

# ANTI-CORRUPTION HELPDESK

PROVIDING ON-DEMAND RESEARCH TO HELP FIGHT CORRUPTION

## TRANSPARENCY OF STATE-OWNED ENTERPRISES

### QUERY

Could you please provide a summary of international best practices, guidelines and recommendations on the transparency of state-owned enterprises? Is there any available research on the topic done by Transparency International or other NGOs?

### PURPOSE

We are launching a research and advocacy project on the transparency and disclosure requirements for state-owned enterprises in Hungary.

### CONTENT

1. State-owned Enterprises and their Particular Corruption Challenges
2. International Standards of Corporate Governance for State-owned Enterprises
3. Best Practice from Country Examples
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### SUMMARY

State-owned enterprises (SOEs) compete with private companies and should therefore be subject to the same high standards with regards to accounting, auditing and reporting. In addition to corruption risks facing companies in general, SOEs are also exposed to specific governance challenges due to their proximity to policy makers and market regulators.

The particular position of SOEs, however, requires additional safeguards against market distortion and misuse of public funds. The state's role as an owner of the company needs to be clearly separated from its role as a regulator and communicated as such. SOEs need to be open about their governance and ownership structures, their relations to other state-owned entities, such as banks and financial institutions, and disclose any received state grants or guarantees. Transparency of SOEs implies integrity and openness from both the state's and the SOEs' perspectives.

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## 1 STATE-OWNED ENTERPRISES AND THEIR PARTICULAR CORRUPTION CHALLENGES

### What is a State-owned Enterprise?

State-owned enterprises (SOEs) are legal entities, often created by the state, that operate in commercial activities. There are many forms of SOEs and no standard definition. An SOE can be wholly or partially owned by the state; the OECD refers to an SOE when the state has “significant control, through full, majority or significant minority ownership”.

SOEs can operate in competitive or non-competitive sectors of the economy, be listed or not, and may or may not pursue a public policy objective. According to the OECD, the rationale for state ownership of companies typically combines social, strategic and economic interests, such as industrial policies, supply of public goods or regional development.

SOEs represent a significant part of GDP in many countries. They often play a role in utilities or infrastructure industries, for instance in transport, telecommunication or energy (OECD 2005). SOEs have a significant economic and social impact in many regions. If well managed, these companies can promote an effective use of the state’s resources and be a major asset for its development (Revenue Watch 2012).

### What Particular Corruption Risks are State-owned Enterprises Exposed to?

There are several governance challenges specific to SOEs, which is grounded in the intrinsic closeness between the government, or policy makers, and the company. It is important that adequate safeguards are in place to avoid market distortion, unfair competition and conflicts of interest. The close relationship between the state and SOEs can also influence the transparency of public financial flows. SOEs have a particular status compared to private companies since they are protected from some of the major risks that shape decision-making in the private sector, such as bankruptcy and takeover.

The OECD identifies political interference in the affairs of the SOE as a major governance risk. The organisation also points to the complexity of the accountability chain as a fertile ground for corruption

in SOEs. The proximity of SOEs to other state organs or state-owned entities such as banks or financial institutions – who can be clients or suppliers of the SOEs – creates a potential risk for favouritism and unfair procurement.

SOEs, in many countries, play a significant role in the extractive industries and control very important revenue flows. In best-case scenarios, these revenues are re-invested in the state and contribute to development. However, the opacity of management of many SOEs in many countries has had negative consequences on the governance of natural resources and the country’s development – what is known as the “resource curse” (EITI 2012).

## 2 INTERNATIONAL STANDARDS OF CORPORATE GOVERNANCE FOR STATE-OWNED ENTERPRISES

### Standards of Corporate Governance Should Apply to SOEs

SOEs that are listed on the stock exchange may be more accountable and transparent due to listing requirements, pressure from investors and competition with other businesses. Indeed, companies listed on the stock exchange show higher levels of transparency than their peers (Transparency International 2008). However, irrespective of whether they are listed or not, all SOEs should be accountable to their stakeholders and minority shareholders and comply with similar corporate governance standards as that of private companies.

The OECD gathered standards and good practices of corporate governance in its report *Principles of Corporate Governance*, which was published in 2004 and endorsed by OECD ministers. With regards to transparency requirements, the report promotes the mandatory or voluntary disclosure (depending on the national legislation) of:

- The company’s financial and operating results through audited financial statements, including the balance sheet, the profit and loss statement, the cash flow statement and notes to the financial statements.
- Company objectives, regarding its commercial activities as well as environmental and social policies.
- The ownership structure of the company and

voting rights, extended to the group of companies, if relevant.

- The remuneration policy for the executive management and the board, as well as information about the selection, qualification and independence of board members.
- Related party transactions involving major shareholders (and their family and close relations), including the nature of the relationship and the nature and amount of the transaction.
- Foreseeable risk factors.
- The company's governance structure and policies.

Similarly, SEOs should be subject to internationally accepted accounting standards and introduce independent auditing of their accounts in order to abide by the same standards as listed companies, as well as to facilitate performance monitoring and comparability (Transparency International 2011). The company information should be disclosed in a timely manner and a number of countries have adopted provisions for continuous disclosure, as promoted by the International Organization of Securities Commissions (IOSCO) *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* (OECD 2004).

It is becoming increasingly demanded that companies conform to Corporate Social Responsibility requirements and disclose information about their sustainability, in a similar way to financial reporting. The Global Reporting Initiative (GRI) provides a comprehensive Sustainability Reporting Framework to help companies share data about their economic, social, environmental and governance performance, which also allows for comparison between companies. A number of countries have adopted regulations requiring SOEs to report on sustainability in accordance with GRI guidelines.

### *Managing the Risk of Bribery and Corruption*

SOEs are exposed to the risks of bribery and corruption and like any non-state-owned enterprises they should strive to develop a corporate culture of integrity where bribery and corruption are not tolerated. To achieve this, SOEs must regularly evaluate their exposure to bribery and corruption and put in place anti-bribery policies and systems that will effectively address this risk. There are numerous models for comprehensive anti-bribery policies

including the *Business Principles for Countering Bribery* developed by Transparency International and a multi-stakeholder steering committee. Other similar tools such as the *Partnering Against Corruption - Principles for Countering Bribery* or the International Chamber of Commerce's *Rules for Combating Bribery* can be of help.

### **Specific Guidelines for State-owned Enterprises**

The state, as the main shareholder of SOEs, must ensure that an adequate framework is established for SOEs in the country to disclose the necessary information for the state to play its role as an owner, for parliament to be able to monitor the performance of SOEs, and for the media and the public to have a clear view of SOEs and their activities (OECD 2010). In 2005, the OECD published a comprehensive set of guidelines on corporate governance of SOEs, to complement the organisation's *Principles of Corporate Governance*. These guidelines go slightly beyond disclosure requirements and put forward the following specific recommendations:

### *Ensuring an Effective Legal and Regulatory Framework for SOEs*

The defining characteristic of SOEs is the prominent role played by the state in the management and strategic orientation of the company. An essential requirement to ensure corporate governance in SOEs is the establishment of a clear separation between the state's role as market regulator and owner of the company to create a level playing field for SOEs and private companies and to avoid market distortion. Likewise, the ownership functions should be separated from the responsibility for industrial policy. General procurement rules and their transparency requirements should be applied to SOEs when working with government entities, in particular to avoid conflicts of interest.

SOEs are sometimes expected to carry out public service responsibilities and they receive adequate compensation from the state budget for these activities. These activities should be clearly mandated by laws or regulations to ensure that the market and general public are informed of these obligations and their financial compensation.

The state often grants SOEs guarantees with regards



to the access to finance and debts, which can lead to wasted resources and market distortion. Such practices of state guarantees should be disclosed to avoid abuse.

### *The State Acting as an Owner*

The governance structure of SOEs is often complex and the role of ownership of the state needs to be clarified through a clear and consistent ownership policy that sets out the state's objectives and its role in the corporate governance of the SOEs, which should be made publicly accessible. In order to increase public confidence, the governance structure of SOEs should be disclosed and explained. The state ownership should be distinctly identified within the administration, preferably through the creation of a co-ordinating or ownership entity that will be held accountable to representative bodies.

The state should not take part in everyday management but, as the main owner, should build a transparent board-nomination process. Board members should act independently in the interest of the company, and should not act as representatives of different constituencies or take part in regulatory decisions concerning the SOE. The responsibilities of SOE boards should be identified in relevant laws, regulations and in the government ownership policy, to ensure that the board has the necessary authority to carry out its functions and can be held accountable. All potential conflicts of interest concerning board members should be disclosed together with the chosen management decision.

### *Relations with Stakeholders*

SOEs, much like listed companies, are increasingly required to disclose their relations with stakeholders, such as concerning environmental and social responsibility policies. SOEs should disclose the public policy objectives and general service obligations they are pursuing, as well as the costs involved.

### *Transparency and Disclosure*

SOEs should abide by high standards of transparency, many of which are in accordance to principles of corporate governance applying to private companies.

The government's ownership entity should establish

consistent and aggregate reporting on SOEs and produce an annual aggregate report, as a key transparency tool directed to parliament as well as the media and general public. It should provide information on the financial performance, main financial indicators and value of SOEs, as well as the general statement of the state's ownership policy and its implementation, including information on how the ownership function is organised. This report should also contain individual reporting on the most important SOEs. The OECD suggests that ownership entities develop a website to centralise the information made available to the public on the country's SOEs.

Large SOEs should have an internal audit structure in place to ensure robust disclosure processes and internal control, with internal auditors reporting to the board. Internal audit reports should be included in the financial statements. These companies should also be subject to an annual external audit by auditors that are independent from the management and shareholders.

On top of general disclosure requirements (as described in the previous section), SOEs should pay particular attention to their openness about company objectives and their fulfilment, as well as their public policy objectives, if any. Any state grant and/or guarantee should be disclosed to give a complete picture of the financial situation of the SOE. They should also disclose their respective ownership and voting structure, clarifying who holds legal ownership of the state's shares and who exercises the state's ownership rights. SOEs ought to report on risk factors and related measures. SOEs operating in the extractive industries should disclose their reserves and public-private partnerships should be clearly identified. Lastly, SOEs should disclose any transaction with related entities, such as other SOEs, to avoid potential abuses.

Transparency International also provides recommendations and guidance to companies in relation to their corporate reporting, most of which can equally apply to SOEs:

- Companies should disclose detailed information about their anti-corruption programmes. Global Compact's *Anti-corruption Reporting Guidance* provides a matrix for anti-corruption reporting, ranging from zero-tolerance statements and

whistleblowing mechanisms to staff training and publicity of corruption cases.

- Companies should publish complete lists of their affiliates, subsidiaries, joint ventures and other related entities.
- Companies should publish individual financial accounts for each country where they operate.
- Companies should have a corporate website that centralises all disclosed information and is available in at least one international language.

### Guidelines for State-owned Enterprises Operating in the Extractive Industry

The Extractive Industries Transparency Initiative (EITI) and Revenue Watch offer specific guidelines for SOEs and states with SOEs operating in extractive industries. They promote:

- The reconciliation of all material revenues received by the SOE, following the standard EITI reporting form, where the companies disclose their payments and the SOEs disclose the receipts of payment. These reports should include bonuses, royalties, area fees/surface rentals, dividend payments, and petroleum and minerals received by the SOE in the frame of production sharing agreements, among others.
- The reconciliation of material transfers made by the SOE to the national treasury, including transfers of revenues resulting from the sale of state shares, transfers of other revenues, income taxes and dividend payments.

These NGOs also push for the disclosure of production volumes and reserves by licenses, as well as equity holdings and the sale or purchase of shares.

## 3 BEST PRACTICE FROM COUNTRY EXAMPLES

According to the OECD, significant changes can be noticed with regards to corporate governance of SOEs since member states endorsed the guidelines in 2005. In particular, progress has been made in the areas of transparency, disclosure and separation of the state's roles, as reflected by the various country examples below.

### Best Practices in Transparency and Disclosure for State-owned Enterprises

#### Korea

In 2005, the Korean government launched a website to facilitate the public's information in real time about public entities in Korea. To comply with the new regulation, Korean SOEs should disclose both financial and non-financial data following 27 standardised categories. New categories are planned to be added, in relation to subsidiaries.

#### Portugal

According to the OECD, Portugal has been one of the most active countries with regards to the implementation of SOE good governance legislations and guidelines. The government issued the *Principles of Good Governance for Companies Belonging to the State-owned Corporate Sector* in 2008, requiring SOEs to establish a clear governance structure, separating executive and supervisory roles. Portuguese SOEs are subject to the same standards as companies listed on the stock market; they should submit their annual accounts to independent external auditors and adopt a code of ethics that should be made available to employees, suppliers, customers and the general public.

#### Sweden

In 2007, the Swedish government adopted new guidelines regarding SOEs reporting requirements, making the reporting requirements as thorough as for listed companies. These requirements include the publication of the annual report, interim reports, the corporate governance report, the statement on internal control and the sustainability report. The government gives the SOEs' boards the responsibility to submit a sustainability report in line with the Global Reporting Initiative (GRI). All these documents should be available on SOEs' corporate websites from 2008 on. The guidelines follow the principle of "comply or explain" and SOEs should justify any deviation in the annual report.

#### Turkey

Since 2009, the Turkish Under-secretariat of Treasury has been empowered to collect and publish information about the country's SOEs, including the companies owned by local governments. The treasury has published aggregate reports on public

enterprises since 2007, extending the scope of the report to additional companies every year.

## Best Practices in the Separation of the State's Roles

Beyond the transparency requirements that apply to all companies, SOEs need to make their relation to the state very clear in order to avoid risks of market distortion and conflicts of interest. The task of clarifying the separation between the state's ownership and regulatory role falls on the state and not on the company. It is, however, an important facet of SOE transparency.

### Finland

To mark a clear separation between the state's role as owner and regulator, the Finnish state adopted the *State Shareholdings and Ownership Steering Act* in 2007. This law created the Ownership Steering Department, centralising the ownership functions of the state. This department is responsible for the implementation of the *Resolution on State Ownership Policy* of 2007, providing a harmonised approach of the state's role as the owner for all SOEs and a unique decision-making line, independent from other regulatory organs.

In 2011, the Finnish government adopted a resolution requiring non-listed SOEs to report their sustainability performance in order to allow for greater comparison between companies. Finnish SOEs also need to ensure that their subcontractors obey the principles of responsibility as well. The resolution provides SOEs with a corporate responsibility reporting model based on GRI's G3 and G3.1 *Sustainability Reporting Guidelines*.

### New Zealand

New Zealand's government adopted a centralised state ownership model in 2009, putting the ownership functions in the hands of the Crown Ownership Management Unit, which is an integral part of the Treasury. This model concentrates the monitoring, appointment and governance roles of the state in a unique independent entity.

More best practices and country examples are available here:

OECD, [Corporate Governance of State-Owned](#)

[Enterprises change and reform in OECD countries since 2005](#) (2010)

## 4 EXAMPLES OF NGO PROJECTS

The following overview of NGOs' research and advocacy projects is not meant as a comprehensive list of civil society activities and initiatives, but provides a few examples of the work of some of Transparency International's chapters and other organisations in this area.

### Transparency International

#### *Transparency International India and Integrity Pacts*

Forty-four Indian SOEs have signed integrity pacts with Transparency International India to increase the level of transparency in public contracting. Some of India's major oil and gas corporations are participating in the project. In 2012, TI India issued its first assessment report on the implementation of these integrity pacts in participating companies.

[Report](#)

[Blog post](#)

#### *Transparency International Russia's Monitoring of Procurement to SOEs*

As of recently, Russian SOEs need to publish rules for purchasing and service contracts, as well as report all public contracts exceeding €2,500. Since 2009, Transparency International Russia has been involved in monitoring buying patterns and procurement in Russian SOEs, starting with Rosatom, followed by Olympstroy, Rostekhnologii, Vnesheconombank and other SOEs.

[Blog post](#)

#### *Transparency International Slovakia's Ranking of Slovak State-owned Companies*

In 2012, Transparency International Slovakia produced a transparency ranking of the state and municipality-owned companies in Slovakia. The data was collected on companies' websites as well as through freedom of information requests and journalists answers to a questionnaire. The survey

measures information availability, as well the presence of anti-corruption measures in six policy areas: economic indicators; communication and access to information policy; public procurement policy; human resources policy; ethics; grants and charity policy.

[Survey and ranking](#)

[Blog post](#)

## Other Civil Society Organisations

### *Revenue Watch Institute (RWI)*

The Revenue Watch Institute is a non-profit policy organisation that promotes the effective, transparent and accountable management of oil, gas and mineral resources for the public good. RWI produces an index of government disclosure in the management of hydrocarbons, measuring among other things the availability of information regarding the governance structures of SOEs and the reporting practices related to their activities. It has also undertaken research on selling patterns and transparency of SOEs operating in the hydrocarbons sector.

[Revenue Watch Index 2010](#)

[Policy briefs](#)

### *Extractive Industries Transparency Initiative (EITI)*

EITI is a coalition of governments, companies, civil society organisations, investors, journalists and international organisations, promoting transparency in the extractive industries sector. EITI regularly works on transparency in SOEs, and published a [paper on disclosures by SOEs](#), in collaboration with RWI:

### *Global Reporting Initiative (GRI)*

The Global Reporting Initiative is a non-profit organisation that promotes economic, environmental and social sustainability, and provides companies with a comprehensive sustainability reporting framework. GRI presents a [few examples](#) of what countries have done to promote transparency and

sustainability in SOEs.

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