A Transparency and Accountability Guide for State Ownership

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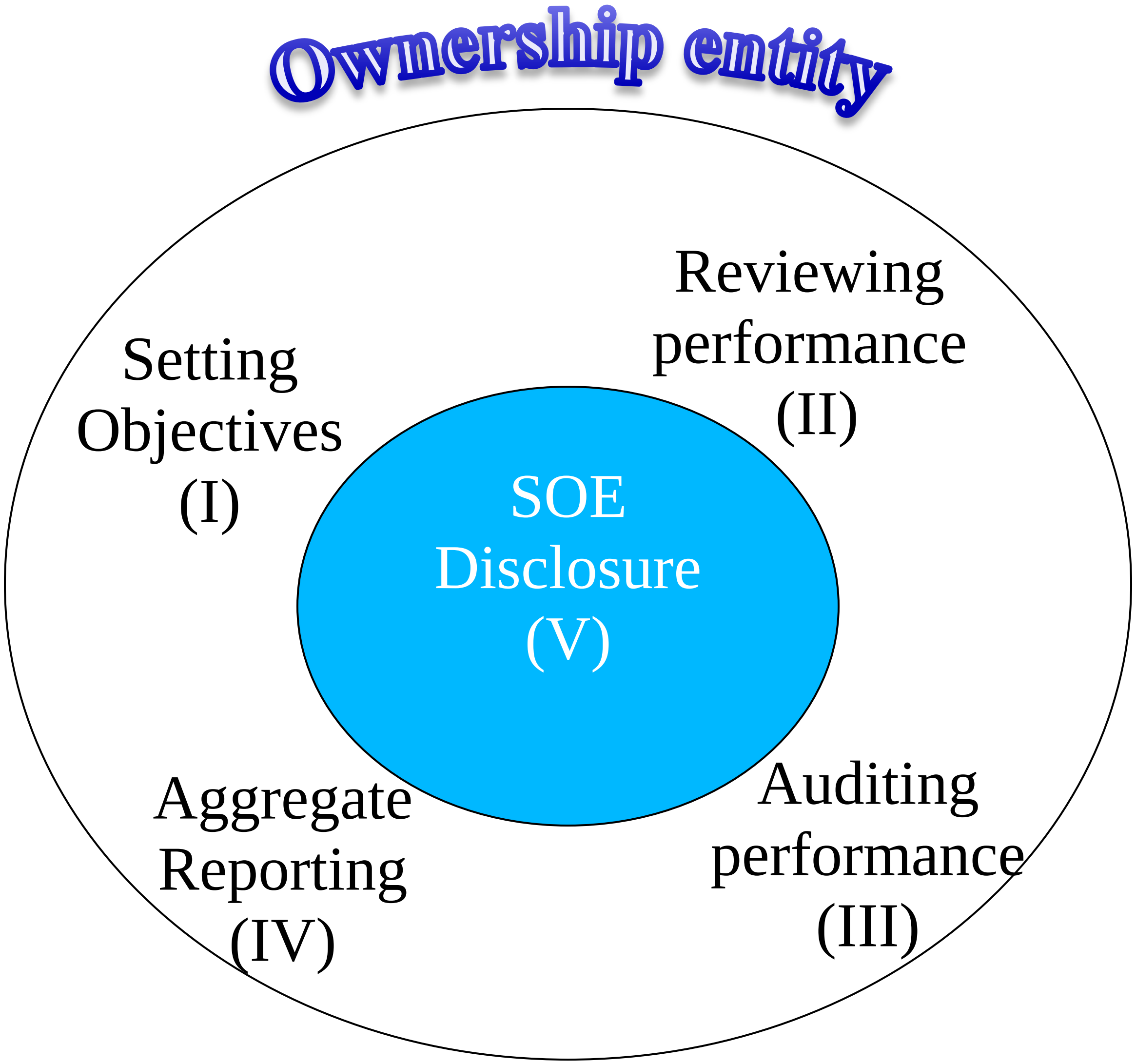
the TrAc Guide… why and what for?

- Why?...Transparency and accountability is crucial:
  - Gives substance to shareholders rights
  - Choice remedy for fraude and manipulation
  - Prerequisite to and underpins public trust

"The state should act as an informed and active owner (…) 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" (Chapter II).

- What for?... Objectives of the OECD Guide:
  - facilitate the implementation of the OECD Guidelines:
  - help evaluate existing practices
  - provide policy options and « roadmaps »
  - examples of successful practices, for reference and inspiration

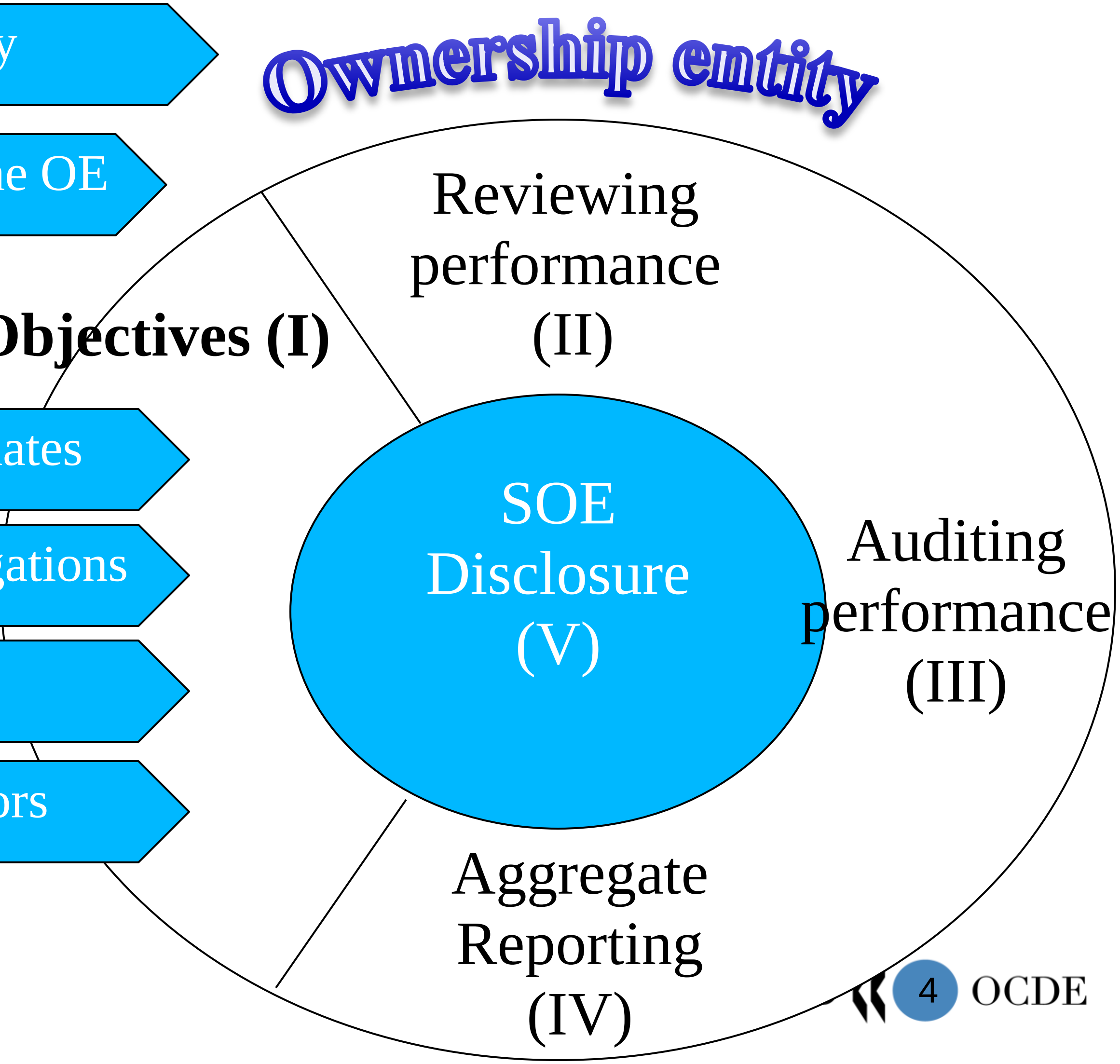

Ownership entity
Setting Objectives (I)
Reviewing performance (II)
SOE Disclosure (V)
Aggregate Reporting (IV)
Auditing performance (III)

Setting Objectives (1)

- Develop an ownership policy
- Setting specific targets for the OE

Setting Objectives (I)

- Define & review SOE mandates
- Identify & cost special obligations
- Setting SOE objectives
- Define performance indicators



Setting Objectives (1)

Develop an ownership policy

- **short** but **high-level** policy document
- defining the state' overall ownership objectives and practices
- an effective tool for public communication
- an **iterative and inclusive process**…
- obtain and demonstrate **high-level political support**
- endorsement by relevant public servants
- **public disclosure** and wide circulation

Examples of ownership objectives

In **Sweden**, “creating value for the owners”

In **France**, “to contribute to a better valorisation of state shares in SOE”.

In the **UK**, “To ensure that Government’s shareholdings deliver sustained, positive returns and return their cost of capital over time within the policy, regulatory and customer parameters set by Government, by acting as an effective and intelligent shareholder”

In **Finland**: “The State seeks to achieve an economic and societal overall result that is as good as possible ... The economic overall result is the sum of the development in value of the shares owned and their annual dividend yield”

In **Norway**, “The purpose of state ownership is to attend to the common good. As an owner, the State also expects these companies to take corporate responsibility and to uphold our basic values in an exemplary manner”

Overarching goals of state ownership in New-Zealand

To be **clearer with SOE boards about shareholding Ministers' expectations of the companies;**

To provide shareholding Ministers with a **greater understanding of, and therefore confidence in, the performance of SOEs,** through enhanced benchmarking;

To **develop appropriate capital structures which impose financial disciplines** on SOEs while ensuring they have sufficient capital to make operational investment decisions without recourse to the Crown

To ensure that **request for capital are considered in line with the business needs the SOE**, while recognizing the Crown's preference that major investments are considered relative to other demands for capital across the Crown by incorporating SOE requests for equity for significant investments into the normal budget process.

Source: CCMAU, "Owner's Expectations Manual for State-Owned Enterprises, 29 October 2007.

Setting Objectives (1)

Develop an ownership policy

Setting specific targets for the OE

– appropriate mix of both quantitative and qualitative targets
– focus on relevance and close link with the ownership objective
– effectively reflect the ownership entity's performance
– analyse their impact on motivation and behavior
– include Parliament, relevant Ministries, state audit agencies, etc.
– clearly disclosed

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
Indicator 2: Financial profitability (net result / equity)

Indicator 3: Operational margin (operational results / turnover)

Indicator 4: Indebtedness sustainability (EBITDA/net debt)

Objective 2: Ensure the success of selling 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 except the state
Indicator 2: Decrease in debt and interest charges of the State

Case Study: Pros and Cons of a unique target for the ownership entity in the UK

The advantages of a unique target

"*To increase by £1 billion in the three years to 2007 the value of the core portfolio of businesses owned by Government, within a framework of clearly defined policy, customer and regulatory objectives*" (a). This quantitative and clear cut objective allows improved communication about meaningful targets. It is also considered as an important "educational" tool to highlight the concept of value creation and focus on it. It is also instrumental in making SOEs and the general public understand that capital is not free.

Critics of the unique target by the National Audit Office

"*It is difficult to link the achievement of the target with the Executive's own performance in managing the shareholding on behalf of the government. Furthermore, the earnings of these target businesses can potentially be volatile and the performance of a single one can have a decisive influence on whether or not the financial target is achieved. Continuing with a single, portfolio-level target alone is, therefore, inappropriate*."

Setting objectives (1)

Develop an ownership policy

Setting specific targets for the OE

Define & review SOE mandates

– simple and brief descriptions of the high-level objectives and missions of the individual SOEs in the long run.

valid over a long period of time

– publicly disclosed.

– transparent process, based on discussion with SOEs' boards, with appropriate consultation of stakeholders

– reviewed periodically and systematically, internally, by independent panels or by relevant Parliamentary committees.

Examples of mandates or overall objectives for similar SOEs (Post) in different OECD countries

Canada Post Corporation: To operate postal service on a self-sustaining basis with a standard of service that meets the needs of Canadians. To be a world leader in providing innovative physical and electronic delivery solutions, creating value for customers, employees and all Canadians.

Posten Norge / Norway. To fulfil its societal and operational obligations in a sound, cost-effective manner, and with these parameters effectively administer the State's assets and promote good commercial growth.

Posti / Finland. To develop its business towards integrated information and material flow management, enabling versatile messaging and logistics solutions.

Posten AB / Sweden. Posten's profitability target is 10 percent of net profit in relation to average shareholders' equity, assuming an equity/assets ratio of 25 per cent.

Royal Mail / UK. To ensure the universal provision of postal services in the UK. Within that to ensure a publicly owned Royal Mail Group, fully restored to good health, providing excellent quality service to customers and rewarding employment to its people.

Setting objectives (1)

Develop an ownership policy

Setting specific targets for the OE

Define & review SOE mandates

Identify & cost special obligations

– agreeing on a clear definition (not trivial)
– ask SOEs to identify and **map existing "special obligations"**
– provide info on actual costs, based on a consistent methodology
– make them the result of a well-though process and explicit political

Definition of Community Services Obligations in Australia

"A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices".

Setting objectives (1)

- Develop and ownership policy
- Setting specific targets for the OE
- Define & review SOE mandates
- Identify & cost special obligations
- **Setting SOE objectives**

– Short and agreed usually on a yearly basis, duly approved by the general shareholder meeting

– include financial (including sustainable dividend levels) and non-financial objectives and related performance indicators

– collaborative process with ongoing communication between the SOE itself (its board and CEO) and the ownership entity

– informal negotiation is key for building consensus and ensuring clarity

– formal feedback should be received from the ownership entities

– the final document should be officially approved, clearly endorsed, in some cases tabled in Parliament and always publicly disclosed

Purpose of financial targets for SOEs in Sweden

The purpose of financial targets from the perspective of the owner is to:

- Secure the **creation of value** by the board and executive management working towards ambitious, long term targets;
- Achieve **efficient use of capital** by clarifying the cost of capital;
- Keep the company's **risk at a reasonable level;**
- Assure the owner **sustainable and predictable dividends** taking into consideration the company's future capital requirements and financial position;
- Make possible and **facilitate measurement, follow-up and assessment** of the company's profitability, efficiency and risk level.

Credit rating benchmark in New-Zealand

The government has a **credit rating benchmark policy** whereby SOEs are expected to have a **capital structure consistent with a BBB (flat) credit rating** (unless the SOE can demonstrate good reasons for an alternative benchmark).

This is to ensure that all SOEs have **appropriate financial disciplines** to **manage capital efficiently at similar risk levels.**

The application of this credit rating benchmark may involve moving to a higher gearing ratio. (…).

Ministers expect Boards to use their best endeavours to negotiate prudent levels of borrowing to closer reflect shareholder preferences, and if necessary **explore alternative banking arrangements.**

Shareholding Ministers additionally expect Boards to report on the likely timing for a change in gearing levels, to better align with the BBB (flat) benchmark.

Main steps in negotiation corporate objectives in New-Zealand

Shareholding Ministers write to each Crown company board to detail the information requirements; Boards are then required to assess their business environment; reassess their strategic direction; p**rovide a detailed plan for the immediate year**; and provide financial projections for the following 2 to 4 years;

Advisors then prepare a report on these documents for the shareholding Ministers' consideration. Draft SCIs are delivered together with the business plans, at least one month before the end of each financial year;

Shareholding Ministers may then, through their advisors:a) **seek further information**; b) **consult with boards** on any issues or concerns they have with the business plans and draft SCIs (by letter or meetings between shareholding Ministers, advisors and the board); c) **write to boards outlining their understanding** of the main outcomes and issues.

Boards then consider the outcomes from business planning meetings and the shareholding Ministers' written comments, and if necessary, **revise their business plans and SCIs**. Boards then deliver to shareholding Ministers finalised business plans and SCIs;

Shareholding Ministers **table the finalised SCIs in the Parliament.**

Advices on how to review and challenge SOE corporate plans in Canada

Based on 1996-2000 reviews, the review of the governance of SOEs by the Auditor General advises the government to review and challenge the corporate plans by asking itself a series of typical questions, as follows:

- Has the corporation ***properly interpreted its mandate?***

- Are the corporation's objectives, strategies and targets appropriate and do its performance indicators ***provide a strong basis for holding it in account****?*

- Are the ***trade-offs*** *the corporation has made between its commercial objectives and its* ***public policy objectives reasonable****?*

- Do its performance targets ***sufficiently "stretch" the corporation****?*

- Has the plan ***taken government priorities into account****?*

*- Is the corporation capitalized appropriately, and are t****argets for dividends and return on equity appropriate?***

- Has the corporation met its past performance targets?

- Is there a need to assess whether the corporation's mandate is still relevant?

Setting objectives (1)

Develop and ownership policy

Setting specific targets for the OE

Define & review SOE mandates

Identify & cost special obligations

Setting SOE objectives

Define performance indicators

- relevant, accurate and reliable, with challenging but achievable targets
- actual results duly documented,
- audited and reviewed regularly

Developing Relevant Performance Indicators in New South Wales (Australia)

Useful Performance Indicators exhibit the following characteristics:

Appropriateness: Ability to relate to the SOE objectives

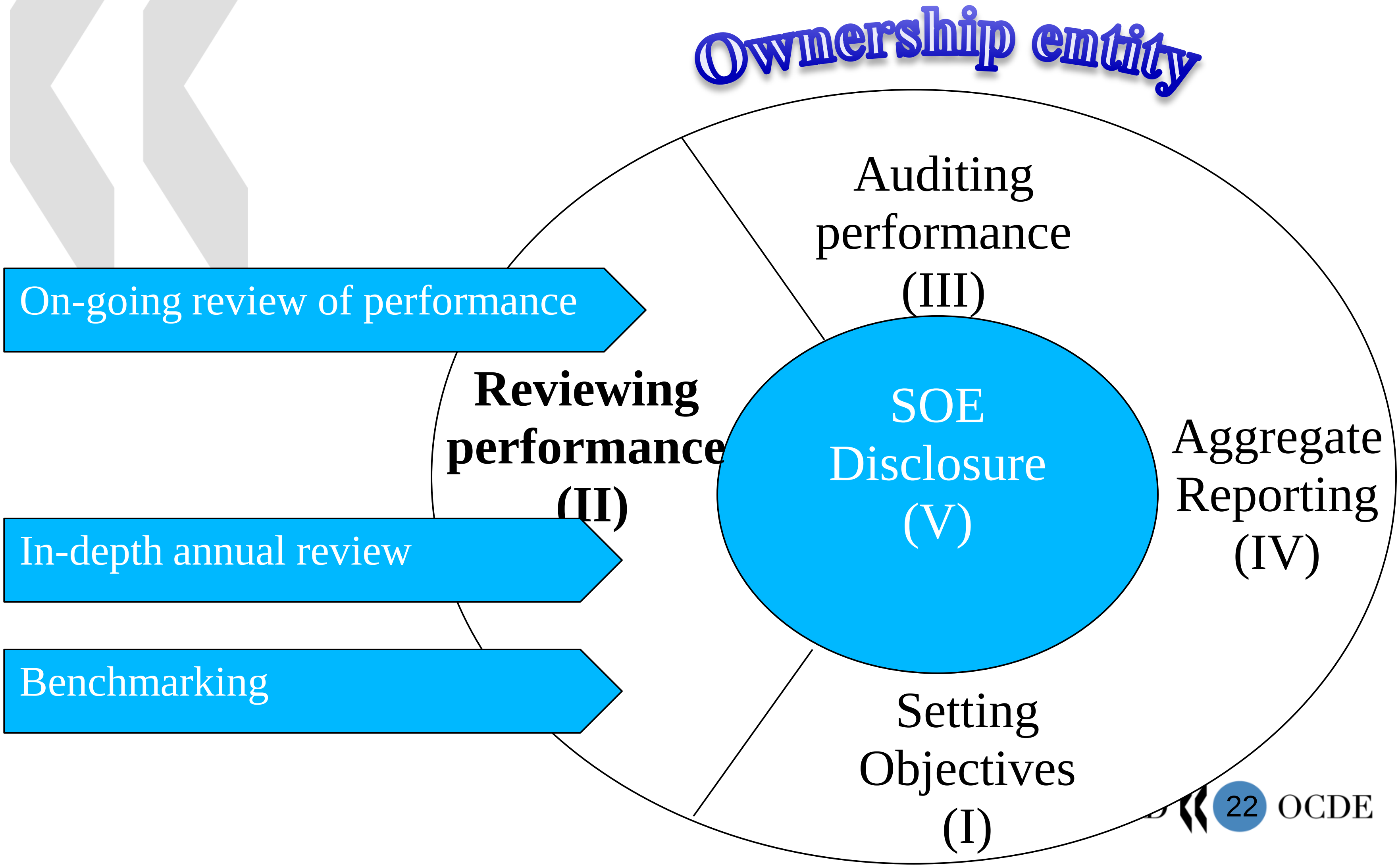
Relevance: Relating to the primary purpose of the SOE, focusing on high level results, effectiveness or efficiency

Timeliness: Reporting the most recent data available

Accuracy: Reflecting the situation as truthful and as free from error as possible, indicating the use of estimates

Completeness and comprehensiveness: Showing a true picture of achievements, mixing qualitative and quantitative measures

Reviewing performance (2)



Reviewing performance

On-going review of performance

- typically combines **formal and more informal** mechanisms
- “No surprise” or continuous disclosure policies
- **Complementary** information channels
- **balance**, no excessive reporting requirements, not by-passing the board
- Ownership entities **capacity** to treat this information

In-depth annual review

- assessment of financial and non-financial results against key performance indicators
- **costs and benefits analysis** information requirements
- At the centre: discussion between board and ownership entity.

Benchmarking

- identify performance gaps and areas of potential improvement
- rate of return often very useful, as well as synthetic financial ratios (EVA)
- **care** always required **in interpreting** comparisons

No-surprise policy in New-Zealand

The “no surprise” policy is clearly articulated as follows: “*Shareholding Ministers expect Crown Company boards to adhere to the “no surprise” policy and* ***be informed well in advance of everything considered potentially contentious in the public arena,*** *whether the issue is inside or outside the relevant legislation and/or ownership policy*”. Examples of matter that could fall within the “no surprise” policy include:

Changes in CEOs

Potential / actual conflicts of interest by directors or litigation by or against the company, its directors or employees

Fraudulent acts by the company’s directors or employees or breaches of an SOE’s corporate social responsibility obligations

Significant company restructuring, large-scale redundancies,

Industrial disputes or Significant health and safety issues

Significant acquisitions and disinvestments

Imminent media coverage of any activity that could attract critical comment or on which shareholding Ministers could be asked to express a view.

Relationship between SOEs and the ownership entity (APE) and contact points in France

Acting as an interface between companies and the Government as a shareholder, the APE looks after the following aspects:

1. Monthly reporting implementation: Companies transmit monthly to the APE sourced directors reports containing the main financial indicators and if necessary qualitative indicators of the activity based on the Executive Committee's internal reporting. The choice of indicators is adapted to each company and is revised regularly.

2. Regular financial book meetings and preparation of important milestones : On a regular basis and at least once a year company management teams meet the APE to present main transactions and strategic prospects. During work on annual budgets milestone meetings are organized between the concerned public services and the company for a detailed discussion if arbitration is needed.

3. Searching for better company operational knowledge : Management teams ***define regular correspondents as contact points*** within the APE. Management teams propose to their APE contacts fixed meeting programs relative to their specific areas of activity as well as site visits.

Traffic lights in the UK

In the UK, a quarterly "Traffic Light" Review is done for each SOE. This review evaluates

- the quality of the shareholder relationship,

- the implementation of the shareholder model,

- the quality of the board and management team,

- the strategy and the financial performance.

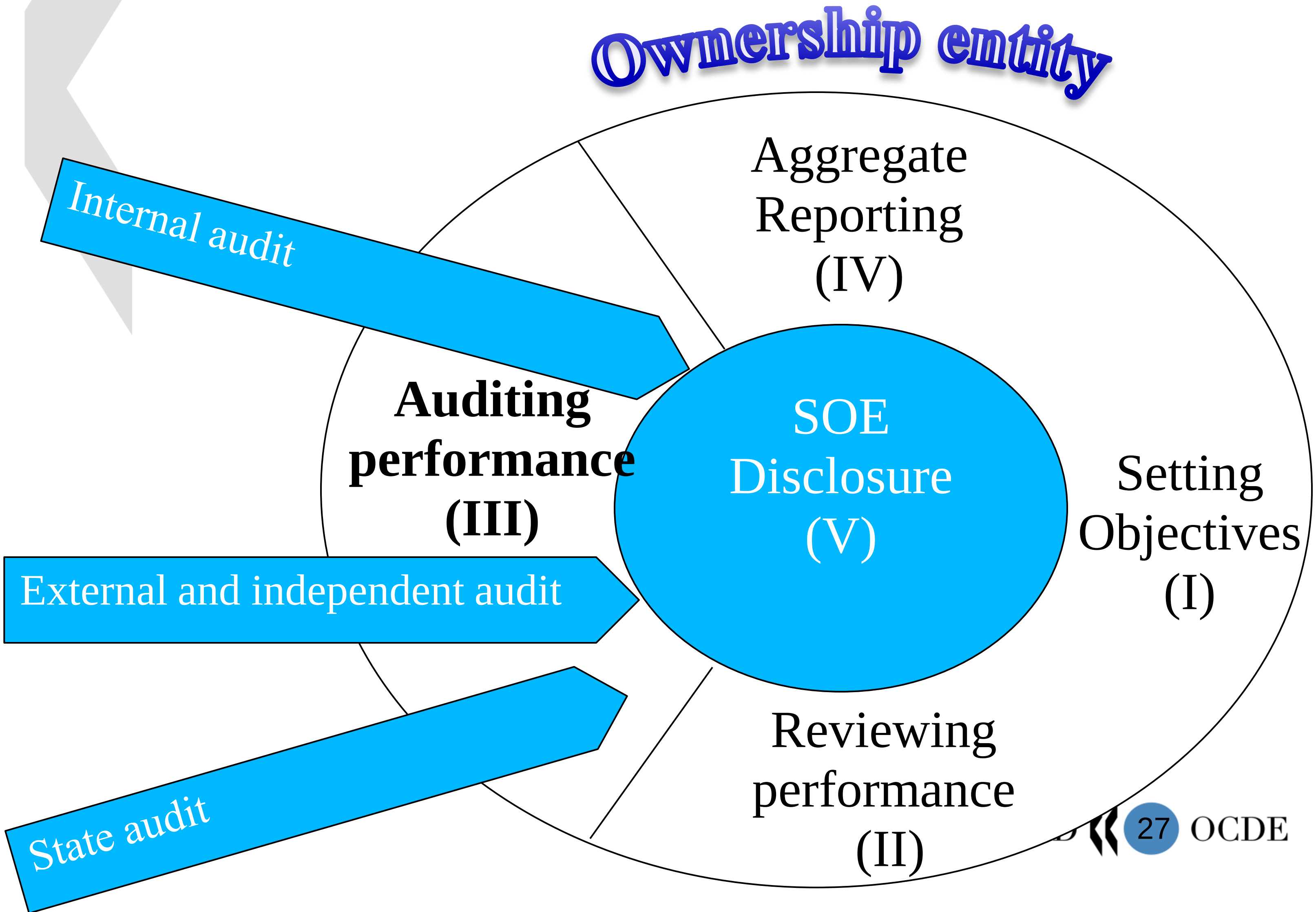
For each of these categories, a series of questions are to be answered by "yes" or "no" by the portfolio manager with a possibility also to comment.

All, or nearly all, "yes" answers give an overall green light, some specific "no" answers may trigger a red light, otherwise the light is amber. (This type of "traffic light" review is sometimes criticized for lacking nuances).

For each category, in addition to the general appreciation, the portfolio manager must indicate the action taken to improve the situation.

An aggregate monitoring table is then built up, indicating for each SOE the colour of the light for each of the category mentioned above. This is a type of control board for the Shareholder Executive's work.

Auditing performance (3)



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Auditing performance (3)

- Avoid duplication and promote complementarity
- Central role of the audit committee (supports and oversees)

Internal audit the first level of control

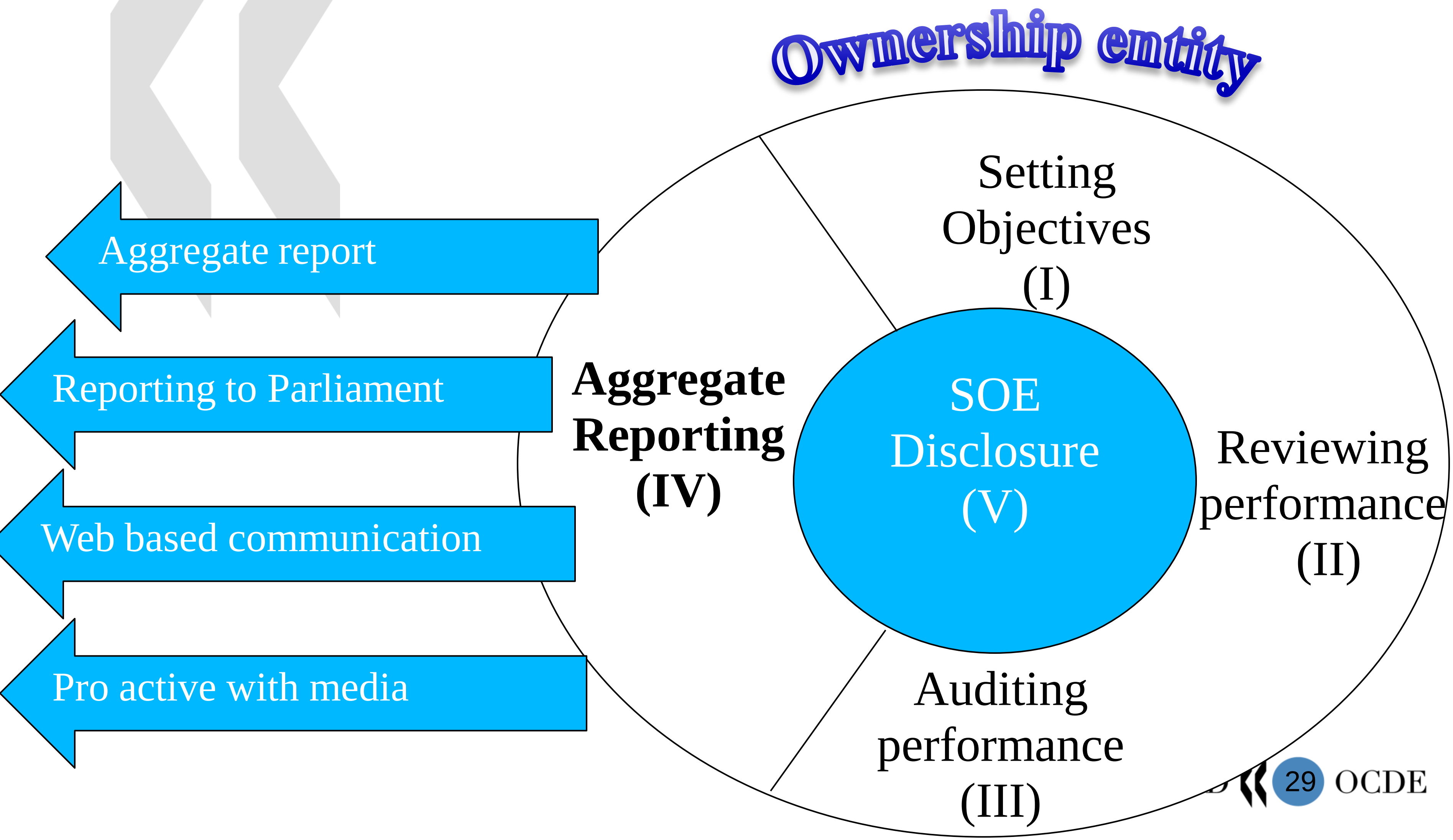
- appropriate procedures for internal auditing, meeting the *International Standards for the Professional Practice of Internal Auditing*,
- focus not only on compliance but on risk management.
- financial statements should comprise an internal control report
- direct reporting line to the audit committee

External and independent audit

State audit

- powerful tools and information sources for the Parliaments.
- focus on audits of the ownership entities and performance audits
- specific processes to discuss results with the concerned boards.
- disclosure of audit findings to the public

Reporting on performance (4)



Reporting on performance (4)

Aggregate report

– short, easy to read and regular reports
– key **communication tools** and **trust-building** instruments
– clarifies policies, makes information **consistent** and improves internal reporting systems
– useful for **building consensus** on specific and sensitive policy choices
– their central component is the review of financial performance
– highlights of main events and short presentations on the largest SOEs
– developing AR involves active consultation and co-ordination
– **clarification of key messages** might trigger a lot internal discussion
– the collection of information both within the ownership entity and from the SOEs themselves is the central stage
– endorsement by the relevant authority gives **visibility and political weight**
– make active use of aggregate reports, including with the media

Reporting on performance

Aggregate report

Reporting to Parliament

- represent the **ultimate owners** of SOEs, i.e. the general public
- requires a process of compilation, checking, reviewing and questioning that includes a large number of parties… a **"disclosure dynamic**"
- need for more concise information and better structured debates
- avoid excessive oversight leading to **undue political interference**
- active co-operation and co-ordination necessary
- appropriate use of specialised committees
- deal with **confidentiality** issues
- reports to the Parliament as well as minutes of discussions made available to the general public

Web based communication

Pro active with media

Reasons for appearing before a select committee in New-Zealand

There are several reasons for which an SOE may appear before a select committee.

An SOE could be asked to **advise** a select committee on legislation under formation

An SOE may wish to **make a submission on a bill as a witness**

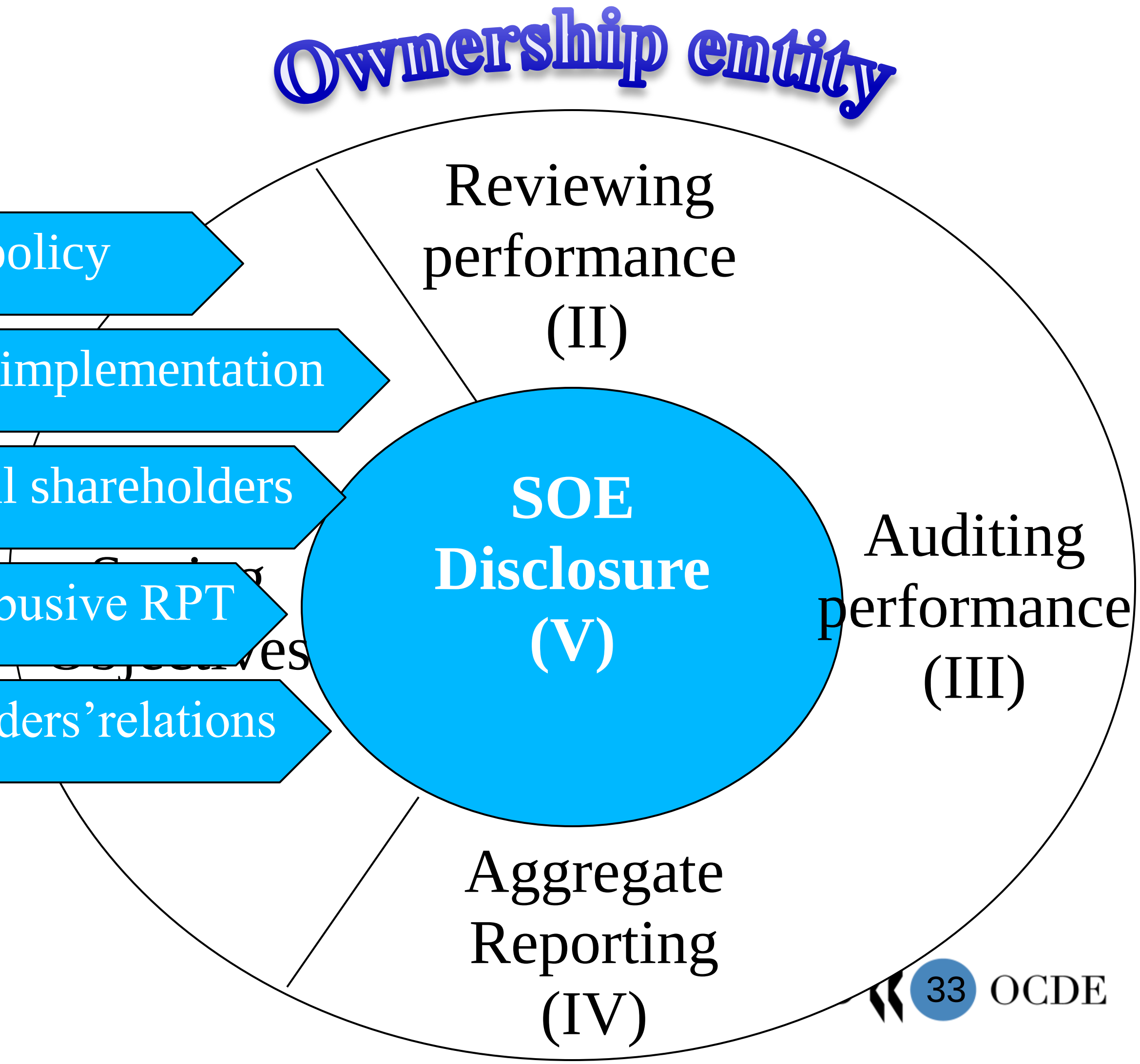
A select committee may receive **a petition form private citizens** regarding an SOE, which may then be called in for a review

Every select committee has the power **to launch an inquiry,** and could call an SOE in to provide evidence

In addition, SOEs are regularly required to appear before the Finance & Expenditure Committee for a **financial review.**

SOE disclosure (5)

- Develop a coherent disclosure policy
- Encourage & monitor effective implementation
- Ensure equitable treatment of all shareholders
- Ensure SOEs don’t undertake abusive RPT
- Adequate reporting on stakeholders’relations



Disclosure and transparency at SOE level (5)

Develop a coherent disclosure policy

- review of the current requirements as well as actual practice
- adapt and complete the framework, with adequate consultation
- focus on material information and proper use of RIA

Encourage & monitor effective implementation

- measure and assess effective implementation
- develop guidance in sensitive areas
- underline boards' responsibilities and the role of the audit committee
- communicate effectively on the new framework,
- Special initiatives (meetings open to the general public and mimicking AGMs, special transparency awards, etc.)
- encourage SOEs to go beyond (sustainability reporting)

Guidelines for external reporting by SOEs in Sweden

The Swedish Government adopted the following Guidelines for external reporting by state-owned companies on 29 November 2007. These guidelines are based on the principle of “comply or explain”. The board shall describe in the annual report how the guidelines have been applied during the past financial year and comment on any deviations.

Criteria for Performance Information for the Award for Excellence in Reporting by Crown Corporations in Canada

Objectives are clear and stated in an appropriate level of detail. They include commercial, public policy, and financial objectives. Wherever possible, these are **measurable**. Significant changes in the corporation's objectives, if these arise, are highlighted and **trade-offs for conflicting objectives are explained.**

The relationship between the corporate plan summary and the annual report are clear. Budget amounts used in the financial analysis are consistent with those in the corporate plan or the difference between the two sets of numbers is explained.

The corporation's **performance is compared with each stated objective** in terms of outputs, outcomes, or secondary impacts.

Performance reporting (preferably subject to some form of **external validation**), **clearly presents results as compared with targets.** Actual results numbers used in the financial analysis are consistent with those in the audited financial statements or the difference between the two sets of numbers is explained.

The corporation **evaluates its performance with respect to its public policy objectives.**

Disclosure and transparency at SOE level (5)

Develop a coherent disclosure policy

Encourage & monitor effective implementation

Ensure equitable treatment of all shareholders

- an essential prerequisite: the duty of loyalty of SOE board members
- consistent menu of mechanisms with good balance *ex ante* / *ex post*
- nomination process favourable to minority shareholders representation
- encourage active participation in general shareholder meetings
- simple and effective option: submit SOEs to CL, LR and Codes etc.
- encourage SOEs to communicate actively with all shareholders

Ensure SOEs don't undertake abusive RPT

- usual definition IAS 24 modified in the case of state control
- mandating adequate decision processes for approval, tough standards regarding their disclosure, outright prohibition of certain types of RPT
- provide adequate guidance to SOEs
- underline the role of the audit committee in their review and disclosure
- encourage gatekeepers and the media to be vigilant

Disclosure and transparency at SOE level (5)

- Adequate **reporting on stakeholders' relations** allows SOEs
  - to demonstrate their commitment to co-operation with stakeholders
  - To build up trust and improve their reputation
  - important tool for managing risks related to stakeholder expectations
- require and encourage SOEs to follow existing best practices
  - recently developed guidelines on sustainability reporting
  - due consideration for the costs involved
  - reporting independently scrutinised to reinforce credibility
  - include information on compliance with internal codes of ethics and mechanisms protecting stakeholders reporting on illegal or unethical conduct by corporate officers
  - SOE boards encouraged to fulfil their responsibility and have at least an annual discussion

Requirements on stakeholder reporting by SOEs in Norway

In **Norway**, the “Government’s Ownership Policy” mentions specific requirements for SOEs in terms of stakeholder relations:

“The state expects companies in which the state has an ownership interest **to maintain an open dialogue with their surroundings** about their finances, social responsibility and environmental matters, and that the companies take steps to **provide information about how they deal with these matters in practice and the results they achieve.**

Both the companies’ annual reports and their websites are appropriate channels in this context.

Large companies with international operations should consider **using the reporting norm “Global Reporting Initiative”.** This norm has broad support and is supported by the UN’s environmental programme, UNEP”.

Requirements on sustainability reporting in Sweden

The recently adopted "***Guidelines for external reporting by state-owned companies***" require SOEs to publish "sustainability reports":

"A sustainability report **in accordance with the Global Reporting Initiative Guidelines** shall be published on the respective company's website in conjunction with publication of the company's annual report. The sustainability report can either be **a separate report or an integrated part of the annual report document**. The sustainability report shall be **quality assured by independent scrutiny and assurance.** The date for publication of the report shall be in compliance with the reporting cycle for the annual report".

Thanks!

The *Guidelines,*

the background *Survey* & soon

the *Transparency and Accountability Guide*

can be downloaded on our website at:

www.oecd.org/daf/corporate-affairs/soe

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