and, consequently, to add another layer of oversight to the company’s supervising structure.

**Given the nature of the SOEs involved, the organization of this chapter slightly departs from the previous ones.** Section 8.2 characterizes the institutional framework that supervises and regulates the activities of the Panama Canal, and briefly describes some of the corporate governance practices implemented in that company, focusing on accountability, transparency, information disclosure, and audit. Section 8.3 presents the case of PEMEX and follows a similar organization.

## II.8.2 The Case of the Panama Canal

### Background

**The Panama Canal is approximately 80 kilometers long and connects the Atlantic and Pacific Oceans.** It first opened on August 14, 1914, and provides transit service to vessels of all nations: approximately 14 thousand vessels navigate the Canal every year. Commercial transportation activities through the Canal represent approximately five percent of the world trade. Most of the traffic through the Canal moves between the east coast of the United States and the Far East. Movements between Europe and the South American coast constitute the second major trade route using the waterway. The Canal is also vital for the development and trade of neighboring countries of Central and South America.

**The Canal makes various significant contributions to Panama’s economy.** Its workforce is composed of approximately 9,000 employees; traffic through the Canal generates a net income that represents 6.2 percent of Panama’s GDP; a fraction of that net income is directly transferred to the National Treasury (an amount that represents 3.9 percent of the GDP or 8.0 of the central government’s revenue); it also contributes to the government’s finances through taxes, social security tax, and the educational insurance tax (0.84 percent of GDP or 1.75 percent of the central government’s revenue); and the Canal’s activities amount to 4 percent of the country’s total exports. Table II.18 below summarizes these indicators.

**TABLE II.18: Economic Contribution of the Panama Canal**

	<b>As % of GDP</b>	<b>As % of Central Gov. Revenue</b>
Net Income	6.20	
<i>Total Revenues</i>	8.60	
<i>Total Expenses</i>	2.40	
Direct Contribution to National Treasury	3.90	8.00
Indirect Contribution to National Treasury	0.84	1.75
<i>Income Tax</i>	0.20	0.45
<i>Social Security</i>	0.04	0.08
<i>Educational Insurance Tax</i>	0.60	1.22
Total Exports	4.00	

Source: Canal de Panamá, 2011 Annual Report.

## Institutional and Organizational Framework

**The Panama Canal constitutes an inalienable property of the Republic of Panama, which means that it may not be sold, mortgaged, or transferred.** The model of corporate governance chosen to administer its operations includes:

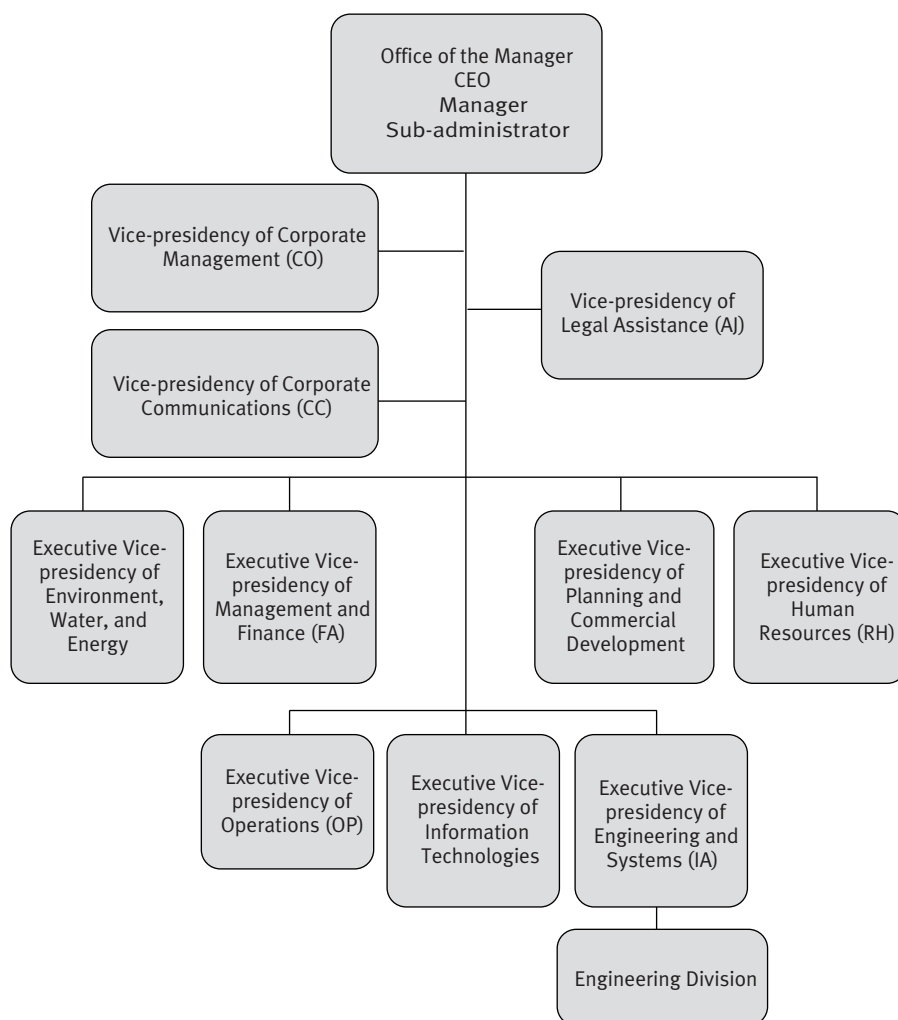
- The Panama Canal Authority (*Autoridad del Canal de Panamá—ACP*) established under Title XIV of the National Constitution of Panama (the ACP’s constitutional mandate serves to protect it from political interferences);
- A Board of Directors formed and appointed in accordance with internationally recommended principles and standards;
- The Director of the Canal Authority is also the President of the Board of Directors, holding the rank of Minister of State for Canal Affairs, and serving as the ACP’s effective nexus with the government;
- A layer of management and administration that is independent of the board;
- An independent Advisory Board formed by Canal users, knowledgeable parties, and specialists in maritime transportation.

**Panama Canal Authority (ACP).** The ACP is the entity that exercises the ownership function on behalf of the Government of Panama. Title XIV of the National Constitution grants ACP an exclusive mandate to operate, administer, manage, preserve, maintain, and modernize the Canal, as well as its

activities and related services. The Organic Law of June 11, 1997, provided ACP with the legal tools to set up its organization and operation. ACP is financially autonomous, owns its assets, and has the right to administer them.

**ACP is headed by an Administrator and a Deputy Administrator under the supervision of a Board of Directors.** The Administrator is the highest-ranking executive officer and legal representative of the Authority, and is responsible for its administration and the implementation of the policies and decisions of the Board of Directors. The Administrator is appointed for a seven-year term, and may be re-elected for one additional term.

**FIGURE II.6: Organizational Chart of the ACP**



**Board of Directors.** The ACP Board is responsible for establishing policies for the operation, improvement, and modernization of the Canal, as well as supervising its management. The board of directors is formed by eleven members, who are appointed as follows:

- Nine directors are appointed by the President of the Republic of Panama, with the consent of the Cabinet Council, and ratified by an absolute majority of the members of the Legislative Assembly;
- One director is designated by the legislature, and may be freely appointed or removed by that branch;
- The President of the Republic designates one director, who chairs the board of directors. The director has the rank of Minister of State for Canal Affairs. The Canal Affairs Minister attends Cabinet Council meetings, having the right to voice and vote; and
- The directors serve for nine years.

To ensure independence from political influence, members of the first board of directors were **appointed** for overlapping terms.

**Advisory Board.** In December 1999, the Panama Canal Authority established the advisory board. The advisory board serves as a consultative body for the Canal enterprise. Its main responsibility is to provide guidance and recommendations to the Board of Directors and the Canal administration. The Advisory Board is formed by highly recognized professionals with broad experience in maritime transportation, trade, business, telecommunications, construction and development, academia, and the banking sector. There are no citizenship requirements for members of the advisory board: both Panamanian and non-Panamanian citizens are eligible.

**The Panama Canal Authority Board of Directors makes the appointment of the Advisory Board members for an initial period of two years.** This period can be extended at the discretion of the board of directors. The advisory board meets at least once a year, at the request of the board of directors.

## **Accountability, Transparency, and Disclosure of Information**

**The good economic performance of the Panama Canal is based, among other things, on the implementation of key accountability tools.** Those tools include a reliable accounting system, a clearly defined financial planning and budgeting process, high reporting standards, an adequate risk management policy, and effective oversight mechanisms.

**Accounting System.** The accounting system includes the necessary internal controls to assure that assets are protected; disbursements are duly

approved and supported; revenues applicable to the assets and operations of the authority are charged and accounted for properly; and financial reports are reliable and timely.

**Financial Planning.** The administration operates under a regime of planning and financial administration for a period of three years, with annual implementation and control. However, given the nature of the activities developed by the company, longer projection periods are usually considered at the planning stage. The Administrator organizes and coordinates the marketing strategy and marketing of the Canal in accordance with the guidelines dictated by the board. New activities are backed by a cost-benefit analysis, then approved by the board.

**Budgeting.** The Administrator prepares a draft of the annual budget according to financial planning policies adopted by the board of directors. The Administration also issues frequent reports about ongoing activities and projects, and the implementation of other aspects of the budget. The Administrator submits a draft of the annual budget for consideration by the board at least five months before the beginning of the next fiscal year. Once approved by the board, the Administration submits the draft for consideration of the Cabinet Council at least three months prior to the beginning of the next fiscal year. The budget is executed by the Administration, with internal control exercised by the authority designated by the Board of Directors. The Comptroller General of the Republic only exercises *ex-post* control and audit functions.

**Reporting.** ACP requires the Canal administration to prepare (unaudited) quarterly and semi-annual interim financial statements, and an annual report. The Board of Directors reviews this information, and may require the preparation of additional reports at their discretion. The annual report includes financial information (balance sheet, income statement, cash flow report, and complementary notes, management reports, and explanatory material describing the financial position of the company, as well as the risks that it faces), and information about the Canal's operations and projects. All of these reports, in addition to the audit results for those subject to audit, are available online at the Canal's website.<sup>167</sup>

**To increase accountability and promote transparency, the ACP also discloses other types of information.** For instance, the Administration reports salary of every employee, as well as foreign trips by staff and associated expenses. Furthermore, the ACP publishes an ethics and conduct code for ACP and its staff (*Reglamento de ética y conducta de la Autoridad del Canal de Panamá*). This document provides a comprehensive framework for a code of good conduct with clear definitions; overall ethical principles, particularly regulations for top executives; a guide for conducting internal

activities as well as relations with external parties; and other information such as guidelines for the availability of reports. The ACP has made all these mechanisms available for the public on its transparency section on its website.<sup>168</sup>

**Risk Management.** The Administration is also in charge of assessing the financial outlook of the company. The Board of Directors is responsible for establishing and monitoring risk management policies so that the Canal's profitability can be improved without significantly increasing risk. The main risks identified are:

- *Market Risk:* The Administration is authorized to sign hedging contracts to mitigate exposure to volatility in commodity prices related to the operation, maintenance, and expansion of the Canal and capital investments, interest rates, and exchange rates.
- *Credit Risk:* The company is allowed to invest its funds in short-term investment grade instruments.<sup>169</sup> Article 43 of the Financial Regulations sets the parameters for the investment of assets of the institution. It states that it should be done through highly negotiable short-term financial instruments and can only be placed in banks and financial instruments, with credit ratings of no less than A-2 Standard & Poor's, P-2 by Moody's Bank Deposit Ratings or F-2 by Fitch Ratings.
- *Liquidity Risk:* The company funds its regular operations and investments with its own resources. As a consequence, it has to monitor on a daily basis the availability of liquid funds to meet its cash obligations with suppliers, contractors, employees, and the state.
- *Operating Risk:* The Panama Canal mitigates operating risk through internal controls, quality management systems and routine audits performed by the Office of the Auditor General, and the Comptroller General of the Republic. The internal control system provides reasonable assurance that ACP properties, assets and other financial resources are properly used and safeguarded to prevent waste, damage, destruction, and misappropriation.

## **Audit Mechanisms**

**The internal monitoring and control system of the Canal is assigned to the Auditor General.** The board of directors also hires external independent auditors. The Office of the Comptroller General is in charge of reviewing all acts (*ex-post*).

**Every year, the Administrator submits to the Board the company's financial statements for their approval after review by an external**

**auditor, within three months after the end of the respective fiscal year.**

Nonetheless, the financial statements (even if they have not been audited) are required to be made available to the Board upon request. The Board evaluates the accounting principles and estimates that have been employed by the Administrator in preparing the budget.

**The procedures for external audit follow international standards and the report includes an opinion about the accuracy of the financial statements.** This provides a reasonable assurance that financial statements are free of significant errors, and are presented in accordance with international accounting standards. The Auditor General is responsible for evaluating the quality of the external audit.

## II.8.3 The Case of PEMEX

### Background

**PEMEX holds exclusive rights to exploit and manage Mexico's oil and gas reserves since the nationalization of these resources in 1938.**<sup>170</sup>

From an institutional standpoint, PEMEX is a decentralized public body of the Mexican Government. It is a vertically integrated company, whose legal mandate is to commercialize oil and oil by-products, and to satisfy the national demand for oil.

**Since its creation, PEMEX has been one of the major pillars of the Mexican economy.** For instance, PEMEX's total sales amount to almost 9 percent of Mexico's GDP; its exports represent 4 percent of the GDP; and it contributes to the government's finances by generating 30 percent of the government's total revenue. Moreover, PEMEX is the only producer of crude oil, petroleum and natural gas in the country; and the sole company responsible for the exploration and development of coal reserves. Furthermore, it is the only supplier of refined petroleum products (imports 40 percent of domestic consumption of gasoline); the main company in charge of hydrocarbon storage and transportation; and the sole provider of first-hand gas sales (regulated market).

**PEMEX is one of the most important oil companies in terms of its level of production, exports, and crude oil reserves.** Relative to other international companies, PEMEX ranks as follows:

- 11th producer of oil and gas;
- 3rd in crude oil production;
- 12th in oil reserves; 16th in gas production;

- 13th in refining capacity; and
- 35th in gas reserves.

## **Institutional and Organizational Framework**

**The 2008 Energy Reform.** The year 2008 marks the beginning of a new era for corporate governance at PEMEX. In October of 2008, the Mexican House of Representatives approved seven initiatives, which together made up what is commonly known as the Energy Reform. These initiatives defined new guidelines for the institutional framework in which PEMEX should operate. One of the fundamental objectives of the reform was to strengthen and modernize the company’s management by establishing a new corporate governance structure consistent with international practices. Some of the most salient features of the reform are:

- Strengthening corporate governance by granting the Board of Directors (*Consejo de Administración—CA*) greater autonomy and decision power.
- Professionalization of the board by bringing in four independent directors (*consejeros profesionales*).
- Creation of seven executive committees to support the board.
- Creation of an audit and performance evaluation committee (*Comité de Auditoría y Evaluación del Desempeño—CAED*) that is responsible to the board.
- Issuance of “citizen bonds.” Citizen bonds are debt securities that grant their holders a return based on the issuers performance. This tool served two functions: it provided a new source of funding for PEMEX, while also introducing a new mechanism of social oversight.
- The overhaul of regulation to grant PEMEX greater autonomy for taking on external financing, and issuance of debt in international markets.
- Establishment of a special procurement system, lease, public works, and services, which is more flexible, considers the complexities of the activities developed by PEMEX.

**Regulatory and institutional context.** The Energy Reform also overhauled the regulatory framework for PEMEX, and established more clear definition of responsibilities for all actors involved in the sector. Under the new regulatory framework the Energy Secretariat (*Secretaría de Energía—SENER*) is the chief authority for the sector and is in charge of setting sector policy. The Secretary of Energy is the President of the Board and the Undersecretary of Hydrocarbons serves as a member of the Board. The Finance and Public Credit Secretariat (*Secretaría de Hacienda y Crédito*



*Público*—SHCP) determines the macroeconomic framework used in the company's budget process, and sets the goal for primary and financial balance that must be met each year. The SHCP is represented on the board of the company by the Finance Minister.

**The reform created the National Commission of Hydrocarbons** (*Comisión Nacional de Hidrocarburos*—CNH). The CNH is a technical, decentralized body of the SENER, in charge of establishing technical guidelines for the exploration and production of hydrocarbons. The Energy Regulatory Commission (*Comisión Reguladora de Energía*—CRE) is responsible for the economic regulation of the “industrial processing” of hydrocarbons. The CRE is a decentralized body of the SENER, with full technical, operational, management, and decision-making autonomy. It is also a decentralized body of the SENER. The Secretariat of Public Administration (*Secretaría de la Función Pública*—SFP) sets the external auditor's annual audit program and monitors its implementation. The SFP reports to the Committee on Auditing and Performance Evaluation (CAED).

**Board of Directors.** The board of directors and a CEO lead and manage the company. The Board of Directors of PEMEX is composed of 15 members: six representatives designated by the Federal Government, including the President of the Board of Directors; five representatives of the National Oil Workers' Union and four “professional” board members.<sup>171</sup>

**Professional board members must meet certain requirements.** Members are expected to have a deep knowledge of the oil and gas industry; relevant experience as public servants; proven technical skills; and strong academic credentials. The appointment lasts for six years and can be renewed once. Professional board members have also been granted a differentiated “vote”: at least two professional board members should vote favorable on certain issues considered by the board. The appointment of professional board members does not coincide with the presidential term. The board meets every two months, with additional meetings taking place in extraordinary sessions if necessary to discuss special topics.

**The board's activities are supported by seven committees:** auditing and performance evaluation (CAED); strategy and investment (CEI); procurement, leasing and works and services (CAAOS); transparency and accountability (CTRC); remuneration (CR); development and technological research (CDIT); environment and sustainable development. State and professional board members participate in the committees, with their representation set at the proportions shown in Table II.19.

**TABLE II.19: Board Committees**

Committee	Board Members	
	State	Professional
Auditing and performance evaluation	4	3
Strategy and investments	4	1
Leasing, procurement, and works and services	4	1
Transparency and accountability	3	1
Remuneration	3	1
Research and development	4	1
Environment and sustainable development	3	3

Source: PEMEX.

**The representation in the committees is important for the decision-making of the board or Administrative Council.** The government representatives have the power to influence decision-making as the resolutions are approved with a simple majority of the members present.

The board is responsible for a number of key functions, including:

- Approving the budget, business plan, and operating and financial programs of the company;
- Reviewing and approving the annual report prepared by the CEO, which is then submitted to Congress; and
- Reviewing and approving the quarterly and annual financial statements, which are later made publicly available.

**The law grants the board an important role in the operation of PEMEX, which the board executes through its committees.** However, the latter has complicated even further the operations of the company: by allowing the board to be involved in daily decision-making processes, it has significantly hindered the company's operations. In many cases, the lack of business experience of some board members has caused unnecessary delays in important and urgent decisions.

**General Director or CEO.** The President of Mexico appoints the Director General or CEO of PEMEX, who, by law, must not be a member of the board. The board cannot dismiss the CEO; it is limited to recommending removal, but the President of Mexico or the board has the final say in whether to follow the board's recommendation. The CEO is by law<sup>172</sup> charged with

the duties to “implement the strategic plan” and “providing to the Ministry of Finance and Credit” budgetary and financial information required. The CEO is also in charge of PEMEX’s subsidiaries. In practice, however, there is no clear separation of responsibilities between the CEO and the board. The rest of the management team consists of four general directors (one for each of the four business lines), and five corporate directors.

### **Accountability, Transparency, and Disclosure of Information**

**Budgeting process.** The company initiates its budget cycle by presenting a business plan and a budget draft to the board. The figures in the final draft are calculated employing estimates of domestic prices and levels of production supplied by the company, while the government supplies the macroeconomic framework and financial and primary balance which inform the budget. Once approved by the board, the budget draft is submitted for consideration by the SHCP. By this time, the SHCP sets the level of domestic prices for the oil sector and current expenditures and investment ceilings. The financing of investment projects which have been registered with and authorized by the government are included in the budget at this stage. The final budget of the company is approved by Congress jointly with the approval of the central government’s budget. The drafting of the budget does not consider the use of performance indicators.

The final approval of the budget involves the following stages:

<b>Business Plan</b>	→	<b>Draft Budget Prepared</b>	→	<b>Preliminary Draft Sent to Congress</b>	→	<b>Final Project</b>	→	<b>Internal Project</b>
The company formulates the budget tied to the Business Plan. The CA approves.		Proposed by the company. Sent for approval to SENER and SHCP.		SHCP defines expenditure and investment ceilings, and reviews and integrates the company’s budget into the federal budget.		Congress approves the budget (Revenue Law and the Federal Expenditure Budget).		Company reallocates resources as needed.

**The Energy Reform granted the board more budgetary flexibility.** It can now approve its own annual budget, subject to only two requirements: (i) the deficit cannot exceed certain limits specified by the federal fiscal budget; and (ii) it cannot increase spending on staff and pensions.

**The new legal framework lays out a transition period of five years, to give a greater budget and financial autonomy throughout the year.** The

company's flexibility in managing its finances is subject to previously established rules on the maintenance of financial and primary balance.

**Reporting.** The company must prepare and submit the following reports:

- Quarterly financial statements: The reports should include total sales, tax payments, rights and land use, cost of sales and operating expenses, oil and natural gas production, international trade, assets and liabilities, and short- and long-term debt;
- Annual "Consolidated Financial Statements," information about the external auditor's reports;
- Bi-monthly and annual reports on the company's performance, prepared by the CEO and submitted to the board;
- Quarterly and annual reports on the company's performance, elaborated by the CEO and submitted to the Congress; and
- Annual report on short- and long-term debt submitted to the Congress.

**In addition, PEMEX annually publishes the following reports:**

Annual Report, Statistical Yearbook, sustainable development report; hydrocarbon reserves, minutes (*Memoria de Trabajo*), statistical report, collective labor agreement (every two years), and financial reports pertinent to its issue of bonds in the national and international markets.

## **Audit Mechanisms**

**Internal audit.** Internal auditors constantly monitor the company and support the external evaluations. The internal audit function is performed by two committees of the Board of Directors: the Transparency and Accountability Committee (*Comité sobre Transparencia y Rendición de Cuentas—CTRC*), and the Audit and Performance Evaluation Committee (*Comité de Auditoría y Evaluación del Desempeño—CAED*). These committees are joined by the Commissioner in addition to the Internal Control Agencies (*Órganos de Control Interno—OIC*).

**The CTRC determines what information should be published, ensures that reports are prepared to standard, and presents accountability mechanisms to the board.** The CAED assesses the financial and operative performance of the company, verifies the sufficiency of the information, and, when it deems necessary, orders specialized internal audits, among others. However, this committee does not define the work programs or the type of risks that should be monitored. The CAED is formed by three professional board members and is also responsible for choosing, monitoring, and evaluating a firm to perform the external audit.

**By law, the commissioner, who is directly appointed by the President of the Republic, is responsible for representing the interests of citizen bondholders.** It oversees and formulates an annual report on the accuracy, completeness, and rationality of the information submitted by the Board. The commissioner is also in charge of anti-corruption efforts and compliance with legal guidelines.

**As an entity within the public sector, PEMEX is subject to the control of the Federal Public Administration structure through the Internal Control Agencies (OIC) of the SFP.** There are five OICs whose members are appointed by the executive through the SFP. As part of their responsibilities, the OICs receive general complaints and complaints from breach obligations in the provision of public services, and are empowered to impose sanctions upon individuals that do not comply with laws and regulations.

**Internal audits have focused mostly on combating corruption.** While focusing on the company's compliance with laws and regulations, they do not assess the company's performance.

**External audit.** The *Auditoria Superior de la Federación* (ASF) is the Congressional oversight body. It is a highly professionalized body, with technical autonomy and management. The ASF monitors resources used by all federal public entities and audits their performance. The ASF audits the completed results for the full fiscal year, and is only empowered to make nonbinding recommendations. Since PEMEX is under the authority of the executive, it is also subject to congressional oversight. Finally, the CAED is in charge of appointing the external auditor of PEMEX, which must be approved by the board. The external auditor audits the financial statements of the company, and its consolidated accounts.

## **Challenges Ahead**

**Even though there have been important improvements in transparency and accountability, public opinion still associates PEMEX with a distinct lack of opacity.** To change this perception, it is essential that the company continues to press forward with the implementation of good corporate governance practices.

Some of the specific challenges that the company still needs to tackle are listed below:

- Ensure that the board does not become excessively entangled in the administration of the company. The role of the board is essentially to provide a strategic guide, which enables it to exercise a more effective

oversight function. The proliferation of board activities not focused on core functions results in a high number of lengthy board meetings, and a plethora of board committees.

- Even though the board has been professionalized, the executive, by law, still concentrates a significant amount of power in the decision-making process of the company.
- Reconfiguration of lines of authority, to ensure that the internal auditor is responsible to the CAED, ensuring that internal control of operations and performance audits are performed in accordance with best practices.
- Commit to publishing more information in areas where disclosure remains deficient (for example, bidding and contracting processes).

## Notes

167. The reports can be found at <http://www.pancanal.com/eng/fn/index.html>.
168. For more information refer to <http://www.pancanal.com/esp/rend-ctas/index.html>. The published list of salary and representation allowances offers a full overview for each of the permanent and temporary workers at the ACP. It includes their position, salary scale, and basic wage as well as representation costs. This information is supported by a list that tracks official foreign trips and their costs on an annual basis (it contains information about destination, purpose of the trip, duration, and cost of each trip). In addition to improving transparency, this list allows the ACP administration to make a more accurate estimate of the money spent in traveling.
169. However, these funds may not be used to buy financial investment instruments from other public or private entities, Panamanian or foreign, or to grant loans to such entities or the national government.
170. PEMEX's structure consists of a Corporate Office and four subsidiary entities: PEMEX *Exploración y Producción* (Exploration and Production), PEMEX *Refinación* (Refining), PEMEX *Gas y Petroquímica Básica* (Gas and Basic Petrochemicals), and PEMEX *Petroquímica* (Petrochemical).
171. In 2013, the six government representatives designated by the executive branch are: the Secretary of Energy, who chairs the board, the Sub-Secretary of fossil fuels (*hidocarburos*), the Secretary of Finance, the Sub-Secretary of Revenues, the Secretary of Communications and Transport, and the Coordinator of Cabinets and Special Projects of the Office of the President's Office.
172. Law of *Petróleos Mexicanos*, 2008.





## **ANNEXES**





## ANNEX A

# List of Brazilian SOEs under DEST Federal Oversight

Name	Acronym	Sector Ministry Oversight
Companhia das Docas do Estado da Bahia	CODEBA	Presidency
Companhia Docas do Ceará	CDC	Presidency
Companhia Docas do Espírito Santo	CODESA	Presidency
Companhia Docas do Estado de São Paulo	CODESP	Presidency
Companhia Docas do Pará	CDP	Presidency
Companhia Docas do Rio de Janeiro	CDRJ	Presidency
Companhia Docas do Rio Grande do Norte	CODERN	Presidency
Empresa Brasil de Comunicação S.A	EBC	Presidency
Empresa Brasileira de Comunicação S.A.	RADIOBRÁS	Presidency
Centrais de Abastecimento de Minas Gerais S.A.	CEASAMINAS	MAPA
Companhia de Armazéns e Silos do Estado de Minas Gerais	CASEMG	MAPA
Companhia Nacional de Abastecimento	CONAB	MAPA
Companhia de Entrepostos e Armazéns Gerais de São Paulo	CEAGESP	MAPA

*(continues on next page)*

<b>Name</b>	<b>Acronym</b>	<b>Sector Ministry Oversight</b>
Empresa Brasileira de Pesquisa Agropecuária	EMBRAPA	MAPA
Alcantara Cyclone Space- Binacional Brasil/Ucrania	ACS	MCT
Centro de Excelência em Tecnologia Eletrônica Avançada	CEITEC S.A.	MCT
Financiadora de Estudos e Projetos	FINEP	MCT
Indústrias Nucleares do Brasil S.A.	INB	MCT
Nuclebrás Equipamentos Pesados S.A.	NUCLEP	MCT
ATIVOS S.A.—Securizadora de Créditos Financeiros	ATIVOS S.A.	MF
Banco da Amazônia S.A.	BASA	MF
Banco do Brasil S.A.	BB	MF
Banco do Estado de Santa Catarina S.A.	BESC	MF
Banco do Estado do Piauí S.A.	BEP	MF
Banco do Nordeste do Brasil S.A.	BNB	MF
Braslian American Merchant Bank	BAMB	MF
BB Administração de Ativos—Distribuidora de Títulos e Valores Mobiliários S.A.	BB DTVM	MF
BB Administradora de Cartões de Crédito S.A.	BB CARTÕES	MF
BB Administradora de Consórcios S.A.	BB CONSÓRCIOS	MF
BB Banco de Investimento S.A.	BB INVESTIMENTOS	MF
BB Banco Popular do Brasil S.A.	BPB	MF
BB Corretora de Seguros e Administradora de Bens S.A.	BB CORRETORA	MF
BB Leasing Company Limited	BB LEASING	MF
BB—Leasing S.A.—Arrendamento Mercantil	BB LAM	MF
BBTUR—Viagens e Turismo Ltda.	BB TURISMO	MF
BESC Distribuidora de Títulos e Valores Mobiliários S.A.	BESCVAL	MF
BESC Financeira S.A.—Crédito, Financiamento e Investimentos	BESCREDI	MF
BESC S.A. Arrendamento Mercantil	BESC LEASING	MF
Caixa Econômica Federal	CAIXA or CEF	MF
Casa da Moeda do Brasil	CMB	MF
COBRA Tecnologia S.A.	COBRA	MF
Empresa Gestora de Ativos	EMGEA	MF
IRB—Brasil Resseguros S.A.	IRB	MF
Serviço Federal de Processamento de Dados	SERPRO	MF
Hospital de Clínicas de Porto Alegre	HCPA	MEC
Agência Especial de Financiamento Industrial	FINAME	MDIC

<b>Name</b>	<b>Acronym</b>	<b>Sector Ministry Oversight</b>
Banco Nacional de Desenvolvimento Econômico e Social	BNDES	MDIC
BNDES Participações S.A.	BNDESPAR	MDIC
Alberto Pasqualini—REFAP S.A.	REFAP	MME
Baixada Santista Energia Ltda.	BSE	MME
Boa Vista Energia S.A.	BVENERGIA	MME
Braspetro Oil Company	BOC	MME
Braspetro Oil Services Company	BRASOIL	MME
Centrais Elétricas de Rondônia S.A.	CERON	MME
Centrais Elétricas do Norte do Brasil S.A.	ELETRONORTE	MME
Centrais Elétricas Brasileiras S.A.	ELETROBRÁS	MME
Centro de Pesquisas de Energia Elétrica	CEPEL	MME
Companhia de Eletricidade do Acre	ELETROACRE	MME
Companhia de Geração Térmica de Energia Elétrica	CGTEE	MME
Companhia de Pesquisa de Recursos Minerais	CPRM	MME
Companhia Energética de Alagoas	CEAL	MME
Companhia Energética do Piauí	CEPISA	MME
Companhia Hidro Elétrica do São Francisco	CHESF	MME
Downstream Participações Ltda.	DOWNSTREAM	MME
Eletróbás Participações S.A.	ELETROPAR	MME
Eletróbás Termonuclear S.A.	ELETRONUCLEAR	MME
Empresa de Pesquisa Energética	EPE	MME
ELETROSUL Centrais Elétricas S.A.	ELETROSUL	MME
Fafen Energia S.A.	FAFEN ENERGIA	MME
Fronape International Company	FIC	MME
FURNAS—Centrais Elétricas S.A.	FURNAS	MME
Indústria Carboquímica Catarinense S.A.	ICC	MME
Ipiranga Asfaltos S.A.	IASA	MME
Liquigás Distribuidora S.A.	LIQUIGÁS	MME
Manaus Energia S.A.	MANAUS ENERGIA	MME
Biocombustível S.A.	PETROBIO	MME
Petrobras Comercializadora de Energia Ltda.	PCEL	MME
Petrobras Distribuidora S.A.	BR	MME

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<b>Name</b>	<b>Acronym</b>	<b>Sector Ministry Oversight</b>
Petrobras Gás S.A.	GASPETRO	MME
Petrobras International Braspetro B.V.	PIB BV	MME
Petrobras International Finance Company	PIFCo	MME
Petrobras Negócios Eletrônicos S.A.	e-PETRO	MME
Petrobras Netherlands B.V.	PNBV	MME
Petrobras Química S.A.	PETROQUISA	MME
Petrobras Transporte S.A.	TRANSPETRO	MME
Petroquímica Triunfo S.A.	TRIUNFO	MME
Petróleo Brasileiro S.A.	PETROBRAS	MME
Refinaria Abreu e Lima S.A.	RNEST	MME
SFE—Sociedade Fluminense de Energia Ltda.	SFE	MME
Termobahia S.A.	TERMOBAHIA	MME
Termoceaná Ltda.	TERMOCEARÁ	MME
Termomacaé Ltda.	TERMOMACAÉ	MME
Termorio S.A.	TERMORIO	MME
Transportadora Associada de Gás S.A.	TAG	MME
Transportadora Brasileira Gasoduto Bolívia-Brasil S.A.	TBG	MME
5283 Participações Ltda.	5283 PARTICIPAÇÕES	MME
Empresa de Tecnologia e Informações da Previdência Social	DATAPREV	MPS
Empresa Brasileira de Hemoderivados e Biotecnologia	HEMOBRÁS	MS
Hospital Cristo Redentor S.A.	REDENTOR	MS
Hospital Fêmeina S.A.	FÊMINA	MS
Hospital Nossa Senhora da Conceição S.A.	CONCEIÇÃO	MS
Companhia de Navegação do São Francisco	FRANAVE	MT
Companhia Docas do Maranhão	CODOMAR	MT
VALEC—Engenharia, Construções e Ferrovias S.A.	VALEC	MT
Empresa Brasileira de Correios e Telégrafos	ECT	MC
Telecomunicações Brasileiras S.A.	TELEBRÁS	MC
Companhia de Desenvolvimento de Barcarena	CODEBAR	MMA
Empresa Brasileira de Infra-Estrutura Aeroportuária	INFRAERO	MD
Empresa Gerencial de Projetos Navais	EMGEPRON	MD
Indústria de Material Bélico do Brasil	IMBEL	MD

<b>Name</b>	<b>Acronym</b>	<b>Sector Ministry Oversight</b>
Companhia de Desenvolvimento dos Vales do São Francisco e do Parnaíba	CODEVASF	MI
Companhia Brasileira de Trens Urbanos	CBTU	MCidades
Empresa de Trens Urbanos de Porto Alegre S.A.	TRENSURB	MCidades
Itaipu Binacional-Binacional Brasil/Paraguai	Itaipu	MME/MRE

*Note:* MAPA (Ministry of Primary Sectors), MC (Ministry of Communications), MC (Ministry of Communications), MCidades (Ministry of Cities), MCT (Ministry of Science and Technology), MD (Ministry of Defense), MDIC (Ministry of Development, Industry and Trade), MEC (Ministry of Education), MF (Ministry of Finance), MI (Ministry of National Integration), MMA (Ministry of Environment), MMA (Ministry of Environment), MME (Ministry of Mines & Energy), MPS (Ministry of Social Security), MRE (Foreign Affairs), MS (Ministry of Health), MT (Ministry of Transport).



## ANNEX B

# List of SOEs in Chile

Sector	Company	Full Name	State-owned %	SEP
Transportation	METRO S.A.	Empresa de Transportes de Pasajeros	100	X
	EFE	Empresa de los Ferrocarriles del Estado	100	X
	EPA	Empresa Portuaria Estatal Arica	100	X
	EPI	Empresa Portuaria Estatal Iquique	100	X
	EPA	Empresa Portuaria Estatal Antofagasta	100	X
	EPCO	Empresa Portuaria Estatal Coquimbo	100	X
	EPV	Empresa Portuaria Estatal Valparaíso	100	X
	EPTHNO	Empresa Portuaria Estatal Tahno-San Vicente	100	X
	EMPORMOTT	Empresa Portuaria Estatal Puerto Montt	100	X

*(continues on next page)*



Sector	Company	Full Name	State-owned %	SEP
Transportation (continued)	EPCHA	Empresa Portuaria Estatal Chacabuco	100	X
	EPA	Empresa Portuaria Estatal Austral	100	X
	EPSA	Empresa Portuaria San Antonio	100	X
Mining and Oil	ENACAR S.A.	Empresa Nacional del Carbon S.A.	100	X
	CODELCO	State Copper Mining Company	100	
	ENAMI	Empresa Nacional de Minería	100	X
	ENAP	Empresa Nacional del Petróleo	100	
Service	ZOFRI S.A.	Zona Franca de Iquique S.A.	72.7	X
	CASAMONEDA S.A.	Casa de la Moneda de Chile S.A.	100	
	CORREOSCHILE	Empresa de Correos de Chile	100	X
	POLLA S.A.	Polla Chilena de Beneficencia S.A.	100	X
	COTRISA S.A.	Empresa Comercializadora de Trigo S.A.	97.2	X
	SASIPA LTDA.	Sociedad Agrícola y Serv. Isla de Pascua Ltda.	100	X
	SACOR LTDA.	Sociedad Agrícola Ltda.	100	X
	EMAZA	Empresa de Abastecimiento de Zonas Aisladas	100	X
Finance	BECH	Banco Estado de Chile	100	
Water and Sewage	ECONSSA Chile S.A.	Empresa Concesionaria de Serv. Sanitarios S.A.	100	X
	PEÑUELAS S.A.	Empresa de Serv.Sanitarios Lago Peñuelas S.A.	98.7	X
Communications	TVN	Televisión Nacional de Chile	100	
	LA NACION	Empresa Periodística La Nación S.A.	69.3	
	GPM	Puerto Madero Impresores S.A.	69.3	
Defense Companies	ASMAR	Astilleros y Maestranzas de la Armada	100	
	ENAER	Empresa Nacional de Aeronáutica	100	
	FAMAE	Fábrica y Maestranzas del Ejército	100	

**ANNEX C**

**List of Colombian National SOEs**

Sector	Company	Characteristics				Ownership Function				
		GDP	Gov. Budget	Market <sup>(a)</sup>	Type	State Particip. <sup>(c)</sup>	Shareholders	Type of Partic. <sup>(d)</sup>	Sector Ministry	
OIL	Ecopetrol	6.81%	19.70%	M	MCC <sup>(b)</sup>	89%	MF	D	MME	
POSTAL	Servicios Postales Nacionales S.A.	0.01%	0.04%	M	SOICE	93%	Postal management (in liq.)	I	MITC	
TRANSP.	Centro de Diagnóstico automotor de Cúcuta LTDA		0.00%	M	SOICE	82.50%	MT	D	MT	
	Centro de Diagnóstico automotor de Caldas LTDA	0.00%	0.00%	M	SOICE	57%	MT	D	MT	
					SOICE	20%	Local gov.	I		
	Centro de Diagnóstico automotor de Tolima LTDA		0.00%	M	SOICE	13.20%	MT	D	MT	
TELECOM	Sociedad Canal Regional de Televisión	0.00%	0.01%	O	SOICE	98%	Reg. gov. Risaralda, Quindioy Caldas	D/I	MITC	
	Sociedad Canal Regional Limitada		0.00%	O	SOICE	90.4%	MITC	D	NTC	
	Canal Regional de Televisión del Caribe	0.00%	0.01%	O	SOICE	21%	MITC	D/I	MITC	
	Radio Televisión Nacional de Colombia		0.00%	O	SOICE	79%	Regional gov. Teveandina Ltda. Par Adpostal	I	MITC	

Sector	Company	Characteristics				Ownership Function				
		GDP	Gov. Budget	Market <sup>(a)</sup>	Type	State Particip. <sup>(c)</sup>	Shareholders	Type of Partic. <sup>(d)</sup>	Sector Ministry	
ENERGY/ ELECT.	Empresa Multiproposito de Urra S.A.	0.05%	0.19%	O	MCC, PDU	77%	MF	D	MME	
						22%	MME			
	Centrales Eléctricas de Nariño S.A.	0.04%	0.15%	O	MCC, PDU	64.90%	IPPES	D/I	MME	
						35%	MF			
	Gestión Energética S.A. E.S.P.	0.09%	0.34%	O	MCC, PDU	95.21%	MF	D	MME	
	Empresa de Energía del Amazonas	0.00%	0.02%	O	MCC, PDU	90.70%	IPPES	D/I	MME	
						0.93%	Local gov.			
	Empresa Distribuidora del Pacífico	0.01%	0.04%	O	MCC, PDU	75%	MME	D	MME	
						25%	MF			
Generadora y Comercializadora de Energía del Caribe	0.20%	0.60%	O	MCC, PDU	100%	MF	D	MME		
Empresa de Energía de Boyaca S.A.	0.05%	0.19%	O	MCC, PDU	99.40%	MF	D	MME		

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Sector	Company	Characteristics			Ownership Function					
		GDP	Gov. Budget	Market <sup>(a)</sup>	Type	State Particip. <sup>(c)</sup>	Shareholders	Type of Partic. <sup>(d)</sup>	Sector Ministry	
FINANCIAL	Almagrario S.A.	0.01%	0.04%	C	MCC	64,6%	Banco Agrario	I	MARD	
	Banco Agrario S.A.	0.31%	1.11%	C	MCC	99,99%	MF	D/I	MARD	
	Fondo Financiamiento Sector Agropecuario	0.07%	0.25%	M	MCC	65.30%	MARD	D/I	MARD	
	Central de Inversiones	0.01%	0.04%	M	SOICE	12.90%	MF			
	Fiduagraria	0.01%	0.03%	C	MCC, EICE	21,8%	Private banks			
	Fiduciaria La Previsora	0.02%	0.02%	C	MCC, EICE	99,90%	MF	D	MF	
	Fiducodex	0.00%	0.02%	C	MCC	93.70%	Banco Agrario	I	MARD	
	Bancoldex S.A.	0.20%	0.74%	C	MCC	99,90%	La Previsora S.A. Co. de Seguros	I	MF	
	La Previsora S.A. Compañía de Seguros	0.12%	0.43%	C	MCC, EICE	89.10%	Bancoldex	I	MIC	
	Findeter	0.07%	0.26%	O	SOICE	91.90%	MIC		D	MIC
	Fondo Nacional de Garantías	0.03%	0.11%	M	MCC, EICE	7.80%	MF		D	MIC
	Financiera Energética Nacional S.A.	0.03%	0.11%	M	MCC, EICE	99.50%	MF		D	MF
						0.17%	MSD			
					92.50%	MF		D	MF	
					61.6%	MF		D/I	MIC	
					17.30%	MIC				
					95.36%	MME		D/I	MME	

Sector	Company	Characteristics				Ownership Function				
		GDP	Gov. Budget	Market <sup>(a)</sup>	Type	State Particip. <sup>(c)</sup>	Share-holders	Type of Partic. <sup>(d)</sup>	Sector Ministry	
FINANCIAL ( <i>continues</i> )	Fondo Ganadero de Córdoba S.A.	0.00%	0.00%	M	MCC, PSHC	15%	MARD	D	MARD	
	Positiva Compañía de Seguros S.A.	0.00%	0.00%	O	MCC	90.50%	MF	D/I	MF	
	Bolsa Nacional Agropecuaria S.A.	0.01%	0.02%	M	MCC	11.80%	MARD	D	MARD	
OTHERS	Sociedad Hotelera Tequendama		0.00%	C	MCC, EICE	97.97%	Armed Forces, Retirement Funds	I	MND	
	Artesanías de Colombia S.A	0.00%	0.01%	M	MCC, EICE	57%	Proexport	D	MIC	
						23.5%	MF	I		
						4.30%	MIC			
Vecol S.A.	0.01%	0.04%	C	MCC, PSHC	61.70%	MARD	D/I	MARD		
Corporación de la Ind. Aeronáutica Colombiana	0.01%	0.03%	M	MCC, EICE	99.96%	MND	D	MND		
Central de Abastos de Cucuta S.A.		0.00%	0.00%	C	MCC	75.15%	MARD	D	MARD	
						24.85%	Other companies, subnat. gov.			

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Sector	Company	Characteristics			Ownership Function				
		GDP	Gov. Budget	Market <sup>(a)</sup>	Type	State Particip. <sup>(c)</sup>	Shareholders	Type of Partic. <sup>(d)</sup>	Sector Ministry
OTHERS	Central de Abastos del Caribe	0.00%	0.00%	C	MCC	31,09% 17,17% 51,74%	Ministry of Finance MARD Public institutions/companies, local gov.	D	MARD

*References:*

IPPE: Institute for Planning and Promotion of Energy Solutions

MARD: Ministry of Agriculture and Rural Development

MF: Ministry of Finance

MIC: Ministry of Industry and Commerce

MITC: Ministry of IT and Communications

MME: Ministry of Mining and Energy

MND: Ministry of National Defense

MSD: Ministry of Social Development

MT: Ministry of Transportation

NTC: National Television Commission

PDU: Public Domiciliary Utilities

PSHC: Public stock-holding corporation

SOICE: State-owned industrial, commercial enterprise.

*Notes:*

(a) C: competitive; O: oligopolistic; M: monopolistic.

(b) Ecopetrol S.A. is a MCC organized as a Public stock-holding corporation. See [www.ecopetrol.com.co](http://www.ecopetrol.com.co).

(c) MCC in which the State owns ninety percent (90%) or more of its share capital are subject to the regulations for State Industrial and Commercial Enterprises.

(d) Direct participation means that the government institution exercises the ownership rights directly. Indirect participation implies that the government institution exercises its ownership rights through an enterprise which is the shareholder.

## ANNEX D

# List of Peruvian SOEs under FONAFE's Oversight

Sector	Name	Line of Business	State Participation
Electricity	ADINELSA	Management of electrical infrastructure developed by state agencies.	100%
	EGASA	Generation and commercialization	100%
	EGEMSA	Generation and commercialization	100%
	EGESUR S.A.	Generation and commercialization	100%
	ELECTRO ORIENTE S.A.	Generation, transmission distribution and commercialization	100%
	ELECTRO PUNO S.A.A.	Distribution and commercialization	99.59%
	ELECTRO SUR ESTE S.A.A.	Distribution and commercialization	99.61%
	ELECTRO UCAYALI S.A.	Generation, transmission distribution and commercialization	99.90%
	ELECTROCENTRO S.A.	Distribution and commercialization	100%
	ELECTRONOROESTE S.A.	Distribution and commercialization	100%
	ELECTRONORTE S.A.	Distribution and commercialization	99.99%
ELECTROPERU S.A.	Generation and commercialization	100%	

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<b>Sector</b>	<b>Name</b>	<b>Line of Business</b>	<b>State Participation</b>
Electricity <i>(continued)</i>	ELECTROSUR S.A.	Distribution and commercialization	100%
	HIDRANDINA S.A.	Distribution and commercialization	95.11 %
	SAN GABAN S.A.	Generation and commercialization	100%
	SEAL S.A.	Distribution and commercialization	87.33%
Financial	AGROBANCO	Financial services to agricultural producers	100%
	BANCO DE LA NACION	Financial services	100%
	COFIDE S.A.	Financial services to the infrastructure projects and micro and small enterprises.	98.70%
	FONDO MIVIVIENDA	Financial services to develop real estate projects and housing acquisitions.	100%
Transportation and Communications	CORPAC S.A.	Operate, equip and maintain airports and air navigation systems	100%
	EDITORA PERU S.A	Printing, publishing and distribution of the official newspaper and news, graphic services.	100%
	ENAPU S.A.	Manage and provide port services in publicly owned ports.	100%
	SERPOST S.A.	Postal services	100%
Water and Sanitation	SEDAPAL	Provision of water and sewage services	100%
Environmental Remediation and Mining	ACTIVOS MINEROS	Remediation of environmental mining passives.	100%
	PERUPETRO S.A.	Promote investment in exploration and exploitation of hydrocarbons.	100%
Other Sectors	ENACO S.A.	Domestic trade: Production and commercialization of coca leaf products and by-products.	100%
	FAME SAC	National Defense.	100%
	SIMA IQUITOS S.R.L.	Shipbuilding and metalwork: Construction, maintenance and repair of ships for the Peruvian Navy in the Amazon region.	100%
	SIMA PERU S.A.	Shipbuilding and metalwork: Construction, maintenance and repair of ships for the Peruvian Navy.	100%

## ANNEX E

# SOE Portfolio Managed by SEPI in Spain

SOE	Sector	Ownership %	Staff
<b>Fully-Owned or Majority Shareholder SOEs</b>			
1. Agencia EFE	Media	100.00%	1,253
2. Alimentos y Aceites	Portfolio Mgmt.	91,96%	90
3. CETARSA	Tobacco	79.00%	573
4. Corporacion RTVE	Media	52,19%	6,397
6. Grupo Cofivacasa	Portfolio Management	100.00%	In Liquidation
7. Grupo Defex	Defense	51.00%	19
8. Grupo Ensa	Manufacture	100.00%	689
9. Grupo Enusa	Energy	60.00%	939
10. Grupo Hunosa	Mining	100.00%	2,347
11. Grupo Izar	Civil Shipbuilding	100.00%	In Liquidation
12. Grupo Mercasa	Food Distribution	51.00%	161
13. Grupo Navantia	Navy Shipbuilding	100.00%	5,665
14. Grupo Sepides	Investment Fund	100.00%	56

*(continues on next page)*

<b>SOE</b>	<b>Sector</b>	<b>Ownership %</b>	<b>Staff</b>
15. Grupo Tragsa	Agro-industry	51.00%	21,520
16. Hipodromo Zarzuela	Entertainment	96.00%	145
17. Mayasa	Mining	100.00%	In Liquidation
18. Saeca	Finance	80.00%	32
<b>Minority Shareholder</b>			
1. Enagas	Energy	5.00%	—
2. Enresa	Radioactive Waste Management	20.00%	—
3. CASA-EADS	Aerospatial	5.48%	—
4. Hispasat	Telecommunications	7.41%	—
5. Red Electrica Corp.	Energy	20.00%	—
6. IAG	Air Transportaion	2,71%	—
7. P4R	External Trade	11,87%	—
<b>Adscribed</b>			
1. Ente RTVE	Media	100%	In Liquidation
<b>Public Foundations</b>			
1. Fundacion Laboral	Foundation	100%	51
2. Fundacion SEPI	Foundation	100%	18

## ANNEX F

# Six Largest SOEs in Uruguay

Name		Sector Ministry	Description	Type of Market
Oil State Company (Administración Nacional de Combustibles, Alcohol y Pórtland)	ANCAP	MIEM	Autonomous entity	Fuels = M Rest = C
Power State Company (Administración Nacional de Usinas y Transmisiones Eléctricas)	UTE	MIEM	Autonomous entity	Generation = C Rest = M
Telecom State Company (Administración Nacional de Telecomunicaciones)	ANTEL	MIEM	Decentralized service	Land phone lines = M Rest = C
Bank of the Republic (Banco República)	BROU	MF	Autonomous entity	C
Water & Sewage State Company (Obras Sanitarias del Estado)	OSE	MUPEP	Decentralized service	M
National Administration of Ports (Administración Nacional de Puertos)	ANP	MTPW	Decentralized service	M

*References:* MIEM: Ministry of Industry, Energy and Mining; MUPEP: Ministry of Urban Planning and Environment Protection; MTPW: Ministry of Transportation and Public Works; MF: Ministry of Economy and Finance; M: monopoly; C: competitive.



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Reglamento de la Ley del Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado

Reglamento del Decreto Legislativo no. 1031, que promueve la eficiencia de la actividad empresarial del Estado

## **Uruguay**

Constitución de la República Oriental del Uruguay

The main objective of this report is to provide a descriptive analysis of the current practices and trends of corporate governance of State-owned Enterprises (SOEs) in several Latin-American countries. It provides practitioners of SOE corporate governance with a stocktaking of current practices and trends in several Latin American countries, as well as international experiences and good practices elsewhere. By doing so, this report intends to contribute to the discussion and growing interest on SOE corporate governance in the Region and beyond.

In most Latin American and Caribbean countries, the SOE sector contributes significantly to GDP and represents an important part of consolidated public expenditures. In several cases, the SOEs are key and strategic actors in the country's economy—providing essential goods and services—and frequently hold a dominant market position in critical sectors, such as petroleum, electricity, and transportation. They also operate in competitive markets such as financial services, telecommunications, etc. SOEs are also increasingly under pressure, by both their governments and by international competition, to operate and achieve their goals more efficiently and effectively. Within this context, achieving good corporate governance practices is critical to SOEs effectively providing goods and services, and achieving their short-, medium-, and long-term goals, within a sustainable fiscal framework.

This report has been prepared by a World Bank team with the direct collaboration of government officials involved in the SOE sectors of eight countries in Latin America and the Caribbean, and Spain.