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**UKRAINE  
SYSTEM OF FINANCIAL OVERSIGHT AND GOVERNANCE  
OF STATE-OWNED ENTERPRISES**

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## **ACRONYMS AND ABBREVIATIONS**

CCU	Commercial Code of Ukraine	MOF	Ministry of Finance
CMU	Cabinet of Ministers of Ukraine	NAS	National Accounting Standards
EC	European Commission	OECD	Organization for Economic Cooperation and Development
EU	European Union		
FDI	Foreign Direct Investment	PIFC	Public Internal Finance Control
GDP	Gross Domestic Product	ROSC	Report on the Observance of Standards and Codes
IFC	International Finance Corporation	SAI	Supreme Audit Institution
IFRS	International Financial Reporting Standards	SBA	Stand-By Agreement
IMF	International Monetary Fund	SCI	Statement of Corporate Intent
ISA	International Standards on Auditing	SOE	State-Owned Enterprise
JSC	Joint-Stock Company	SPF	State Property Fund
KRU	State Control and Revision Service	WB	The World Bank
MOE	Ministry of Economy		

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## **EXECUTIVE SUMMARY**

- i. State-owned enterprises (SOEs) continue to represent a significant share of Ukraine's economy, and play a dominant role in sectors such as rail, transport, utilities, energy and telecommunications. These enterprises play an important role for the government by remitting dividend payments to the national treasury to fund the country's development agenda. At the same time, these same enterprises receive fiscal support from the government – through a transfer of budgetary resources, issuance of guarantees for enterprise debt, facilitation to lines of credit and other financial instruments, etc.
- ii. While Ukraine's large structural fiscal deficits were masked during the growth years of 2004-2008, public and publicly guaranteed debt levels are growing. The current weak fiscal position and tightening budget constraints will require government action to improve the performance and profitability of the overall SOE sector, as it is significant driver of the country's economic output. As the global economic crisis has hit Ukraine particularly hard, there is a pressing need to rationalize and improve the allocation of fiscal resources in order to stabilize the economy and to resume industrial production and growth.
- iii. The continued presence of SOEs combined with both a slowdown in privatization as a result of the financial crisis and the reassertion of the state through temporary takeovers or outright nationalization of companies has brought SOE corporate governance squarely on to the reform agenda. This report is not an assessment of performance of individual SOEs. Rather, it focused on the current system of SOE oversight as a whole with an objective to identify areas of weakness and to propose measures to align Ukraine's systems and practices with international benchmarks, standards and good practice.
- iv. **Summary of Findings.** Ukraine's SOE sector has a wide range of ownership and management schemes. The basic legal framework for SOE oversight, defined in the Commercial Code of Ukraine, provides for the delegation of responsibilities across several ministries/agencies. As a result, there are overlapping roles across different government institutions, and gaps with regard to active monitoring and oversight.
- v. In practice, the SOE oversight function of the line ministries is primarily exercised through a review of the reports submitted by the SOEs on the implementation of financial plans. However, the review is typically light, and its efficiency is undermined by the limited clarity of the operating objectives for SOEs, and limited usefulness of the performance management framework. Moreover, the underlying data used to measure performance indicators is not validated and its reliability is uncertain. Even though the current performance management framework can be improved, performance evaluations are not conducted for a substantial number of SOEs which seriously undermines the effectiveness of oversight.

- vi. Transparency and disclosure requirements are in need of significant strengthening and should first be clearly established in a modern legal framework. Many of the deficiencies in Ukraine's current financial reporting architecture, in particular incomplete consolidations and the absence of appropriate or complete disclosures relating to related parties and owners, make it difficult for users to make a proper assessment of the financial position and performance of an SOE. There is no requirement for entities to be subject to an annual external audit. Additionally, SOEs are not required to disclose or publish basic financial information, corporate results, or other non-sensitive company information. There is also a need to enforce the proper application of transparency and disclosure policies and ensure that public access to information is guaranteed.
- vii. **In attempting to strengthen its system of oversight and in order to improve the performance of the SOE sector, there are three basic issues, which once resolved, would enable the government to better target its reform initiatives.** First there is an urgent need to establish a single and comprehensive database of all SOEs operating in Ukraine. The lack of complete and thorough information is representative of some of the weaknesses identified in the current system of management and oversight. Second, in order to focus attention and efforts to improve the performance of those enterprises which represent either significant value to the economy (or to a specific sector) or which represent significant risk (e.g., fiscal risk), it would be important to segment the sector – distinguishing large SOEs from small and medium enterprises. Third, all large SOEs should be subject to process that utilizes the principles of corporatization with a clear purpose to improve the enterprise's internal management structures. This effort would also include establishing independent, professional and competent boards of directors (which will assume the responsibility for primary oversight of the enterprise), strengthening internal controls, and modernizing (or implementing) operational and risk management systems and practices.
- viii. **Looking forward, the detailed recommendations below focus on three interrelated and critical areas which underpin any effort to reform or improve SOE performance: (i) legal framework, (ii) state ownership policy, and (iii) transparency and disclosure.** A strong legal framework not only requires the implementation of modern corporate governance practices within an enterprise, but it also supports the development of clear objectives and goals against which performance can be objectively measured. In trying to improve the performance of SOEs, it is also necessary to ensure that these enterprises are insulated from political interference, to clarify the government's oversight and monitoring role, and to establish an arms-length relationship between government and SOEs in terms of managing an enterprise's operations. Lastly, transparency is the cornerstone of any governance reform and open access to information provides the basis for accountability and enhances the ability to assess performance and allocate capital and resources effectively.
- ix. **Legal Framework. The legal framework for unitary and kazenni SOEs is in need of modernization and upgrading.** In revising the legal framework for SOEs, it is desirable to establish a single, unifying and basic set of regulations which would be applied evenly across all sectors. This effort should strive to reduce, or eliminate

entirely, the current differences between regulations applicable to joint-stock companies and those which apply to unitary and kazenni enterprises. It is also important to simultaneously better define what the role of government oversight entails as well as clarify the government ministry/agency which is responsible for a specific function. It is essential that the legal framework establish a clear arms-length relationship between government and an SOE and should include specific limits on the government's role or influence regarding an SOE's access to finance and credit. Modern corporate governance practices (including establishing independent and professional boards of directors, including board committees for all large SOEs) should be integrated into the revised and upgraded framework. Lastly, the legal framework should require that SOEs establish clear operating objectives as this would strengthen the performance management framework and in turn, help focus efforts on those enterprises which require restructuring or additional forms of assistance.

- x. **State Ownership Policy.** In formulating the state's ownership function, which should be underpinned by a strong corporate governance framework, the government of Ukraine should first develop a clear ownership policy which separates the regulatory function from management and oversight, and which provides the general public with a clear understanding of the state's objective as an owner. In attempting to strengthen accountability, the government, as the ultimate guarantor of SOE debt and liabilities, should develop clear limits with regard to its financial obligations and exposure. There should also be clear criteria which would help evaluate SOE proposals or requests to access financial instruments.
- xi. While Ukraine has implemented a performance management framework, there is a need to improve both the quality of indicators as well as the quality of information used for measurement. As there are significant gaps in compliance with performance evaluations and even with remittance of dividends to the national treasury, it will be important to develop mechanisms by which to enforce compliance with these requirements.
- xii. **Transparency and Disclosure.** The transparency framework and basic accountability requirements and practices for all SOEs can be strengthened. SOEs should be required to *ex-ante* publicly disclose/publish the enterprise's operating objectives (commercial and non-commercial objectives) as well as financial plans. It will be important that the transparency framework establish the requirement for public disclosure of the annual reports on SOE performance – both in aggregate as well as for individual enterprises.
- xiii. Although there are some material differences between International Financial Reporting Standards (IFRS) and Ukrainian National Accounting Standards (NAS), large SOEs (with primarily commercially oriented operations) should be required to fully comply with National Accounting Standards in preparing their annual financial statements. The MOF has recently taken several steps to upgrade NAS and to eliminate the remaining differences with IFRS. The introduction of IFRS should remain a medium to longer term goal as it would align Ukraine with international practices. Large SOEs



should also be required to report comprehensively, including consolidation of financial information for its subsidiaries. Upgrading the underlying standards of financial reporting would also significantly help improve the reliability and usefulness of data used for performance measurement. The draft Law on Accounting can be broadened to also include this category of SOEs in the application of IFRS as the international standard will be implemented over time.

- xiv. In aligning with international good practice, the transparency and accountability framework would require that all large SOEs (whose operations are commercially oriented) have their financial statements audited by statutory auditors in accordance with International Standards on Auditing – and all SOEs should be subject to some form of independent annual financial audit. The audit requirement would also help to ensure that company financial data and results, which are used for performance measurement, is validated and reliable. The current draft Law on Auditing can be amended to incorporate this category of SOEs within its mandate.
- xv. Finally, it is important that all SOEs, especially the large SOEs, be required, *ex-post*, to publish (at a minimum) their annual reports and audited financial statements in a timely manner. There is a need to significantly strengthen and enforce compliance with the Law on Information to ensure that the general public, including interested users of financial information, has unrestricted access to company information that is not determined to be commercially sensitive.

## **SECTION I: INTRODUCTION<sup>1</sup>**

1. **Ukraine has a vibrant democracy but faces severe governance weaknesses that are at the root of many reform challenges in the country.** In February 2010 a new President was democratically elected, the second time free and fair elections were held since 2005. The media is lively and civil society is vibrant if disorganized. However, the accountability of public officials remains low and the elite often rule with impunity. Moreover, frequent elections and contradictions in the constitution have led to political volatility and diverted the attention of leadership away from burning economic and social challenges. Ownership of the governance agenda has been limited due to strong vested interests within government and key business groups. Poor governance has caused deep discontent with state performance, lack of trust in government, and low social mobilization for governance building initiatives.

2. **Ukraine was an average growth performer in a fast growing region between 2000 and 2008.** Since the economy bottomed out in 1999 following the Russian crisis, real GDP growth averaged 7 percent between 2000 and 2008 (see table 1), just above the Europe and Central Asia (ECA) region's<sup>2</sup> average of 6.4 percent, but below the group of countries in the Commonwealth of Independent States (CIS) that averaged 7.5 percent.<sup>3</sup> Growth performance appears to be less impressive, however, taking into account the low base caused by the deep and protracted economic contraction of Ukraine in the 1990s. Therefore, Ukraine had been growing with the region, but not significantly converging toward the new EU countries levels of income.

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<sup>1</sup> World Bank's Country Partnership Strategy Progress Report for Ukraine (2010) and the 2010 Country Economic Memorandum (forthcoming).

<sup>2</sup> The ECA region includes the following countries: Albania, Armenia, Azerbaijan, Belarus, Bosnia & Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kosovo, Kyrgyz Republic, Latvia, Lithuania, FYR Macedonia, Moldova, Montenegro, Poland, Romania, Russian Federation, Serbia, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine, Uzbekistan

<sup>3</sup> The CIS include most of the former Soviet Union republics, except for the Baltic countries.

**TABLE 1: MAIN MACROECONOMIC INDICATORS FOR UKRAINE, 2001-2008**

	2001	2002	2003	2004	2005	2006	2007	2008
Real GDP (change in percent)	9.2	5.2	9.6	12.1	2.7	7.3	7.9	2.1
Real Industrial Production (change in percent)	14.2	7.0	15.8	12.5	3.1	6.2	10.2	-3.1
CPI, a.o.p. (change in percent)	12.0	0.8	5.2	9.0	13.5	9.1	12.8	25.2
CPI, e.o.p. (change in percent)	6.1	-0.6	8.2	12.3	10.3	11.6	16.6	22.3
Real Exchange Rate, a.o.p. (change in percent, a decline means depreciation)	11.2	-3.7	-8.2	-2.1	10.2	4.8	1.4	9.3
Current Account Balance (percent of GDP)	3.7	7.5	5.8	10.6	2.9	-1.5	-3.7	-7.2
Foreign Exchange Reserves (USD billions)	3.1	4.4	6.9	9.7	19.4	22.4	32.5	31.5
Net FDI (USD billions)	0.8	0.7	1.4	1.7	7.5	5.7	9.2	9.7
Fiscal Balance (percent of GDP)	-1.6	0.5	-0.9	-4.4	-2.3	-1.4	-2.0	-3.2
Public and Publicly Guaranteed Debt (percent of GDP)	38.6	36.5	29.0	24.7	17.7	14.8	12.4	20.1
<i>Memo:</i>								
Nominal GDP (in billions of USD)	38.0	42.4	50.1	64.9	86.2	107.8	142.7	180.2
GNI per capita (USD, Atlas method)	720	780	970	1260	1520	1960	2560	3140

Sources: SSC; NBU; IMF; WB staff calculations.

3. **Large structural fiscal deficits were masked by rapid growth since 2004.** Cash fiscal deficits during 2001-2008 averaged 1.9 percent GDP but in 2009, the general government fiscal deficit on cash basis was 8.8 percent of GDP (including Naftogaz but not including the costs of bank recapitalization).<sup>4</sup> While the headline deficits during 2001 and 2008 looked moderate, the underlying structural balances were much worse. This has been sharply revealed as a result of the crisis. The public and publicly guaranteed debt level is growing and needs to be stabilized and reduced over time. The current weak fiscal position and the lack of up-front action to rein in the deficit will significantly increase debt. Without corrective measures this may have unintended consequences on the costs of external financing as capital markets become more selective. There is thus a significant risk of crowding out private investments by raising the cost of finance both domestically and externally.

4. **As the crisis unfolded Ukraine's economy contracted by 15 percent in 2009, exposing its underlying macroeconomic and structural vulnerabilities.** These included: (i) a weak maturity structure of the fast growing private sector external debt; (ii) banking sector vulnerabilities associated with the rapid loan growth supported by predominantly external funding and weak regulatory and supervision controls; (iii) volatile terms of trade and lack of diversification in external demand (mainly related to the steel and heavy industry sectors on the export side and the gas sector on the import side), (iv) expansionary fiscal policies in the context of problematic expenditure and revenue structures; (v) weak competition and ability to diversify and generate higher value added products; and (vi) an overall burdensome regulatory environment and large government footprint that hamper private sector development

<sup>4</sup> The costs of bank recapitalization amounted to 2.3 percent of GDP. They were agreed as part of a below the line adjuster under the IMF's SBA.

5. **To close the gap with its eastern European peers and neighbors and achieve sustained fast economic growth, Ukraine thus needs to accelerate and deepen structural reforms.** Ukraine will have to improve its business climate, increase export sophistication and diversification, and build up its physical and social infrastructure. As fiscal pressures continue to mount, rationalization and improved allocation of fiscal spending has become a priority. Strengthening banking sector regulation and supervision will be critical to safeguarding financial stability and ensuring a sustainable recovery. Improved SOE governance and management has linkages to several key reform fronts: (i) it can help safeguard scarce fiscal resources, (ii) it can help create a level playing field and improve competition in the private sector, and (iii) it can help provide cheaper, better quality and more efficient public services in areas where the state continues to have a role to play as an owner (and sometimes as an operator) or key public infrastructure.

6. **The continued presence of SOEs combined with both a slowdown in privatization as a result of the financial crisis and the reassertion of the state through temporary takeovers or outright nationalization of companies has brought SOE corporate governance squarely on to the reform agenda.**<sup>5</sup> A long history with SOE reform shows that significant corporate governance challenges contribute to poor SOE performance. Driven by a wide separation of ownership (by the citizens of a country) from control (by the directors and managers that run the company), SOEs are frequently governed by multiple government bodies (one or more ministries, cabinet, a dedicated ownership entity, Parliament), each using the companies to achieve short-term goals. SOEs are also characterized by weak legal and regulatory frameworks, unclear or conflicting objectives (an ineffective ownership function), lack of transparency and accountability and weak boards of directors. Together, these factors undermine SOE efficiency and service delivery, impact the use of public funds, and open the door to corruption. As such, the unfinished reform program to restructure and modernize the system of SOE governance will be of critical importance to the agenda of the new administration.

#### **KEY DEVELOPMENT ISSUES AND RATIONALE FOR BANK INVOLVEMENT**

7. **The World Bank had commissioned two separate studies (the 2002 “Study on Management of State-Owned Enterprises in Ukraine” and the 2007 “Analysis of Performance of State-Owned Enterprises”).** While both studies analyzed the full range of SOEs (Unitary, Corporatized and Joint-Stock Companies), they have provided a complete background and overview into the structural limitations of current management responsibilities. The 2002 study in particular noted a series of cross-cutting weaknesses including the lack of enforcement of state corporate law, significant gaps in state corporate principles and actual practice, lack of a single government agency with responsibility for oversight, significant gaps in financial reporting – which is

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<sup>5</sup> Concept Paper: Toolkit for Improving SOE Corporate Governance (2010). See also the 2010-2014 Reform Program prepared under the auspices of the Economic Reform Council.

simultaneously incomplete and repetitive - and weak ministerial management and surveillance.<sup>6</sup>

8. **SOEs have a varying degree of managerial independence—relatively low where the state has majority ownership.**<sup>7</sup> Most types of enterprises fail the test for managerial independence based on one or more of the following elements:

- **Under pricing is widespread.** The *kazenni* SOEs have been designed to supply goods and services to the state below cost. Ordinary SOEs and key holding companies also tend to under price, particularly in ‘sensitive’ sectors, such as energy and household services. As an example, cost recovery rates for water supplied via communal enterprises ranged from 60 to 90 percent in 2003.
- **Employment policies are not fully in line with market practices.** Wage setting is based on labor union agreements for *kazenni* and unitary SOEs. More independence is given to those companies where government control is looser, but even for these the government has recently imposed restrictions on wages paid.
- **The commercial orientation of Ukrainian SOEs is weak.** Many of the largest companies (including in the energy sector) hold the majority of their market or operate as monopolies. A large fraction of their turnover may be highly reliant on sales to the state and local governments. Studies suggest that managers have little or no experience in defining market-oriented policies, especially at the local level, for instance, the communal service providers.

9. **Additionally, the International Finance Corporation (IFC) had commissioned a comprehensive study on corporate governance practices in Ukraine.** The 2008 study had two inter-related objectives: (i) to explore the level of development of internal audit practices and internal control systems in Ukrainian companies and banks and (ii) to estimate the attitude of investors in Ukraine about the internal audit function and internal control systems in companies and banks in Ukraine. While the focus of the IFC work was to evaluate the private sector, the study revealed that the internal audit function is not a common component of the overall internal control system/framework in Ukrainian companies and even where internal audit was found to exist, the department’s independence from management was in question. The more startling result was the attitude of investors. Approximately half of the investors surveyed agreed that adequate internal controls and a functioning internal audit department reduced investment risk. About 84% of the investors responded that they were not satisfied with the information (lack of) concerning internal controls being disclosed by companies – a majority indicated this should be included in a company’s annual report. Finally, over 50% of the investors surveyed indicated that investments were not made because of inadequate

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<sup>6</sup> While the 2002 study reported an extensive number of systemic and cross-cutting weaknesses, for the purposes of this study, the most relevant weaknesses have been included. For a full list, please see the 2002 report annex 5 “Problematic Areas for State-Owned Enterprises.”

<sup>7</sup> Leonov and Stetsenko (2007) and the IMF Country Report No. 07/47

internal controls and internal audit or where improvements in these areas were required as a pre-condition for the investment.

10. **It is evident that the awareness of and culture to put into practice modern oversight systems has not yet matured in Ukraine.** Where the private sector enterprises have inherent incentives to modernize or to align with accepted international practices in order to attract private capital and investment, the public sector has no such inherent incentives. The results from the IFC study underscore the importance to evaluate the degree to which public sector enterprises, SOEs, are effectively monitored and supervised, and implement modern corporate government practices.

#### **OBJECTIVE**

11. **The overall objective of this study is to analyze the current system of SOE oversight and propose measures to bring Ukraine's systems and practices to the level of international good practice.** The study attempts to achieve this objective by reviewing the performance and current functions of governmental bodies responsible for oversight and through a comparative analysis of Ukraine's systems of oversight with other developed and emerging market economies. In doing so, the study supports the Government of Ukraine's efforts to improve the level of transparency, efficiency and effectiveness in the management and oversight of SOEs.

12. **The study complements rather than duplicates previous analytical work.** This study has updated the analysis of the 2002 commissioned study which identified general weaknesses in how SOEs are effectively monitored and supervised but did not put forth concrete policy recommendations. Additionally, this study responds to the IFC study by evaluating the practices of SOEs with regard to transparency and disclosure, and evaluating the degree to which these practices align with international norms and standards. With regard to SOE practices, the study further examined the degree to which these practices, as they relate to the OECD Guidelines for Corporate governance of State-Owned Enterprises, are aligned with international best practice.

#### **METHODOLOGY**

13. **This study analyzed the current arrangements for financial oversight in SOEs and the role of government units in exercising this function.** The study reviewed the functions and practices of central government ministries (Ministry of Economy, Ministry of Finance, and line ministries). Given the size of the SOE in Ukraine, the study focused on the overall system of oversight and governance rather than analyze practices at the enterprise level. This study did not address related topics such as the roles and functions of SOE Boards of Directors or Securities Market regulations as these areas merit their own in-depth reviews. This report also analyzed the tools of and actions the State Property Fund takes with respect to exercising its oversight role for Joint-Stock Companies. While the assessment of the State Property Fund was not a direct objective of this work, it was nevertheless an important component in assessing the quality of the central government's oversight arrangements for SOEs.

14. **In reviewing the oversight arrangements for SOEs, it was necessary to focus the scope of this work on the legal and regulatory framework, the ownership policy and state functions of ownership and transparency and disclosure policies.** A strong legal framework not only requires the implementation of modern corporate governance practices within an enterprise, but it also supports the development of clear objectives and goals against which performance can be objectively measured. In trying to improve the performance of SOEs, it is also necessary to ensure that the government has established a clear ownership policy which insulates SOEs from political interference, clarifies the government's oversight and monitoring role, and establishes an arms-length relationship between government and SOEs in terms of managing an enterprise's. Lastly, transparency is the cornerstone of any governance reform and open access to information provides the underlying basis for accountability/oversight and enhances the ability to assess performance and allocate capital and resources effectively. While these three areas may appear to be distinct, they are in fact closely intertwined and are the foundations of any attempt to improve the performance of SOEs. The questionnaires used as one of the primary means to collect information can be found in annexes 6 and 7.

15. **Additionally, the 2005 OECD Guidelines on Corporate Governance of State-Owned Enterprises have been used as a benchmark against which Ukraine's system of financial oversight can be evaluated.** This paper also includes an analysis of how the current system in Ukraine measures against relevant examples from OECD member where the use of performance monitoring indicators is one component of the broader oversight system. The recent OECD Survey of Corporate Governance practices (Chapter 1, *Ensuring an Effective and Regulatory Framework for State-Owned Enterprises*, Chapter 2, *Organization of the Ownership Function within the State Administration* and Chapter 5, *Transparency and Disclosure* – see Annex 3 for details on the OECD code) in member countries also offers useful country case studies which have been used to measure the effectiveness of the practices in Ukraine. Additional research is included as to provide additional country cases/comparisons – in particular, seeking examples from industrialized or similar emerging market economies.

16. The structure of this paper is as follows:

- Section 1 – Introduction, including objectives and scope of the study
- Section 2 – Basic elements of the SOE sector in Ukraine
- Section 3 – Assessment of Ukraine's system of SOE oversight
- Section 4 – Benchmarking Ukraine against the OECD Guidelines and good international practice
- Conclusions and Recommendations
- Annexes

## **SECTION II: BASIC ELEMENTS OF THE SOE SECTOR IN UKRAINE**

### **CONTEXT OF STATE-OWNED ENTERPRISES IN UKRAINE**

17. **Ukraine has made progress during the transition to a market-oriented economy but major challenges still remain.** Large-scale privatization, enterprise restructuring, and implementation of modern governance frameworks still remain largely incomplete.<sup>8</sup> In 1998/9 Ukraine shifted from large-scale privatization to case-by-case privatization. By 2001, the government had recouped 1.3 percent of GDP in privatization receipts. The IMF found that through 2000, Ukraine's cumulative receipts resulting from privatization was about 3 percent of GDP, compared to an average for all transition economies during the same period of 9 percent.<sup>9</sup> While progress was noted in that the privatization process was more transparent than before, the process was still plagued with problems, including political interference. Often the government only sold a minority share in enterprises that had been put up for bidding. Widespread collusion amongst bidders was a frequent deterrent to attract non-CIS interest and managers of enterprises claimed control through front companies initiating bids.<sup>10</sup>

18. **Despite previous efforts to privatize numerous state managed and controlled operations, the government still maintains a considerable share of the economy.** Though acknowledging that reliable data has been difficult to obtain, IMF and Bank staffs have estimated that SOEs currently represent approximately 22-25% of GDP. Previous analytical work has identified the oversight of SOEs as a critical issue.<sup>11</sup> Specifically, the issue of transparency in the management and oversight of SOEs has been a central concern over the past several years.

19. **Successive governments have recognized the need to reform the SOE sector. During the period 2001-2006 the government had established several working and policy analysis groups which have proposed a series of recommendations to improving government ownership and management over the SOE sector.** In 2006, the State Agency for Investment and Innovation of Ukraine prepared a *White Paper*<sup>12</sup> which identified several issues and problems in attracting foreign investment to Ukraine, including the issue of corporate governance and oversight/management of state-owned enterprises. The working group, which included a number of high ranking officials (at the levels of deputy minister) from the Ministry of Economy, Finance, Cabinet of Ministers etc., recommended a series of related policy initiatives including: (i) gradual harmonization of the corporate governance legal and regulatory

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<sup>8</sup> Ibid.

<sup>9</sup> IMF Policy Discussion Paper, "Privatization in Ukraine: Challenges of Assessment and Coverage of Fund Conditionality." PDP/02/7

<sup>10</sup> Ibid.

<sup>11</sup> Ukraine – Improving Inter-governmental fiscal relations and public health and education expenditure policy (2008 Report No. 42450-UA); Public Financial Management Performance Report (2007 Report No. 39015-UA); Creating Fiscal Space for Growth (2006 Report No. 36671-UA).

<sup>12</sup> *Attracting Foreign Investment to Ukraine: Problems and Solutions* (2006), State Agency for Investment and Innovation of Ukraine (Main Department of the Civil Service of Ukraine) and the International Centre for Policy Studies



framework with European Union (EU) legislation; (ii) identifying and separating the functions of state ownership rights and functions for SOEs; (iii) implementing strengthened corporate governance rules and practices in the public corporate sector.

20. **The previous government moved rapidly to present its “Ukrainian Breakthrough” program to the public, but the program did not manage to obtain full endorsement by Parliament.** As Table 2 below confirms, the issue of SOE transparency and governance was consistent with the strategic directions of previous governments.

**TABLE 2: COMMON REFORM AREAS IN GOVERNMENT PROGRAMS 2000-2008**

“The Ukrainian Breakthrough: For People not for Politicians” (2007-2009)	Program “Stability, Competitiveness and New Quality of Life” (2006-2007)	“Meeting the People Program”/ “EU Action Plan” (2005-2006)	“Reforms for prosperity”/ “European Choice” (2000-2004)
<p><b>Competitive national economy;</b> through:</p> <ul style="list-style-type: none"> <li>• Budget and tax policy; (including through the implementation of medium term budget framework, low fiscal deficits and debt, better investment planning, and fiscal decentralization)</li> <li>• <b>Improvement of SOE management and transparency of the privatization program.</b></li> <li>• Sectoral policies in relation to the financial sector, energy (including through harmonization of the energy market with the European Union)</li> </ul>	<p>Establishing conditions to increase investment through tax and budget reform, financial market development, and <b>SOEs management improvement</b></p>	<p><b>Strengthening fiscal sustainability</b></p> <p>Adopting an infrastructure financing strategy and pursuing gradual convergence towards EU principles and standards on electricity and gas markets</p>	<p>Improving fiscal situation through <b>fiscal transparency</b>, fiscal austerity, and debt reduction</p>

Excerpts from 3<sup>rd</sup> Development Policy Loan Program Document

21. **In its 2007 Program of Action, the Cabinet of Ministers of Ukraine (CMU) included a comprehensive and detailed program to improve the level of transparency, efficiency and effectiveness in the management of SOEs.** Among the notable items which comprised the program, actions included improvement of financial planning and reporting, the mandatory publication of financial and economic performance, and the application of transparent mechanisms for determining profitability for the purposes of calculating the transfer of dividends to the state. Additionally, the Cabinet of Minister had indicated its intention to enact the new Management of State Property Law, which will establish, *inter alia*, the principles of state property management, corporate rights of the state, and improved management functions.

22. **Ukraine’s SOE sector has a wide range of ownership and management schemes.** In line with Ukraine’s Commercial Code, enterprises fall into two broad categories: state and communal unitary enterprises, and economic enterprises (e.g., joint-stock companies). The first group comprises a number of SOEs with special status (*kazenni*), that are fully controlled by the government, exempt from certain aspects of corporate law, and enjoy guaranteed state orders, as

well as unitary (or “ordinary”) SOEs, fully owned by the government, and controlled by ministries or other government agencies, but which have a relatively greater degree of managerial independence. Economic enterprises include share-holding companies, limited liability companies and other integrated companies, which must abide by Ukraine’s corporate legal framework.

23. **There is no single government entity with full oversight of the SOE sector and oversight responsibilities are spread across a number of government ministries and agencies.** The State Property Fund (SPF) manages all state enterprises undergoing privatization and also has some responsibility to oversee enterprises which have been corporatized. Key strategic firms, such as Naftogaz (which is designated as a *kazenni* SOE), remain under direct responsibility of the Cabinet of Ministers. Other state-owned enterprises (primarily unitary SOEs) are under the control of ministries and other bodies, which can grant SOE status, reorganize and liquidate state property, and appoint the management independently. The Ministry of Economy is responsible for evaluating SOE performance.

#### STATISTICS AND PERFORMANCE OF THE SOE SECTOR

24. **According to the Ministry of Economy (MOE), in 2009 there were 3,589 SOEs (across three different categories – unitary, *kazenni* and joint-stock companies with government share greater than 50%) operating in Ukraine (see Table 3 below).** The total number of SOEs (3,589) reflects the data gathered from the central government but this differs significantly from the records of the SPF Register of State Property. The SPF registry indicates that 4,184 state-owned companies operated in 2009 - the significant disparity in reporting is a concern as it reveals critical weak linkages in the government’s monitoring system. The MOE reportedly is working together with the line ministries and other agencies to address how to reconcile these differences.

**TABLE 3: BASIC DATA ON THE SOE SECTOR IN UKRAINE**

	2005	2006	2007	2008	2009
Number of SOEs in Ukraine, including:	3,981	4,086	3,209	3,546	3,589
<i>Unitary SOEs</i>	3,562	3,686	2,765	3,126	3,169
<i>Kazenni</i>	48	50	43	43	43
<i>JSCs with state share exceeding 50%</i>	419	400	444	420	420
SOE share of GDP	no data	no data	no data	no data	no data
Number of employees in SOEs (percentage of total population employed)	21.0	21.0	15.4	15.3	no data
SOE share of total industrial production (percentage)	no data	no data	no data	no data	no data

Source: Ministry of Economy, Department of State Assets

25. **While no confirmed data is available on the SOE sector's actual share of GDP, the percentage of the people employed by SOEs as a share of the total population employed is a clear indication of the big impact of SOEs on the Ukrainian economy.** There are significant additional fiscal linkages between Ukraine's SOEs and the general government. First, direct gross annual inflows from SOEs to the budget are large. SOEs contribute an important share of tax collections (partial official figures suggest that, in 2005, remittance of current taxes was at least 5 percent of GDP, some 15 percent of total tax revenues), although accumulation of tax arrears has been frequent in the past. In addition, dividend transfers from SOEs have gained importance over time, both as a share of GDP and in terms of government revenues. Second, gross transfers from the budget to SOEs have grown recently, to about 5½ percent of GDP in 2005-06. Third, Ukraine's government has provided explicit and implicit guarantees to SOEs. Data on the stock of explicit government guarantees to SOEs is not available, since official figures on total state guarantees do not identify the party contracting the loan, but they provide an upper bound for guaranteed SOE debt.

26. **State enterprises' financial conditions are closely linked to the macro-fiscal risks they may generate.** Data availability in this area is very limited, both for specific SOEs, as well as for the sector in aggregate. However, existing figures suggest a mixed picture, hinting at an accumulation of risks. Furthermore, key elements of the fiscal relation between SOEs and the government are discretionary. Notably, the policy for SOE dividend transfers to the budget is insufficiently clear. Transfer requirements have been constantly modified by the Cabinet of Ministers, enforcement has been poor, and vagueness in the framework has led to disputes. The same tax regime applies for the private sector and SOEs, but exceptions exist in practice. For example, Naftogaz enjoyed a special VAT zero-rate on imports and sales of gas to intermediate consumers before 2006. Further, the enforcement of SOE tax collection is weak, partly due to the inability of the State Tax Administration to seize assets from key SOEs.<sup>13</sup>

#### **LEGAL FRAMEWORK FOR SOE OVERSIGHT<sup>14</sup>**

27. **The *Commercial Code of Ukraine* (CCU) provides the basic legal framework for management, monitoring and evaluation, and oversight of the state-owned enterprises.** Additionally, there are numerous other special laws and other legal acts stipulating mandate and functions of the various organizations entitled to manage state assets and exercise monitoring, evaluation and oversight over the functioning of the SOE sector in Ukraine.<sup>15</sup>

28. **The CCU is the primary legal act which defines the main principles for commercial activity and regulates commercial relations.** With regard to the public sector, the CCU defines its boundaries and refers to all the entities founded on the basis of the state property as well as entities with the state's share exceeding 50% or with a share that guarantees that the government has dominant control over the entity's business activity (Article 22 Paragraph 2).

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<sup>13</sup> Leonov and Stetsenko (2007), "Analysis of Performance of State-Owned Enterprises."

<sup>14</sup> See Annex 1 for a list of laws and regulations applicable to the SOE sector.

<sup>15</sup> Including resolutions of the Cabinet of Ministers of Ukraine; regulations, procedures and rules issued by the Ministry of Economy (MOE), Ministry of Finance (MOF), the State Property Fund of Ukraine (SPF), line ministries, other state agencies

29. **Article 73 stipulates that if the government/state is a sole founder of a business entity it shall be a “unitary state enterprise”.** Unitary state enterprises can either be classified as a state commercial enterprise or a *kazenni enterprise*. The main difference between the state commercial enterprise and *kazenni enterprise* refers to the government’s role vis-à-vis the enterprise’s assets and liabilities:

- A state commercial enterprise is a state-owned business entity having state’s assets under its economic and commercial control, which is in charge for all the obligations with respect to all its assets. Examples of unitary SOEs include Energoatom, Ukrenegro, and regional railroad companies (e.g., Donetsk, South-Western, Pridneprovska). State commercial enterprise can divest or sell its assets only based on the endorsement of the relevant state governing body. The government in general or governing body in particular is not responsible for the obligations/liabilities of a state commercial enterprise. State commercial enterprise applies public procurement rules and regulations in its business transactions (Articles 74-75).
- A *kazenni* (treasury) enterprise is created in the areas sensitive or vitally important for the government (i.e. sectors restricted for private businesses, or where the government is a major consumer of goods or services, or producing socially significant products or services). Examples of *kazenni* SOEs include scientific and construction companies, producers of military and medical equipment. Naftogaz, which is a joint-stock company, is also a *kazenni* SOE. Enterprises in this category cannot simply divest or sell their assets and governing bodies are fully responsible for their obligations/liabilities - and if necessary provide compensation for their losses. *Kazenni* enterprises also subscribe to public procurement rules and regulations in their executing their business transactions (Articles 74-75).

30. **In addition to state unitary enterprises, a second broad category of SOEs are joint-stock companies.** As defined in paragraph 2 of Article 22 of the CCU, these enterprises are either fully state-owned corporations and joint-stock companies or those SOEs where the government retains dominant control over their business activities - as a rule these are the joint-stock companies where the government’s share exceeds 50%. This category of SOEs may also include limited liability companies and joint ventures, where the majority shareholder is the government.

31. **Ukrainian law establishes different rules regulating the operation, management, oversight and monitoring (including performance evaluation) for unitary and *kazenni* SOEs versus joint-stock companies and corporatized SOEs.** SOEs which are joint-stock companies (where the government still retains shareholdings) are regulated by the legal framework for private sector enterprises listed on the stock exchange (e.g. with respect to audit, transparency and disclosure, financial reporting, relationship with shareholders etc.).<sup>16</sup> While unitary and *kazenni* SOEs are not required to have boards of directors, joint-stock companies

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<sup>16</sup> The 2008 Law of Ukraine On Joint stock Companies No. 514-VI, the 2006 Law of Ukraine On Securities and Stock market No. 3480-IV and the 1996 Law of Ukraine On State Regulation of Securities Market in Ukraine No. 448/96-BP.

have appointed boards, which provide guidance to company management on the enterprise's operations.

32. **Responsibilities of the CMU, SPF, line-ministries and other government bodies in managing the state corporate rights are also defined in the Law “On Management of State Assets” (Articles 5-8).** This law stipulates that state corporate rights may be managed directly by the SPF or transferred into the management of the third party – so called “authorized person” – selected on a competitive basis. The bidding third party elaborates the financial targets expected to be achieved by the state asset (SOE, joint-stock company or other state corporation) and this is used as criteria for the selection of the authorized person (Article 10).

33. **The Law “On Management of State Assets” (Article 16) defines government bodies responsible for monitoring and evaluation, and oversight of SOE performance.** In particular the law defines the CMU, SPF, line-ministries and agencies, and state inspection and audit service (KRU) as the main entities with the responsibility for direct government intervention, management and control. Line ministries and the SPF should submit consolidated financial plans of the SOEs (in their respective portfolios) and information on their implementation to the MOE. The MOE reviews these documents and in turn, submits to the CMU, a consolidated report together with the proposals to improve SOE operational performance. According to the requirements of budgetary legislation, the MOE submits to the MOF a consolidated financial plan for SOE, highlighting the impact of the SOE performance on the state budget. Line ministries are responsible to appoint SOE managers and monitor SOEs primarily through the review of in-year reports and through the annual evaluation of performance against the management performance contracts. In cases where boards of directors have been established, line ministries, often in consultation with the CMU, appoint representatives to the board. The SPF, as the primary government agency responsible for joint-stock companies, is heavily involved in the appointment of company management, appointment of representatives to the board of directors, reviews and approves company financial plans, business strategies and is responsible for the evaluation of company performance. The KRU is entitled to audit SOEs to prevent financial violations and such audits are primarily concerned with compliance with budget legislation and other relevant legal acts and are not meant to conform to the principle of an independent (external) financial audit.

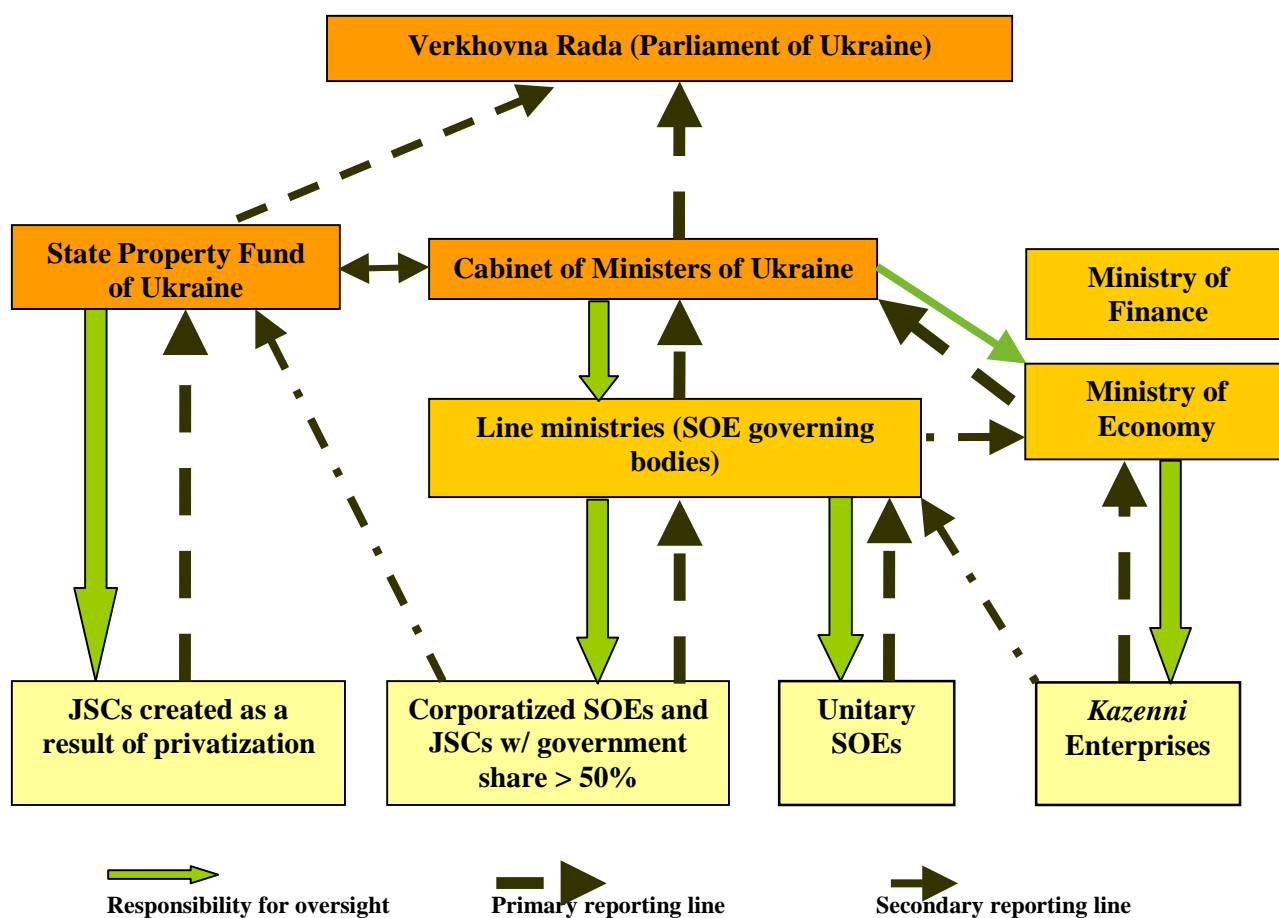
## **THE STATE OWNERSHIP FUNCTION**

34. **While Ukraine has made progress in transitioning to a market-based economy, it still relies on an ownership model with the lead role granted to the Cabinet of Ministers of Ukraine (a legacy from the former Soviet era).** In accordance with paragraph 2, Article 141 of the Commercial Code of Ukraine (CCU), all state-owned entities are governed by the Cabinet of Ministers of Ukraine (CMU) which in turn may delegate its powers and functions to central or local government bodies (within the executive branch). Article 5 of the Law of Ukraine “*On Management of State Assets*” defines a broad range of CMU responsibilities in governing the SOE sector, including policy development, drafting of legislation, selection of governing bodies

and delegation (to them) of the functions in SOE management, monitoring and evaluation, as well as oversight. The CMU delegates its functions of SOE oversight to the line ministries and agencies as governing bodies (ownership entities) for those enterprises not deemed to be of high national interest or of national security.

35. **The government’s ownership function covers a range of roles and responsibilities.** While the specific functions are de-concentrated across several ministries/agencies, the government is simultaneously a shareholder, financier, regulator, supervisor, customer and supplier. While the details of the roles of specific ministries/agencies of government area describes further in this section, the most common functions of ownership in Ukraine are related development of sector policy, appointment of company management, review and approval of company financial plans, evaluation of company performance. The distribution of mandates and functions between different government bodies, including delegated functions, is reflected in figure 1 below:

FIGURE 1: SOE GOVERNANCE SYSTEM IN UKRAINE



\*in the case of *kazenni* enterprises, the lines of responsibilities running from/to the Cabinet of Ministers operate through the Ministry of Economy

36. With regard to influencing and managing SOEs, functional ministries (MOE, MOF) and specialized agencies (the SPF) are legally empowered with the functions of policy development, monitoring and evaluation, and oversight. On a quarterly basis, the MOE and SPF review the financial reports (submitted by line ministries) on the performance of SOEs and in turn, submit a consolidated report to the CMU. Line ministries are required to annually evaluate SOE performance against the targets established in the SOE manager's contract. This consolidated report can also contain recommendations and proposals to improve the system of SOE monitoring and governance.

Cabinet of Ministers of Ukraine

37. The CMU has numerous responsibilities and functions in the management of state assets. Broadly speaking, these responsibilities fall under the three categories reflected in the following table.

**TABLE 4: RESPONSIBILITIES OF THE CABINET OF MINISTERS IN THE OVERSIGHT OF SOES**

Functional Area	Specific roles and responsibilities
<b>Policy and strategic decision making</b>	<ul style="list-style-type: none"> <li>• Determines goals for the SOE creation and operation</li> <li>• Makes decision on SOE creation, reorganization or liquidation</li> <li>• Makes decision on retaining in the state property of the stakes of companies in privatization</li> <li>• Establishes criteria for the evaluation of efficiency of SOE management</li> <li>• Sets procedure for creating and maintaining the state assets register</li> <li>• Approves the list of SOE which have strategic importance for the economy and security</li> </ul>
<b>Ownership functions vis-à-vis other governing bodies</b>	<ul style="list-style-type: none"> <li>• Appoints governing bodies to exercise management</li> <li>• Entitles state bodies to perform oversight for SOE operation</li> <li>• Sets procedure for dividend transfer to the budget</li> <li>• Develops criteria for selecting authorized persons and companies to be managed by them</li> <li>• Approves decisions of governing bodies on creation, reorganization or liquidation of SOEs which have strategic importance</li> </ul>
<b>Direct monitoring and oversight functions</b>	<ul style="list-style-type: none"> <li>• Defines objects and exercises management</li> <li>• Develops procedures for managing the state corporate rights and remuneration of authorized persons</li> <li>• Exercises oversight on SOE performance</li> <li>• Approves annual financial plans of such SOEs as natural monopolies and with pre-planned net profit exceeding UAH 50 million</li> <li>• Makes decisions on creation, reorganization and liquidation of <i>kazenni</i> SOE</li> <li>• Initiates unscheduled inspections of SOEs</li> </ul>

38. While the CMU delegates the state ownership function to line ministries for the majority of SOEs, the CMU does retain a strong role in direct management of the selected SOEs of strategic importance – natural monopolies and SOEs with pre-planned net profit exceeding UAH 50 million. The CMU appoints its representative to participate in the shareholders meeting with a clear mandate from the government and assignments for the meeting developed in cooperation with the line ministries. The government’s representative casts his vote in strict compliance with the CMU’s guidelines and reports back on the results of the meeting and decisions made.

CENTRAL GOVERNMENT BODIES WITH MANAGEMENT FUNCTIONS

39. Line ministries and agencies are the key element in the SOE governance system (including day-to-day management, monitoring and evaluation, supervision and oversight) of the SOEs in their sectors. In accordance with the current legislation the governing bodies (line ministries and agencies) are entitled with a broad set of functions:

**TABLE 5: SOE OVERSIGHT ROLES OF LINE MINISTRIES AND AGENCIES**

<b>Functional Area</b>	<b>Specific roles and responsibilities</b>
<b>Policy development and strategic decision making</b>	<ul style="list-style-type: none"> <li>• Make decisions on creation, reorganization and liquidation of SOEs</li> <li>• Elaborate strategy of SOE development</li> </ul>
<b>Ownership functions</b>	<ul style="list-style-type: none"> <li>• Approve statutory documents and regulations for SOEs under their management</li> <li>• Conclude and terminate contracts with SOE managers</li> <li>• Exercise management of <i>kazenni</i> SOEs</li> <li>• Manage state corporate rights</li> <li>• Contracting of SOE managers</li> </ul>
<b>Monitoring and Oversight functions</b>	<ul style="list-style-type: none"> <li>• Provide annual audits of selected SOEs</li> <li>• Designate employees to monitor performance of SOE</li> <li>• Approve annual and mid-term SOE financial and investment plans, and monitoring their execution</li> <li>• Transfer functions of management of state assets to “authorized persons”, and exercise oversight</li> <li>• Maintain register of state assets</li> </ul>

40. The SOE oversight system at the level of line ministries and agencies is multi-functional and complex, and consists of the following main activities:

- (i) selection, appointment, supervision and dismissal of companies’ managers;
- (ii) review and approval of the financial plans and performance targets, and monitoring of their implementation;
- (iii) operational, financial and managerial oversight and supervision; and
- (iv) review of SOE financial reports, evaluation against the approved targets and decision making based on their results.



41. **An overwhelming majority of the SOEs report to line ministries/central agencies and the SPF.** Line-ministries (and agencies) are responsible for the management of unitary SOEs (both commercial and *kazenni*), state corporations and corporatized state-owned companies.<sup>17</sup> Line ministries are responsible for the submission of the consolidated financial plans for all the SOEs under their management. Separate from the general SOE portfolio, the line ministries submit plans/reports for the natural monopolies and the enterprises with net profits exceeding UAH 50 million.

*THE STATE PROPERTY FUND OF UKRAINE*

42. **The SPF is granted with dual functions with respect to the state’s obligations in joint-stock companies, as established in Article 7 of the 2006 Law “On Management of State’s Assets”.** The SPF is mandated to manage the state’s corporate rights (government’s interest as shareholder) of the joint-stock companies, which were established as a result of the privatization process. Additionally, the SPF also monitors SOEs which have been corporatized (and which technically remain under the supervision of line ministries) and joint-stock companies where the government shareholding is greater than 50%.

43. **The State Property Fund has a special status envisaged by the Constitution of Ukraine and is governed by a special law on the SPF.** The SPF is unique from central government in that it manages virtually all aspects of state corporate rights (including appointment of company management, representation in shareholder meetings, appointment of representatives to boards of directors, etc.) for joint-stock companies – particularly where the government is the majority shareholder. The functions of the SPF as defined by the current legislation are numerous and at times, duplicate the roles of other ministries/agencies with regard to SOEs which have been corporatized but which are still under the complete control and ownership of the government. While the SPF reports directly to the *Verkhovna Rada* (Parliament of Ukraine), the SPF coordinates its activities with the CMU and other central government agencies/ministries responsible for SOE oversight and management. The breakdown of functions assigned to the SPF is as follows<sup>18</sup>:

**TABLE 6: RESPONSIBILITIES OF THE STATE PROPERTY FUND IN THE OVERSIGHT OF SOES**

Functional Area	Specific roles and responsibilities
<b>Policy development and strategic decision making</b>	<ul style="list-style-type: none"> <li>• Makes decision on creation, reorganization and liquidation of SOEs under its management</li> <li>• Makes decisions on transfer of state assets to the statutory funds of business entities</li> <li>• Approves decisions on alienation of state assets</li> <li>• Submits to the CMU proposals on retaining stakes in privatized joint-stock companies</li> <li>• Transfers SOE management functions to other governing bodies upon CMU decision</li> </ul>

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<sup>17</sup> Created as a result of corporatization and in accordance with special legislation requiring large state companies to reorganize into corporations or joint-stock companies.

<sup>18</sup> As defined by the Law of Ukraine “On the Management of State Assets”.

	<ul style="list-style-type: none"><li>• Develops criteria for the evaluation on the efficient management of state corporate rights</li><li>• Develops the dividend policy, in cooperation with the MOF and MOE</li></ul>
<b>Ownership functions</b>	<ul style="list-style-type: none"><li>• Acts on behalf of the state as a founder of economic entities with state assets</li><li>• Appoints representatives of the state to the governing bodies of joint-stock companies</li></ul>
<b>Monitoring and Oversight functions</b>	<ul style="list-style-type: none"><li>• Ensures operation of the state assets registry system</li><li>• Maintains registry of state assets, including state shares in joint-stock companies</li><li>• Exercises oversight for the efficiency of management state corporate rights</li></ul>

44. **The State Property Fund is primarily responsible for oversight of joint-stock companies – many of which are also SOEs where the government retains the majority controlling share.** As the SPF acquired significant experience in dealing with the corporate sector, the government expanded its mandate and assigned additional functions with respect to the state corporate rights, in particular, in the area of policy development, monitoring and evaluation, oversight, and design and maintenance of an asset registry system.

MINISTRY OF ECONOMY

45. **As defined by the 2007 Cabinet of Minister Resolution #832, the Ministry of Economy (MOE) is responsible for monitoring and evaluating SOEs and for developing policy and reform proposals regarding privatization and state property rights.** The MOE is also charged with the responsibility to prevent SOEs from falling into bankruptcy and to restore their financial solvency. The MOE relies on a dedicated department to coordinate the SOE oversight work through collaboration with the MOF, the line ministries and other agencies (e.g., the SPF).

46. **The MOE's primary role is to monitor and evaluate SOE financial plans and implementation of the plans.** The MOE receives drafts of the consolidated financial plans from line ministries, evaluates them against the government's overall strategic objectives and provides either a clearance or objection (and sends the draft back to the ministries for further development in the case of issuing an objection). Additionally, the MOE submits these consolidated financial plans to the Ministry of Finance as an input to the budget process.

MINISTRY OF FINANCE

47. **The role of the Ministry of Finance (MOF) regarding the oversight of SOE performance is limited (as compared to the role of the MOE), and is primarily related to**

**the impact SOEs may have on the national budget.**<sup>19</sup> SOE financial plans (consolidated plans are passed on to the MOF by the MOE) are evaluated by the MOF within the budget planning process. Although Ukraine still utilizes a single year budget, the MOF uses a medium-term perspective in analyzing an SOE's impact on both revenues and expenditures. In case of a large negative impact to the budget, the MOF may provide objections and send them back to the relevant line ministry. Financial plans of natural monopolies and SOEs with a [planned] net profit exceeding UAH 50 million are submitted separately (i.e., not included in the consolidated MOE report for the SOE sector) to the MOF for clearance (and submitted then to the Cabinet of Ministers for an additional approval).

#### GOVERNMENT AUDIT ORGANIZATIONS

48. **The State Control and Revision Service (KRU) is the central internal audit group responsible for the financial control and audit of the use of public resources – but its work is primarily compliance-focused.** While the KRU is undergoing a significant transformation (the government is implementing the EU's PIFC model for internal audit), KRU's audit approach is still limited to ensuring compliance with budget directives and as an arm of the MOF, to ensuring overall fiscal discipline. KRU limits its work with respect to the budgetary resources a SOE receives and does not audit its overall finances. The KRU may undertake inspections of individual enterprises under two circumstances: (i) if the SOE was selected for a scheduled inspection in accordance with the KRU's annual plan, or (ii) in response to an order from the CMU and the MOF that commissions such an inspection.

49. **The primary role of the Accounting Chamber is limited to auditing a SOE with regard to the use of budgetary resources.** The scope of Accounting Chamber's general audit work does not include attesting to the reliability of financial statements, reviewing the enterprise's internal controls, or reviewing the general operations of a SOE. The Accounting Chamber (the Supreme Audit Institution of Ukraine) does not conduct regular performance or value for money audits of SOEs. The Accounting Chamber may, in response to a direct request of Parliament, conduct a special review of a SOE (see box 4 in Section 3).

#### **TRANSPARENCY AND DISCLOSURE**

50. **Ukraine has relied on traditional frameworks for corporate financial reporting (including accounting standards), and public access to information.** All SOEs are required to produce their financial statements on the basis of Ukraine's National Accounting Standards. These standards, which were recently upgraded through the amendment to the Law on Accounting and Financial Reporting, are required to "not contradict" International Accounting Standards. The recently amended Securities and Stock Market Law requires all joint-stock companies, in addition to disclosures based on national accounting standards, to disclose information on their operations, which should be based on International Accounting Standards and in accordance with the procedures established by the Securities and Stock Market

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<sup>19</sup> The responsibilities of the MOF are defined under the 2006 Cabinet of Ministers Regulation #1837 and are also defined in the Law of Ukraine "On the Management of State Assets" and the accompanying Cabinet of Ministers regulations to the law.

Commission.<sup>20</sup> Joint-stock companies, which fall under the supervision of the SPF, are required to have their financial statements audited on an annual basis; unitary and *kazenni* SOEs are not required by law to have their financial statements audited annually.

51. **The Ukrainian Constitution<sup>21</sup> establishes the basic framework for public access to information, and this was further developed under the 1996 amended Law on Information<sup>22</sup>.** Information is first generally classified either as open or limited access. Information determined to be of limited access is further designated as confidential or of significant national importance (state secret) which is subsequently governed by the Law on State Secret. As unitary and *kazenni* SOEs are public entities, they are subject to the laws on information and state secrets.

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<sup>20</sup> 2008 Accounting and Auditing Report on the Observance of Standards and Codes (ROSC).

<sup>21</sup> Article 57.

<sup>22</sup> This law was first enacted in 1992.

### SECTION III: ASSESSMENT OF UKRAINE'S SYSTEM OF SOE OVERSIGHT

52. **Although the size of the SOE sector in Ukraine is significant, the system of management and oversight is complex and ineffective.** The current legal framework has not yet been upgraded to reflect modern corporate governance, ownership and disclosure functions and practices. SOEs still generally operate with unclear mandates and enterprises are not required to establish clear objectives to guide their operations which in turn make performance assessments a difficult endeavor. The Ministry of Economy has the responsibility to monitor and evaluate the financial performance of SOEs but this function can be strengthened. State ownership functions are muddled, and, except for the state corporate sector (joint-stock companies where the government share is less than 50%), the level of transparency and disclosure is poor and inadequate. Ukraine has separate financial reporting and disclosure requirements for SOEs falling under the responsibility of the central government and those which fall under the responsibility of the State Property Fund (e.g., for enterprises which are under the responsibility of the State Property Fund, companies are required to submit annual audited financial statements while there is no such requirement for unitary or *kazenni* SOEs).

#### LEGAL FRAMEWORK FOR SOE OVERSIGHT

53. **In order to create an equitable and competitive business environment (vis-à-vis the private sector), a modern legal framework should separate the functions of state ownership and formulation of industrial policy.** One of the key components to a modern legal framework is to ensure a standardized and consistent form and legal status of SOEs. Additionally, the legal framework would clearly and coherently delineate the ownership roles and lines of accountability (e.g., oversight, monitoring, etc.) and support the underlying corporate governance practices across all levels. A strong legal framework would require SOEs to develop clear objectives (commercial and social or public policy objectives), which in turn would enable the development of a strong performance measurement framework assessments and support high levels of transparency. Lastly, a strong legal foundation would set limits for explicit government financial support to SOEs and force SOEs to access capital financing on competitive rather than preferential terms.

54. **In Ukraine, while the legal form and status of SOEs is somewhat well defined, the current legal framework in Ukraine for SOE oversight does not provide for an adequate separation of industrial policy formulation and state ownership (including the oversight function).** Line ministries, which are responsible for establishing sector policies and regulatory frameworks, are also responsible for effectively discharging the state's ownership function. The Commercial Code of Ukraine (CCU) does not require SOEs to develop objectives to guide their operations which often results in an enterprise trying to manage multiple, and often competing, mandates. While management and oversight functions are delegated to various government bodies and agencies, the lines of accountability are actually weakened by the fact that there is no single repository for information and no single ministry or agency is responsible for ensuring enterprises comply with legal obligations (e.g., payment of dividends, annual performance evaluations). As shown in tables 4, 5 and 6, there are overlapping roles by different government

offices in setting policy, enforcement of legal obligations, monitoring performance. Moreover, well established underlying corporate governance practices (including transparency and disclosure) are not fully developed in the current legal framework.

55. **While the regulatory framework for joint-stock companies is being strengthened (though unitary and *kazenni* SOEs are not covered), some weaknesses may still endanger minority rights.** The CCU provides for various types of legal entities, including SOEs (Chapters 8 and 12). Until recently, regulations had important loopholes which led to asset-stripping practices. Public state-owned corporations (joint-stock companies) and state-owned holdings are subject to the general corporate legal framework, but this remains incomplete and ambiguous, and prone to inconsistencies in judicial interpretation. Finally, the inability to seize assets from SOEs continues to raise creditors' risk and minority rights. New laws on holding companies and state property management were approved in 2006, but their full effectiveness remains to be seen.

**The legal framework for SOEs is in need of modernization. It is important not only to clearly define what the roles of management and oversight entail, but also to clarify which government ministry/agency is responsible for executing these functions. In defining the arms-length relationship between government and SOEs, the legal framework should also define or limit the government's financial influence/role particularly with regard to limiting the state's guarantee for SOE debt and liabilities. Establishing clear operating objectives for SOEs is an essential component to improving the quality of oversight as it establishes a clear benchmark by which to evaluate performance. There is also a critical need to incorporate modern corporate governance practices and requirements in the legal framework.**

#### THE STATE OWNERSHIP FUNCTION

56. **A state's ownership policy, underpinned by a strong corporate governance framework and separated from its regulatory function, should clarify the ownership rights within the central administration and limit the involvement of government in the daily management of SOE operations.** A consistent and effective ownership policy provides the general public with a clear understanding of the state's objectives as an owner as well as its long term commitments and strives to ensure that the ownership function is fulfilled in an efficient and accountable manner. An important part of the state's ownership function is to develop and implement a well articulated dividend and investment policy<sup>23</sup> – balancing the need for SOEs to manage their operations with a degree of independence with the need to preserve accountability. The ownership policy should also clearly articulate the mechanisms through which the performance of SOEs will be monitored. The state has a clear interest in ensuring that SOE performance is strong and a well defined ownership policy, along with strengthened transparency and reporting frameworks, enables the application of more vigorous performance management systems.

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<sup>23</sup> This policy should also include issues such as liquidation or sale of assets, reallocation of capital, divestitures, mergers and acquisitions, changes in capital structure, etc.

57. **The system of governance is complex, and in practice there is no single agency responsible for the SOE sector or for the functions of industrial policy.** Despite the powers granted to the CMU, an overwhelming majority of the ownership functions are delegated to line/functional ministries and agencies. It is clear that, in reality, Ukraine relies on a highly decentralized system of governance and oversight of SOEs with a large number of governing bodies involved, in different capacities, in management, monitoring and evaluation, and oversight. There are two broad categories of the central executive bodies which are responsible for the oversight of state-owned enterprises: (i) ministries and agencies (mainly line ministries and the SPF) directly managing SOEs within their areas of responsibility, and (ii) coordinating ministries and agencies with monitoring and oversight powers (MOF, MOE, KRU).

58. **In practice, line ministries primarily exercise their SOE oversight function through a review of the reports on the implementation of financial plans – though this is typically a light review.** Annual financial plans include performance targets with their quarterly (intermediate) indicators. In case of significant deviations from the approved targets and indicators the line ministry may intervene in an attempt to improve the situation. As noted before, there is no evidence to support that reported data/results are validated, which thereby brings into question the reliability not only of the data itself, but of the effectiveness of the review and oversight function.

59. **In analyzing the governance and oversight system of unitary SOEs (those which are not joint-stock companies), there are gaps in actual practice as compared to international good practice.** For example, according to Ukrainian legislation, unitary SOEs are not required to have Boards of Directors and are governed on the basis of a principle of one-man management inherited from the old Soviet system of control. In practice this means that all important business and operational decisions are made through the manager of the supervising line ministry.

#### PERFORMANCE MANAGEMENT

60. **An SOE's performance evaluation is normally a core function of the company's board of directors and typically measures both financial and non-financial indicators of business performance.** In assessing performance, the evaluation first ensures that the SOE's operating objectives and business performance targets are in alignment and to make certain that the company does not lose focus on its core activities. The performance framework should include a SOE's subsidiaries in order to conduct a complete and comprehensive assessment. For measuring non-financial indicators, it is important to measure business and service performance standards, including pricing and cost recovery, particularly if a company has public service or social objectives. With regard to measuring financial performance, typically there are a series of indicators used to measure profitability, commercial value, credit worthiness, etc. Additionally, it is important to review a SOEs borrowings, lines of credit and guarantees as an additional measure of the company's financial position. Typically in evaluating the financial indicators, the use of cash flow analysis (e.g., in measuring rates of return of capital expenditure, debt servicing, etc.) and the discounted cash flow methodology is standard; the use of the economic value-added

analysis is becoming more common today. Moreover, the underlying financial data used for these analyses (and performance measurement) is validated by an external or third party (e.g., independent financial analysts, independent auditors, credit rating agencies, etc.) in order to ensure completeness and accuracy in the baseline valuations.

61. **In Ukraine the methodology for evaluating the performance of SOEs is weak and further work is needed to upgrade it.** The methodology relies on a very narrow set of evaluation criteria which refer to the SOE's self-reported results on financial and economic performance indicators. Without having established objectives, it is difficult to measure a company's performance as business or service standards are not clearly identified. In addition, the financial indicators of the current performance framework rely on invalidated data, and as elaborated further in this section, the basis for accounting (Ukrainian National Accounting Standards) differs significantly from international standards, thereby questioning the reliability of financial results. The current framework also does not contain criteria to measure the efficiency of service delivery or production standards.

**BOX 1: PERFORMANCE ASSESSMENT CRITERIA FOR UNITARY AND KAZENNI SOES**

<b>Non-commercial criteria</b> (used to compare against results from the previous year): average number of employees; average salary; wage arrears; social expenditures	Defined by the 2007 MOE Order #314, the evaluation of SOE and management performance is graded as follows:
<b>Commercial criteria:</b> sales (rate of growth); net profit; share of net profit paid to the state budget; dividends on share in state-owned JSC (compared to targets in financial plans)	(1) positive (efficient) management (2) satisfactory management (3) negative (inefficient) management
<b>Assets, investments and innovations criteria:</b> value of assets; value of net assets; capital investments; depreciation of fixed assets	
<b>Financial efficiency criteria:</b> return on assets; profitability; financial stability; current ratio; liquidity ratio; capital ratio	
<b>State assets utilization and preservation criteria:</b> manager's compliance with terms of contract; competitive selection of managers; alienation of state assets in compliance with the law	

62. **Supervising line ministries are legally empowered to select SOEs managers on a competitive basis and enter into contracts with them based on the development strategy and performance indicators.** The new competitive mechanism has been introduced recently, but there is a strong view that so far it did not make any significant changes to the routine system of appointing managers. Remuneration policy is an important instrument of the line ministries in managing SOEs but it appears to have not been effective in attracting top candidates to manage public enterprises. Ukrainian legislation empowers line ministries to grant adequate<sup>24</sup> remuneration packages for the managers for their contribution in SOE's performance. But as is

<sup>24</sup> As defined in the Law of Ukraine "On Management of State Assets".



widely observed in Ukraine, the remuneration of successful managers is apparently substantially lower than remuneration of their colleagues from the private sector.

63. **Although line ministries supervise SOE managers on their compliance with the terms of contracts and the achievement of performance targets, the assessment methodology requires upgrading.** Complicating matters is that the performance criteria used to evaluate the performance of SOEs which are joint-stock companies is different from the criteria for the evaluation of unitary and *kazenni* enterprises.

**BOX 2: PERFORMANCE ASSESSMENT CRITERIA FOR JOINT-STOCK COMPANIES**

<p><b>Categorization of joint-stock companies for the assessment of management performance</b></p> <p>In applying the performance criteria, all state-owned JSC are divided into four groups (defined by the 2009 SPF Order #694):</p> <p>Group 1 – joint-stock companies where the state's share exceeds 50%</p> <p>Group 2 - joint-stock companies where the state's share is 50% or less</p> <p>Group 3 - joint-stock companies which have strategic importance</p> <p>Group 4 - joint-stock companies in the process of bankruptcy</p> <p><u>Commercial Indicators</u>: (i) sales, (ii) net profit, (iii) share of net profit paid to state budget</p> <p><u>Non-Commercial Indicators</u> (as compared to previous year): (i) average number of employees, (ii) average salary, (iii) payments to social funds</p>	<p><b>Grades applied for groups 1 and 3</b></p> <p><b>Efficient</b> - Company has no or reduces overdue payables and wage arrears; all commercial indicators are positive; no reduction of employees; dividends paid in the amount set in financial plan; assets value increased.</p> <p><b>Satisfactory</b> - Company has no or reduces overdue payables and wage arrears; more than five of commercial indicators are positive; no reduction of employees; dividends paid in the amount set in financial plan.</p> <p><b>Inefficient</b> - all other cases</p> <p><b>Grades applied for group 2</b></p> <p><b>Efficient</b> - Company has no or reduces overdue payables and wage arrears; all commercial indicators are positive; no reduction of employees; in previous year dividends have been paid; assets value is expected to increase</p> <p><b>Satisfactory</b> - Company has no or reduces overdue payables and wage arrears; more than five of commercial indicators are positive; no reduction of employees</p> <p><b>Inefficient</b> - all other cases</p> <p><b>Grades applied for group 4</b></p> <p><b>Efficient</b> - Company has no or reduces overdue payables and wage arrears; no reduction of employees; profitability rate is within projected range</p> <p><b>Satisfactory</b>- Company has no or reduces overdue payables and wage arrears; no reduction of employees; profitability rate is beyond projected range</p> <p><b>Inefficient</b> - all other cases</p>
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64. **Dismissal of a manager, even in case of poor performance and/or non-compliance with the contract, is a major challenge for the line ministries.** In the first quarter of 2009 line ministries terminated 36 contracts against 35 in the last quarter of 2008 (120 contracts were terminated across the sectors and ministries in all of 2008). A manager who has been fired may appeal his termination of contract. Widely publicized cases noted that terminated managers pointed to a wide range of external factors (including government intervention into operations and management) which contributed to an SOE's poor performance. Given that the methodology and criteria for assessing a manager's performance is weak and ambiguous, line ministries often lose these cases resulting in the reinstatement of the manager.

**Performance management will be successful only once clear objectives have been established. The framework for SOE performance management should require that the underlying data used to populate indicators are validated and reliable. While SOEs should continue to report on their performance, the reported indicators should be subject to testing or validation rather than mere aggregation for further reporting. The performance indicators (and including financial and non-financial indicators) themselves should be able to measure business or service standards so as to enable comparison of actual results against business and corporate plans. The performance framework should, at the very least, ensure that an SOE's operations are financially viable and that the company itself is financially healthy and sustainable.**

MINISTRY OF ECONOMY

65. **While the MOE monitors the profitability of the SOE portfolio, it is not clear what actions, if any, are taken to help the lagging or weak performing enterprises improve their operations to become profitable.** According to the financial reports produced by the MOE, 1,739 SOEs reported a net profit in 2008 (compared to 1,786 SOEs reporting a profit in 2007) and 659 SOEs reported net losses (compared to 699 SOEs in 2007). Additionally, the MOE determined that 134 SOEs "operated on the edge of profitability," indicating (according to the MOE) that these enterprises could become profitable either through restructuring or through improving management.

66. **The mechanisms for financial planning and monitoring of SOEs are gradually improving, but some still weaknesses persist.** The CCU (Article 75) mandates SOEs to prepare annual and quarterly financial plans, which they submit to the ministries or government bodies that have direct oversight responsibility. Since March 2006, the Ministry of Finance has had the explicit mandate to coordinate and agree the financial plans; however, data coverage and content requirements have been continuously modified, and there have been significant delays in the agreement of the plans. This has made performance monitoring by the Ministry of Economy difficult. Further, while SOEs may issue debt on domestic and international markets without

prior government approval, they have only recently been required to submit detailed information on their assets and liabilities to the central government authorities.

67. **In exercising its oversight function, it is not clear if the MOE is actively involved in assessing SOE performance.** The MOE receives from line ministries, quarterly and annual reports on the implementation of the SOE's financial plans. In turn, the MOE prepares consolidated reports for the SOE sector and submits them to the MOF and to the Cabinet of Ministers. Additionally, the study was unable to identify what actions are taken by the MOE or other central body in response to reported failures to achieve important targets.

68. **While MOE works with the ministry to examine the reasons behind the weak results (satisfactory or negative ratings), and subsequently submits to the Cabinet of Ministers proposals for how to improve ministerial SOE management, it is not clear what effect this evaluation system has in terms of driving performance.** The MOE uses a scoring system to evaluate the performance of line ministries in the execution of their role to oversee SOEs. The MOE provides three types of scores to the governing bodies (mainly line ministries) as a mean of assessing efficiency of managing their portfolio of SOEs: (i) *positive* if more than 75% SOEs reached the approved target results, (ii) *satisfactory* between 50 and 75% SOEs achieved their results, and (iii) *negative* if more than 50% of SOEs failed to reach the target results as envisaged in their approved financial plans. In 2008, 12 out of 68 governing bodies were rated as positive (efficient), 25 as satisfactory and 31 as negative (inefficient). The number of positive scores increased and the number of satisfactory scores decreased in comparison with the 2007 results of ministerial performance.

69. **While the MOE is entitled to check evaluation results of SOEs and SOE managers made by the line ministries, this is a limited function in practice.** If the MOE were to check the assessment results, the review work is actually limited to a desk review of submitted documents or a recalculation of self-reported indicators. No data validation takes place and there is no direct audit or field work conducted by MOE staff to ensure the accuracy of reported results. As previously noted the performance assessment framework is not comprehensive and misses certain key dimensions to measure business standards and service delivery. In addition, the underlying data used to generate the indicators may not be completely reliable.

70. **There is a disconnect between the assessment of an SOE manager's contract and the assessment of SOE performance – the number of managers with a positive rating is 2.6 times higher than the number of enterprises rated as such.** The MOE reported that in 2008 199 SOE managers were assessed as underperforming, while only 83 contracts had actually been terminated. Moreover, 1,804 SOE managers were assessed as successfully achieving their targets while only 695 enterprises were evaluated as positive. Additionally, 326 SOEs were evaluated as “not efficient” according to the assessment of line ministries.

71. **Moreover, there appears to be significant gaps in the coverage of SOE performance assessments.** The 2008 MOE reported disclosed that line ministries did not conduct performance assessments for almost a thousand SOEs. While this information was apparently

submitted to the Cabinet of Ministers, it is not clear what disciplinary action, if any, was taken as recourse for non-compliance.

MINISTRY OF FINANCE

72. **While the MOF is responsible for ensuring that SOEs comply with the dividend rates (as established by the CMU) and remit payments to the national treasury, gaps remain in ensuring compliance with the dividend policy.** The revenue targets for line ministries are based on projected SOE profits. In some cases, a line ministry can meet the revenue targets by collecting a high dividend rate from a few highly profitable enterprises – thereby effectively exempting from payment of dividends those SOEs with lower revenues. While line ministries and other government bodies produce reports on the implementation of SOE financial plans, (including indicators on the transfer of dividends to the state budget, capital investments, etc), the 2008 MOE report indicated that only 71.4% of the anticipated dividends had been transferred to the state treasury. 17 ministries were reported to have not met the target regarding the net profitability of their SOE portfolio and transfer of dividends.

73. **The MOF does not perform an active or have a direct oversight function.** While the MOF monitors the implementation of financial plans, it does not evaluate individual SOEs with regard to performance nor does it review the finances of SOEs. Rather, the MOF evaluates the performance of the supervising line ministries, using indicators such as the remittance of dividends to the state budget – though, as previously noted, ensuring the receipt of dividends is not always a consistent practice. In case of deteriorating performance indicators (lower than anticipated dividend receipts), the MOF has a right to inform the CMU regarding the ministry's managerial practice and performance – but it is not clear what impact this has in terms of improving SOE performance. MOF can also commission the state inspection and audit service (KRU) to carry out inspections and audit work for either an entire SOE sector or for a selected enterprise.

**There is a basic need to establish a single comprehensive database of basic financial data for all SOEs. As the government is the ultimate guarantor of SOE debt and liabilities, it will be important to develop a framework and criteria to be used to evaluate SOE requests to access capital financial vehicles (loans, credit lines, guarantees, etc.) or to issue bonds or other debt instruments. While the process to review, evaluate and approve (or reject) such requests is supposedly centralized, observed practice demonstrates that this procedure is in need to strengthening and enforcement. Likewise, there is a need to strengthen the monitoring tools and procedures to ensure that dividends are remitted to the national treasury.**

STATE PROPERTY FUND

74. **The SPF exercises oversight not only for the SOEs under its management, but also for all joint-stock companies which are managed by line ministries.** At the beginning of the period of transition to a market economy, the State Property Fund was established as a leading agency for the privatization of the state assets and possessed the necessary capabilities (and legal

basis) to lead this process. The SPF was granted the additional responsibility to manage the government's remaining stakes in the privatized companies. Over time, the SPF's mission evolved and it began to focus its efforts to improve the performance of public enterprises before privatization – as an attempt to increase the value of their assets. At present, the registry of state assets (database) maintains the state's shareholdings (including the corporate rights based on % of shares controlled by the government) in 811 joint-stock companies (including 83 limited liability companies with government's stake acquired by the state in the course of privatization). The SPF is technically responsible for monitoring and evaluating the performance of each of these companies. But of this total number, the SPF is actively managing and overseeing only 691 SOEs. The remaining 103 joint-stock companies are managed by the line ministries and 17 directly by the CMU (large strategic JSC called “national joint-stock companies” and “state holding companies” but which are not classified as *kazenni*).

**75. In terms of oversight, the SPF demonstrates a more active role than other governing bodies.** In analyzing its annual reports, the SPF includes more detailed quantitative and substantive analyses. The SPF also conducts additional levels of monitoring and evaluation, including the issuance of an annual report which incorporates the enterprise's audit findings and reported quarterly indicators and results.<sup>25</sup> In part this is due to the stricter reporting, transparency and disclosure requirements of joint-stock companies enforced by the State Securities and Stock Market Commission. Additional impetus for improved company reporting (and in-turn, improved SPF monitoring and analysis) also comes from the fact that company information is made publicly available to stock market participants, investors, investment banks, and other interested parties.

**76. The current practices and methodologies for maintaining records are not adequate to enable a proper evaluation of SOE assets, as the registry is based on incomplete company data.** As the agency's mandate has been expanding, the SPF was delegated the responsibility to create and maintain the registry of all state assets, which covers all SOEs and joint-stock companies where the state holds shares. The incomplete coverage of SOEs limits the effectiveness and quality of monitoring and oversight. The current design of the asset database is such that selected SOEs may be registered separately from its subsidiaries and other units. As a result, the asset registry system disguises the overall picture of SOE performance, in particular the total value of its assets and liabilities. Use of the asset registry information to evaluate company performance is considerably less accurate.

**77. The SPF-managed asset registry is not the sole source of data regarding state assets (including the number of SOEs currently operating) and the comparison with data gathered from other government offices reveals a serious weakness in the reliability and comprehensiveness of basic information and statistics.** Similar statistics on state property and assets are maintained by the State Statistics Committee, which presents a completely different set of data, including the number of SOEs in operation. One of the tasks of the government (Ministry of Economy) is to reconcile this data and submit it to the Cabinet of Ministers in its annual report on SOE performance.

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<sup>25</sup> The audit and financial reporting requirements for joint-stock companies are different from the requirements for unitary and *kazenni* enterprises.

**It is clear that the government (through the CMU, line ministries or MOE) is heavily involved in the day-to-day management of SOEs, whereas its role should be focused on broad oversight of the SOE sector as a whole – e.g., performance monitoring, ensuring compliance with regulations, fiscal frameworks, transparency and reporting requirements, etc. Direct operational oversight is normally the responsibility of boards of directors. Given the large number of SOEs currently operating in Ukraine, there is limited usefulness of such close government intervention as it is not possible to effectively or efficiently supervise such a large portfolio of companies.**

GOVERNMENT AUDIT ORGANIZATIONS

78. **International practice shows that SOEs increasingly are being asked to report to their supervising ministries on their risk management systems – of which internal audit is an important component.** This approach is consistent with the trend away from trying to control specific aspects of operations (e.g., salaries or investment decisions) and towards broad-based performance and risk monitoring. This approach is yet another demonstration of how practice of SOE oversight is moving to allowing for greater operational autonomy (implementing the “arms-length” relationship between government and the enterprise). Risk management is a primary oversight responsibility of the board of directors and specifically of the board’s audit committee. This responsibility includes ensuring that internal control processes are in place throughout the company to effectively identify risks, setting acceptable levels of risk, and taking measures to mitigate or respond to risk. Internal audit reinforces risk monitoring and is seen as an integral part of the overall risk management system, which in turn is itself a critical component of enterprise management and strategic planning.

79. **SOE oversight has two primary components - (i) performance indicators and (ii) ex-post inspection by KRU – and efforts are being made to strengthen the internal audit function of government.** While SOEs supposed to have in place internal audit units, the government’s internal audit service (KRU) in effect fills this role. Cabinet of Ministers Decree No. 955/ 08 (August 2001) defines the general scope of work and provides the basic procedures for planning the KRU inspections and revision activities. In January 2006, amendments to the state auditing law granted authority to the KRU to undertake financial and performance audits of SOEs. Essentially all of KRU’s revision and inspection work is still based on the ex-post compliance review of transactions, ensuring that the transaction conform with the appropriate budget expenditure line, that revenue collections are recorded properly and that assets management (including safeguarding of assets and asset valuation) is performed. The KRU is developing methodologies and preparing a work program to audit and strengthen SOE oversight, although it is not yet clear whether the approach will be fully consistent with the public internal financial control concept adopted as the KRU’s long term goal. Nevertheless, it will also be important to ensure that internal audit groups in SOEs function effectively in addition to the program to reform the central government internal audit function, and that these groups complement, rather than substitute, the role of an annual external audit (see next section on *Transparency and Disclosure*).

80. **KRU's oversight function is not limited to ex-post inspection and recently it had been granted the mandate to perform ex-ante expenditure control in the largest and most strategically important SOEs.** In May 2009 the CMU assigned KRU with a new mission – to monitor the financial transactions of the 42 largest and strategically important SOEs.<sup>26</sup> This new role expected that the KRU auditors were to review risky and complex/large financial transactions. This initiative was intended to assist government activities to promote more effective preventative services and better practices to uncover illicit or illegal practices. Past experience demonstrates that such findings usually do not result in meaningful change or improvement, if any (see box 3 below).

**BOX 3: KRU REPORT ON THE INSPECTION OF STATE JSC KHLIB UKRAINY, JUNE 2009**

KRU completed an inspection of the financial and economic activities of State Joint-Stock Company “*Khlib Ukrainy*” (Bread of Ukraine) – the largest enterprise involved in the production of bread-grain and related products. The work included an inspection of the parent company as well as 69 subsidiaries; the most significant findings are summarized below:

- The company's statutory fund (as established by a CMU resolution) was expected to be UAH 1.4 billion. The inspection found that the company cannot confirm the existence of UAH 608.4 million worth of assets in the statutory fund. Dissolution of assets in an SOE which is 100% state-owned is a violation of the law.
- The company has failed to repay loans (un-quantified amount) extended by the government for seasonal purchases of grain.
- UAH 50 million were diverted from the company's activities. For example, company has bought shares in other companies without having clear plans or specified use for the purchases of shares. UAH 7.8 million worth of company stock disappeared from the custodian bank.
- Company's debt to the state reserve for the supplied 860 thousand tons of grain totals UAH 2.6 billion that exceeds twice the value of the company's assets. The company does not include on its balance sheet, the debt incurred as a result of 250 thousand tons of wheat supplied from the state reserve.
- The company does not comply with procurement law and purchased UAH 190 million of goods on a non-competitive basis.
- During 2007-2008 the company's board failed to develop financial plan of the company. The company has routinely not submitted data to the state statistics committee. The company's board has ignored a previous KRU recommendation that the company's assets should be accounted for based on real (market) value rather than on a historical cost basis.

81. **Supreme Audit Institutions (SAIs) characteristically have an important and regular function in SOE oversight and their scope of work usually includes the SOE as well as the supervising/ownership ministry.** SAIs normally are not appointed to conduct the annual external (or independent) financial audit of an individual SOE (though in many countries SAIs can sub-contract this work to private sector audit firms). Increasingly, SAIs conduct

<sup>26</sup> May 2009 Cabinet of Ministers Resolution #506

performance audits at regular intervals (usually every three to five years), focusing their work on the effectiveness and efficiency of the implementation or execution of an enterprises' operations. An SAI's work is not normally limited to auditing or reviewing on the use of budgetary resources but rather its work is more comprehensive and includes an enterprise as well as its subsidiaries.

82. **The Accounting Chamber does not audit SOEs as its oversight role is limited to reviewing compliance with regard to the utilization of budgetary resources.** As the Supreme Audit Institution of Ukraine, the Accounting Chamber operates independently of the executed branch. It usually conducts inspections/audits at the request of the *Verkhovna Rada* (Parliament of Ukraine), special parliamentary committees or individual parliamentarians. The Accounting Chamber sends its reports to the Parliament and in some cases also to the CMU. There does not appear to be action taken by the government in response to the Accounting Chamber's findings.

**BOX 4: ACCOUNTING CHAMBER INSPECTION OF NAFTOGAZ (2006-2008)**

On March 3, 2009 the Auditing Chamber of Ukraine released its report on audit of the National Joint-Stock Company "Naftogaz Ukrainy" – the largest Ukrainian fully state-owned company involved in production, transportation and distribution of natural gas. The objective of the audit was to review the company's compliance with its budget obligations – correctness of expenditures of funds received from the state budget and fulfillment of its tax obligations. Among the numerous findings in the report, the key issues identified were the following:

- The report stated that company continues to manage its operations in a non-transparent. Information on its financial performance and foreign trade activities is contradictory and confusing.
- Solvency of the company to a great extent depends on foreign credits; its financial sustainability and ability to generate profit are very low. Arrears of customers (for consumption of gas) increase from year to year.
- The Ministry of Fuel and Energy (supervising ministry) plays a passive role and does not perform the state functions of oversight and control over the company's activities, as mandated by law.
- The company's financial plan for 2009 (approved with significant delay) envisaged an allocation of state budget resources in the amount of UAH 7.7 billion, while the state budget projected only UAH 1.6 billion in support of the company. Therefore, the financial plan of Naftogaz projected an inherent deficit in the amount of UAH 6.1 billion.
- The Ministry of Fuel and Energy has not endorsed the company's balance and financial report. Moreover, it did not allow the company's internal audit committee to access the financial information.
- The Accounting Chamber came to a conclusion that these violations resulted in misappropriations of UAH 6 billion from the company's budget.
- Wage arrears to the employees have grown significantly. Bad loans increased by a factor of 15.
- At the same time, large amounts of resources from the company's budget go for "sponsorship and charity".

The credit policy of Naftogaz is unsustainable and unbalanced. From 2006 to 2008 the company based its economic and financial activities on attracting credits. As of 2009, the level of company's debt exceeded UAH 35 billion. In just 2009, the company was projected to pay about UAH 17.5 billion to service its debt stock, which represented nearly 50 percent of its own capital and which could realistically lead to insolvency.



Between 2006-2008 Naftogaz had not paid dividends and owed to the state budget approximately UAH 3.7 billion, while the company received dividends on its own investments in the amount of UAH 1 billion.

The issue of compensation (i.e., subsidy) to the company from the state budget for the difference between the price of imported natural gas and tariffs levied on the population, budgetary institutions and companies producing heating for the population remains very important.

The Audit Chamber concluded that manipulations with domestically produced natural gas have been a systemic problem occurring many years. Ukrainian law stipulates that domestically produced natural gas should be used only for the needs of the population. However, during the last two years Naftogaz, in violation of this rule, has sold 11.2 billion cubic meters of natural gas to foreign customers. As a result, shortage of gas for the population in 2006 totaled 4.8 billion cubic meters and resulted in direct losses of UAH 1.7 billion – which was ultimately financed by the state budget. In 2006 the company did not meet demands of population in gas and at the same time pumped into storage facilities about 4 billion cubic meters of domestically produced natural gas. In 2008 the company sold 0.4 billion cubic meters of expensive imported gas to the population and sold cheap locally produced gas to commercial customers.

## TRANSPARENCY AND DISCLOSURE

83. **Broad transparency and disclosure requirements are essential components of any modern corporate governance framework and support efforts to improve the quality and effectiveness of oversight.** These requirements, which include the application of international standards for accounting and financial reporting, being subject to an annual external audit, the *ex-ante* publication of objectives and *ex-post* publication of results, expose company performance to greater public scrutiny, which in turn provides a strong incentive to improve management, monitoring and to execute more effective ownership rights.

84. **While reportable indicators on SOE performance have been established by the MOE, there are gaps regarding the usefulness of such indicators.** Line ministries report on SOE performance and these reports cover a range of financial indicators: net income, gross and net profit, costs, liquidity ratio, accounts payable and accounts receivable, assets value, fixed-assets value, wage arrears etc (see Table 7 below).

**TABLE 7: MAIN FINANCIAL INDICATORS OF SOES, 2007-2008**

Financial indicators	UAH thousands	
	2007	2008
Net income	103,327,034	188,216,364.0
Net profit	931,629	12,440,355.6
Accounts payable	22,002,810	61,186,046.7
Accounts payable, arrears	2,651,934	14,064,741.9
Accounts receivable	14,059,538	52,619,715.4
Accounts receivable, arrears	4,534,742	13,788,350.6
Wage arrears	585,021	308,053.9
Fixed-assets value	510,662,923	1,390,311,659.7
Current and long-term liabilities	n/a	145,040,967.3
Net assets value	n/a	177,987,989.0
Current assets value	n/a	103,756,295.8

*Source: Ministry of Economy*

85. **It is also important to note that these indicators of financial performance are self-reported by SOEs and that there is no evidence of validation of the raw data or of the indicators reported by individual SOEs.** The line ministries aggregate the results for the enterprises in their portfolios and submit this information to the MOE – ministries do not report on an individual enterprise level. Any analysis of these reported results in trying to determining the relative performance of an SOE could be misleading.

86. **Although publicly owned, SOEs lack transparency.** SOEs are not subject to specific public reporting requirements and their accounts and other company information may be treated as a state secret. Opacity undermines performance monitoring, limits accountability, conceals debt that can impose stress and damage to the financial system and creates conditions where corrupt practices go unnoticed and can flourish.

87. **In Ukraine, although SOEs follow the requirements of the Law on Accounting<sup>27</sup> and use NAS to prepare their financial statements, there are still challenges in complying with existing requirements.** Consequently, SOEs experience significant difficulties in applying NAS and the quality of the financial information varies significantly. There are some material differences between National Accounting Standards and IFRS.<sup>28</sup> The impact of these differences on the usefulness of financial statements prepared according to NAS as compared to IFRS may in many cases be material (the differences may be even more significant if the NAS disclosure requirements are not followed). The variable quality of financial information, which often inadequately reflects the financial and economic performance of the entity, becomes particularly restrictive when the Government seeks to privatize the entity or the entity seeks other sources of external financing. It is worthwhile noting though, that the MOF has recently (November 2010) taken several steps to upgrade NAS and to eliminate the remaining differences with IFRS.

88. **SOEs are required to submit annual financial information to the State Statistics Committee (they are now not required to submit their statements with the tax returns as they were until recently).** Additionally, SOEs which generate annual revenue of at least 100 million UAH are expected to submit their financial statements to the Tax Administration. Apart from the limited review of financial statements by regulators, limited to joint stock companies and regulated entities, there appears to be little use made of the financial statements external to the company, its management and owners. According to the 2008 ROSC assessment, limited use of financial statements is made by banks as a basis for loan decisions; collateral-backed lending

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<sup>27</sup> In addition, these enterprises follow the “Statute of the Accounting Procedure for Certain Assets and Operations of the State and Utilities Sectors of the Economy which Use State or Civic Property,” and often are required to prepare separate reports for various governmental authorities, including the State Statistics Committee, their respective ministries, social funds, tax authorities, etc.

<sup>28</sup> 2008 Report on the Observance of Standards and Codes (ROSC), Accounting and Auditing Assessment.

is prevalent. However, there is evidence of increasing demand for, and usage of, financial statements in lending decisions. Areas of noted non-compliance include:

- Non-disclosure of related party transactions;
- Non-disclosure of the accounting policies adopted;
- Non-provision of liabilities for which the measurement is not supported by third party evidence; such provisions are generally not allowable for taxation purposes and would include categories such as holiday pay provision and doubtful debt provision;
- Non-provision of deferred taxation;
- Non-disclosure of earnings per share;
- Assets carried at historical cost where there is evidence of impairment; and
- Failure to include a cash flow statement.

89. **In general, commercial banks do not rely on the financial statements presented by potential borrowers in determining whether to extend credit.** There is a perception among the banks that, with exception of financial statements purporting to comply with IFRS audited by international audit firms, the financial statements of companies in Ukraine are of a low quality and do not represent sufficient basis for assessing the financial position of a potential borrower. Although entities are often required to submit their financial statements as part of the loan application process, banks base their lending decisions on other factors including the amount of collateral, business forecasts and site visits. The financial statements of companies prepared in accordance with Ukrainian NAS and the related auditors' opinions are seen by banks as indications of merely their tax and legal compliance. SOEs should not have more favorable access to finance (loans, lines of credit, guarantees, etc.) than private sector firms. In Ukraine, if SOEs have access to finance on favorable terms, or if the standards used to grant SOEs access to financial instruments are more lenient or flexible, the government, as the ultimate guarantor for SOE debt and liabilities, will face even greater fiscal pressure. As there would essentially be no hard budget constraint, and couple with the insulation from market forces or market discipline, SOEs will naturally have fewer incentives to more effectively manage their resources or to improve performance which undermines their long-term competitiveness.

90. **A few major SOEs (usually joint-stock companies) participating in international capital markets (including Naftogaz) have recently contracted independent external financial audits, but these are not mandated by law and the vast majority of unitary and kazenni SOEs are not subject to independent financial audits.** Article 8 of the Audit Law requires that open joint-stock companies, issuers of securities, professional participants of the stock exchange, financial organizations and other entities falling within the categories obliged to make their financial reports publicly available are required to have their entity and consolidated financial statements audited. The requirement for a statutory audit is different from the EU audit requirement, which requires all companies with limited liability to be audited but permits member states to exempt small companies from the requirement to have an audit. The EU sets

maximum limits on the size criteria for small companies but member states can set smaller size criteria if appropriate for their state. Given the limited current capacity of the audit profession in Ukraine, the statutory audit requirement should be limited to those companies in which there is a public interest in there being an audit.

91. **As mentioned above, there is no general requirement in Ukraine Law for the approval of the appointment of independent auditors and the review of the independent audit report by the entity shareholders, supervisory board or audit committee.**<sup>29</sup> The auditors currently address the report to those with whom they have directly contracted (i.e. the Board of Directors, who are also responsible for the preparation of the financial statements). This close relationship between the independent auditor and the client, in terms of appointment and submission of reports, creates a threat to independence of the auditor and diminishes the reliance other stakeholders can place on the published audit report. Even though the threat is mitigated by the requirement to report to shareholders or their representatives any deficiencies identified during the audit, the auditor's report should be addressed to the shareholders of the entity, not the management.

92. **Enforcing auditing standards contributes to ensuring audit quality which in turn can add credibility to published financial information and act as an important protection mechanism for shareholders, creditors and other stakeholders.** A proper and rigorous enforcement regime for financial reporting is critical to establishing and maintaining the quality of financial reporting and to underpinning confidence in local companies and financial markets. The 2002 and 2008 ROSC assessments noted that, while the regulators generally had sufficient authority to monitor compliance with legal and financial reporting requirements, they lacked the influence, resources and expertise to carry out their functions effectively.

93. **While Ukraine has had a Law on Information since 1992, in reality, this framework does not facilitate public disclosure and access to information of public entities including SOEs.** While both the Constitution and the law provide the right for citizen access to information, the law does not clearly articulate what information can be classified or how such a label can be applied to information so that it is not made available to the public. Even though information such as reports on the state budget's incomes and expenditures should be publicly disclosed, the consolidated annual SOE report, which contains information on the aggregate financial results of the SOE sector including dividend transfers to the treasury, budget subsidies, and other fiscal related items, is not publicly disclosed. Moreover, SOEs are not required to publish annual financial statements (either in print, electronic or multi-media or other formats), and where an SOE may have been audited, the audit report is not disclosed to the public.

**Transparency and disclosure requirements are in need of significant strengthening and should first be clearly established in a modern legal framework. All large SOEs, with primarily commercially oriented operations, should be subject to the same rules as joint-**

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<sup>29</sup> The only exceptions to this rule are banking institutions.

**stock companies and be required to fully comply with national accounting standards, be subject to an annual external audit, and be required to disclose and regularly publish corporate results, performance and non-sensitive company information. The government should take measures to enforce the proper application of transparency and disclosure policies and ensure that public access to information is guaranteed.**

94. **For SOEs which can be classified as small and medium-sized enterprises, it will be essential to implement a simplified framework (e.g., with regard to performance management, requirements for transparency, reporting and disclosure, etc.), and which should be based on the same principles outlined for large SOEs.** Given the considerable number of enterprises operating, this study could not evaluate the needs of a representative sample of companies to develop a detailed series of recommendations. As such, it will be important to consider the availability of existing tools and resources which can be easily applied at the enterprise level to improve internal management and organization, improve the quality of business plans and financial reporting, etc. SOEs falling into this category should, at a minimum, be required to develop clear operating objectives (including non-commercial or policy objectives if applicable), prepare an annual profit/loss statement (also called the income statement) and balance sheet, and be subject to a performance assessment focusing on basic financial results (e.g., profitability, asset turnover, debt/equity ratios). The IFC has supported the development of an on-line portal and tool-kit for Ukraine ([www.vlasnasprava.info](http://www.vlasnasprava.info))<sup>30</sup> where materials, “how-to” resources, business tools (including downloads for bookkeeping and cash management, technology products, operations management, etc.), advisory and other services are available.

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<sup>30</sup> Also see [www.smetoolkit.org/smetoolkit/en](http://www.smetoolkit.org/smetoolkit/en) for a link to the Ukrainian and other websites

## SECTION IV: BENCHMARKING UKRAINE AGAINST THE OECD FRAMEWORK

95. When assessing the performance of and considering any potential reforms for the SOE sector, it is useful to compare the current practices against well established and accepted benchmarks, as this allows for a better appreciation of the discrepancies and gaps observed in practice.

96. In this context, this section of the report analyzes Ukraine's system of SOE corporate governance against the benchmark OECD framework. This section focuses on the most critical and essential areas (legal and regulatory framework; ownership policy; transparency and disclosure)<sup>31</sup> for Ukraine to concentrate its efforts to further improve its system of SOE oversight and governance. These three areas are so closely intertwined and represent the fundamental building blocks for any reform initiative - these three areas reinforce each other and are part of an integrated set of principles which underpin any attempt to improve performance of SOEs.

97. Annex 4 provides a detailed point-by-point assessment of Ukraine's system of oversight as compared to the complete OECD framework (six chapters). This section of the report also includes cases of internationally accepted good practice – from both industrialized and emerging market economies.

### GOOD INTERNATIONAL PRACTICE WITH REGARD TO SOE LEGAL AND REGULATORY FRAMEWORKS

*The legal and regulatory framework for SOEs should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance (Chapter 1).*

98. The state often plays a dual role of market regulator and owner of SOEs with commercial operations. Therefore, the full administrative separation of responsibilities for ownership and market regulation is a fundamental pre-requisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition. A separation of industrial policy and ownership enhances the identification of the state's ownership role and favors transparency in defining SOE objectives and monitoring performance.

99. Many developing countries have undertaken numerous attempts to enhance SOE performance or restructure the SOE sector over the past several decades (through capital infusion, privatization, management performance incentives, etc.). Financial crises and difficult transitions to a market economy have also made clear the key role that corporate governance, which is established through a modern legal and regulatory framework, plays in enterprise reform. Today, improving corporate governance of SOEs is a stated policy objective in many countries around the world.

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<sup>31</sup> See chapters 1, 2 and 5 respectively of the OECD Guidelines.

100. The most common legal form of SOEs is the private limited liability company, followed by the joint-stock company. SOEs in the majority of OECD countries are subject to the same corporate regulations as listed private sector companies (on average, only about 10% of SOEs are listed companies in OECD countries<sup>32</sup>).<sup>33</sup> While some countries (e.g., South Korea, Czech Republic, France) still classify SOEs under special legal categories (or SOEs are classified under special legal status), these examples are increasingly rare. What is notable, however, is that the legal and regulatory frameworks in these countries are based on modern corporate law and practices, and have incorporated many of the corporate governance principles outlined in the OECD framework. Good international practice shows that the same regulatory and legal framework should be applied evenly across all classifications of SOEs (including an SOE's subsidiaries).<sup>34</sup> Additionally, leading international practice demonstrates that the enforcement, by other governmental institutions (or branches of government), of the legal and regulatory framework is an equally essential component.

101. The legal framework for SOEs in Ukraine was originally rooted in the Commercial Code of Ukraine. While the Commercial Code defines the broad boundaries of the public sector, and includes SOEs as part of the responsibility of government oversight, the Code and other legislation (e.g., the 2006 Law "On Management of State Assets") do not provide an adequate management and oversight regulatory framework as it does not prescribe or require specialized oversight or management but rather documents functions and procedures which have arisen spontaneously over time. Many important details of modern governance and oversight systems, including SOE disclosure requirements and public access to information, clear roles and responsibilities of the supervising Minister/Ministry, dividend policy, financial reporting and audit requirements, are currently excluded from Ukraine's legal framework and what has been put into practice, differs significantly from international standards and benchmarks.

102. The legal framework in Ukraine weakens SOE oversight and accountability as these functions are effectively spread across a number of agencies. The dilution of government accountability or responsibility (as the owner of an SOE), in effect, results that no effective oversight is actually performed. The effective rules and regulations applicable to unitary and *kazenni* SOEs differ from those applied to SOEs which are also joint-stock companies or SOEs which are corporatized.

103. Additionally, the current legal framework is overly flexible with regard to the government's role in providing SOE's with more favorable access to financing (or terms of financing) and capital structure. The current law does not limit the state's guarantee of SOEs liabilities nor does the law set minimum levels of creditworthiness in order for an SOE to access capital markets for lines of credit and other forms financing. Often, SOEs' access to loans or other financial instruments is through state-owned banks, which can further increase the burden and effective liability of the government if SOEs are unable to maintain their financial integrity

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<sup>32</sup> See Chapter 1 of the OECD, *Corporate Governance of State Owned Enterprises – A Survey of OECD Countries*, 2005

<sup>33</sup> See Chapter 1 of *The Anatomy of Corporate Law – A Comparative and Functional Approach*, Oxford University.

<sup>34</sup> International experience does show that differentiation (or streamlining) of specific requirements, such as financial reporting standards, should be applied based on the size of an SOE. For example, small and medium sized SOEs should utilize the same financial reporting standards that are applied to private sector SMEs.

and repay the banks. This practice clearly weakens fiscal discipline in SOEs. It also demonstrates the strong influence of the government in an SOE's operations, which in turn actually undermines the government's management and oversight responsibilities.

104. **International Practices.** The *European Union (EU)* has undertaken several recent measures to upgrade its framework regulating company law and approach to corporate governance – this applies both to listed companies and SOEs.<sup>35</sup> While the national frameworks of member states are different, they do comply with a common set of corporate governance principles covering board composition and functions, board committees, transparency and disclosure, shareholders rights (including minority shareholders), and employee representation. The EU has undertaken several initiatives (developed an action plan in 2003 on Company Law and Corporate Governance, updated the action plan in 2006 with a focus strengthening shareholders rights, created the European Corporate Governance Forum in 2004 and updated several key Directives of the Company Law<sup>36</sup>) in recent years to address the issue disparate or lagging corporate (and SOE) practices among EU member states. The objective of the 2003 action on company law and corporate governance was to facilitate the harmonization of rules relating to company law and corporate governance, including accounting and auditing, in support of the Single Market for Financial Services and products.<sup>37</sup>

105. Additionally, a review of international practice indicates that some countries have created specific frameworks to align SOE practices with those of the private sector. *South Africa* initially developed the Companies Act to regulate SOE practices. In 1999, the country passed the Public Finance Management Act which aligned the standards of all public sector entities with relevant international benchmarks. Furthermore, in 2002, the Department of Public Enterprises of the South African government established a specific protocol for all SOEs to implement.<sup>38</sup> While this protocol builds on prior legislation, its primary objective was to establish clear roles and functions, lines of accountability, obligations and requirements for both supervising government bodies as well as for SOEs. The protocol covers all areas of corporate governance – composition, appointment and function of an SOE Board (and its committees); remuneration and appointment policy of the CEO; financial, accounting and audit policy, including transparency and disclosure requirements, in-year reporting, SOE borrowing and state financial guarantees; and corporate ethics.

106. *New Zealand*, first developed the State-Owned Enterprises Act in 1986<sup>39</sup> and later updated the legal framework through the 1993 Companies Act and the 2004 Crown Entities Act. Like South Africa, the New Zealand framework details the full range of corporate governance roles, government oversight functions and responsibilities (including that of ministry supervision

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<sup>35</sup> In the EU law and accompanying directives, SOEs are referred to as public limited liability companies.

<sup>36</sup> Relevant Directives of the Company Law which have been updated include: Accounting and Auditing Rules (2007), Transparency (2005), and Exercise of Shareholders Rights (2007).

<sup>37</sup> European Commission-IFC, "The EU Approach to Corporate Governance", Essentials and Recent Developments, February 2008.

<sup>38</sup> The 2002 Protocol on Corporate Governance in the Public Sector, Department of Public Enterprises, Government of South Africa updated the first Protocol released in 1997.

<sup>39</sup> New Zealand also had enacted separate legislation for noncommercial SOEs through the 1992 Crown Research Institutes Act.



of SOE management and the role of Parliamentary oversight of the SOE and responsible Minister), requirements and functions of the board of directors, requirements for transparency and disclosure, conflict of interest, dividend policy, limitation of liability and tax policy. The New Zealand framework requires each SOE to be based on a founding constitution which sets the company's objectives and missions. The country's legal framework also sets requirements for each SOE to be financially viable (evidenced by through the issuance of at least a BBB credit rating by an independent rating agency<sup>40</sup>).

107. **Canada**, which recently conducted a review of its governance and accountability framework for Crown Corporations (SOEs), has had the legal framework for SOEs<sup>41</sup> in place since 1984. The legal framework created a strong *systemic* oversight function for the supervising ministry. This required that the minister ensured that properly qualified and capable individual were appointed to the board of directors, that the SOE's corporate plan and policy directions were aligned and that the SOE delivered on its mandate. Underpinning all of this is a strong regulatory (and legal) framework on financial reporting, independent (or external) auditing, transparency and disclosure, shareholder rights and a range of other corporate governance issues. The government further strengthened the SOE oversight function through the introduction of the 2003 *Guidelines for Audit Committees of Crown Corporations and Other Public Enterprises*.<sup>42</sup> The 2005 review of the government's governance and accountability framework identified five areas for further strengthening<sup>43</sup> and resulted in the introduction of 31 specific reform measures. The key improvements to the framework included: (i) extending the *Access to Information Act* and the *Financial Administration Act* to all SOEs and subsidiaries; modification of the CEO appointment process by increasing the role of the board of directors vis-à-vis the government's role; (iii) providing a greater role to the Parliament in vetting nominations and introducing a framework to ensure a merit-based process for the appointment of members to the board of directors; (iv) requiring that all government financial support to SOEs (including budget transfers, subsidies, guarantees, etc.) be made transparent and included in the budget submitted to Parliament; and (v) allowing the Auditor General of Canada (Supreme Audit Institution) to be named as the independent external auditor of an SOE and requiring the Auditor General to conduct a value-for-money audit, at least once every five years, of each SOE.

## EVOLUTION OF THE STATE 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 (Chapter 2).***

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<sup>40</sup>2007 Manual for State-Owned Enterprises, CCMAU and Treasury of New Zealand

<sup>41</sup> Financial Administration Act

<sup>42</sup> The Guidelines include not only the functions of the committee, but also a requirement on the technical financial management and accounting qualifications (experience and knowledge) of audit committee members.

<sup>43</sup> (i) Clarifying the relationship between ministers and SOEs and who is accountable to Parliament; (ii) strengthening the accountability regimes of SOEs; (iii) making the process of appointment of the CEO and board of directors more transparent; (iv) strengthening the SOEs' audit regimes (including internal audit) and (v) making SOE operations more transparent.

108. An effective ownership policy addresses key challenges of SOE corporate governance. In establishing its ownership policy, the state should ensure, that regardless of the ownership model or form, that it establishes and practices an arms-length relationship vis-à-vis its enterprises and assets. The functions of an effective state ownership policy include (i) a clear dividend and investment policy for all SOEs; (ii) a monitoring and evaluation framework, which is frequently practiced through the issuance of management performance contracts; (iii) enforcement mechanism, including clear accountabilities and consequences for non-compliance. As evidenced by numerous examples of successful country reform, an improved ownership policy and function places greater importance on the appointment of qualified and professional SOE managers and members of the board of directors.<sup>44</sup>

109. The ownership function for SOEs can essentially be classified in three different models. The decentralized model, where state-owned enterprises are under the responsibility of relevant sector ministries, has been the tradition used in many OECD countries. This decentralized model was most prevalent in socialist economies prior to their transition to a market economy. The dual model is, however, the most prevalent one, where the responsibility is shared between the sector ministry and a “central” Ministry or entity, usually the Ministry of Finance or the Treasury. Finally, a centralized model, in which the ownership responsibility is centralized under one main ministry, has been on the increase more recently. The evolution and reform of the organization of the ownership function have been significant in the last two decades, and a number of countries are still undertaking reforms. These reforms tend to move countries away from the decentralized model and more towards the centralized model.

110. As seen through international experience, there were several disadvantages with the decentralized model. First, there was a difficulty in separating the state’s ownership and regulatory (including industrial policy) functions. The move towards a centralized model of ownership has been largely driven by the effort to devolve regulatory oversight to more specialized institutions while focusing state ownership on maximizing shareholder (state) value. Second, in a decentralized model it was difficult to determine who exactly is running a SOE’s operations. It was commonly perceived that line ministries were heavily involved in the daily operations of an enterprise – which underscored the belief of high levels of government and political interference in a SOE’s commercially-oriented operations.

111. The underlying rationale for the reform of the ownership function is the need to complement the structural reforms of the past two decades in many sectors in which SOEs are still prevalent in many OECD countries. This is particularly the case in non-manufacturing sectors (such as gas and electricity supply, telecoms, postal services, air transport, railways), where access or price regulation is still needed due to the technological or informational characteristics of such industries. Structural reforms in these sectors have included widespread privatization and regulatory reforms.

112. Regulatory reforms have been extensive, involving increased international openness, easier entry to domestic markets, and an increased reliance on market-based and/or incentive mechanisms. The progress in reforming the regulation of non-manufacturing industries has been

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<sup>44</sup> *Corporate Governance of State Owned Enterprises – A Survey of OECD Countries, 2005*

significant in the 1990's in most OECD countries. This progress has been particularly important in network industries (telecoms, utilities and air transport), although the timing and scope differs across OECD countries. These reform efforts are continuing in some industries especially in the EU as part of the drive to complete an open internal market. Most OECD countries have progressively separated clearly the regulatory function within the state administration, mainly to ensure a level playing field between state-owned and privately owned companies. The state is now reforming its ownership function in order to more clearly identify and strengthen this function, as well as to reinforce the incentives for SOE management and boards to produce efficiently and compete effectively.

113. Most SOEs pursue multiple, and sometimes conflicting, objectives. The multiple objectives arise either because they are mandated by legislation or because different government ministries are in a position to exert strong influence on the SOE's operations and mandate. However good international practices show that a SOE will clearly declare its business objective through a company mission statement or other authoritative and publicly disclosed document. An important function of the government's ownership function (and a key component of its oversight role, usually through the managing ministry or specialized agency) is to ensure that the SOE's business objectives align closely with national economic interest and development priorities.

114. Ukraine deviates from the good practices presented above. It does not have a clear and consistent ownership policy. Although the government's dividend policy is developed in conjunction with budget formulation, evidence suggests that there is weak or inconsistent enforcement to ensure that required dividends are remitted to the treasury. While the Law "On the Management of State Assets" was recently enacted, it does not prescribe any specialized management functions or provide a robust framework for oversight. The system of SOE performance evaluation is largely a self-assessment, is not consistently applied and there is little evidence to suggest that the supervising ministry takes meaningful action.

115. Ukraine's current SOE ownership function follows essentially a decentralized model. While the CMU is granted broad power and responsibility for oversight, it delegates this function to the MOE, SPF and line ministries. Given that there are more than 3,500 SOEs currently operating<sup>45</sup>, it is extremely challenging for the government to effectively manage and oversee such a large portfolio. Thus it is more difficult for the government, acting in its ownership capacity, to assess SOE performance as the SOE's operating objectives are unclear (even in cases where an SOE has established its objectives, this information rarely is made available to the public).

116. Where an SOE has special responsibilities or obligation to fulfill (e.g., in providing a unique service or function to benefit the public), this should be clearly rooted in law/regulations, incorporated into the enterprises by-laws, and disclosed to the public – including any potential impact on the SOE's resources and economic performance. For those SOEs in Ukraine with commercial operations and which are competing with private sector enterprises, there is a need to require each SOE to clearly articulate its business objectives. This would enable a better

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<sup>45</sup> This figure does not include municipal or communal SOEs operating under the supervision of local government.

assessment of company performance as relevant benchmarks can be established (apart from improving the overall performance framework, which is also needed).

117. **Good International Practices.** In many former transition economies, centralization of the ownership function meant not only an efficient means to support privatization, but to distinguish from past behavior where the state was involved in very close management of SOEs. Over a period of fifteen years, **Poland** undertook a series of steps to separate the ownership and regulatory functions creating distinct units responsible for privatization and corporate governance (management and oversight). In clarifying the ownership policy, the government's revised framework decided that the function of state ownership would be discharged through the government's representation on SOE supervisory and executive boards. The Ministry of State Treasury was designated as the primary agency responsible for executing the government's ownership function – eliminating the previously divided responsibility with line ministries that had been shared but ineffectively implemented. In upgrading the corporate governance, transparency and disclosure framework, in October 2005, the government issued a revised set of regulations<sup>46</sup> (developed by the Ministry of State Treasury), embedding the full range of the OECD SOE Corporate Governance principles. This approach demonstrated the inherently close link between state ownership policy and SOE corporate governance in order to implement an effective system of oversight.

118. Following a specialized report commissioned to review the state ownership<sup>47</sup>, in 2004 **France** established a new centralized agency (*Agence des Participation d'Etat*) to assume the responsibility for oversight and management of the country's SOEs. The Barbier de la Serre report offered a series of recommendations (which have since been implemented) to clarify and strengthen the state's ownership functions, among them: (i) clearly distinguish the regulatory and ownership roles through separating the functions and placing them in separate agencies/departments; (ii) improve the ownership function by establishing a dedicated entity to improve strategic thinking, transparency and to reinforce the role of SOE boards; (iii) improve accountability to the public and Parliament through regular reporting on the performance of the SOE portfolio and (iv) protect the interests of minority shareholder. With regard to the newly created entity, the responsibilities conferred to

119. Until recently, **New Zealand** had considerable success in utilizing the dual model of state ownership. While the Ministry of Finance focuses on the fiscal impact and economic efficiency of SOE performance (i.e. the company's balance sheet and fiscal position), the Treasury Advisory Unit, CCMAU (Crown Company Monitoring Advisory Unit), is focused on ensuring that SOEs are profitable and successful companies (i.e., performance, commercial environment, enterprise risk management)<sup>48</sup>. CCMAU, and the sector ministries, take the lead to actively monitor and oversee company performance, among other responsibilities including the appointment of members of board of directors. However, due to several years of underperforming state assets, the government of New Zealand in November 2009 disestablished

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<sup>46</sup> This is commonly known as the Ministry of State Treasury Principles

<sup>47</sup> 2003 Barbier de la Serre Report, commissioned by the Ministry of Finance of France

<sup>48</sup> 2007 Owner's Manual for State-Owned Enterprises, CCMAU and the Treasury of New Zealand.

this advisory unit and re-centralized the functions and responsibility for management/oversight of SOEs transferring them back to the Treasury.<sup>49</sup>

120. In 2001, **Indonesia** established a central ministry (Ministry of State-Owned Enterprises) and over a three year period, implemented a series of significant reforms to simultaneously strengthen the oversight/ownership function as well as implement a modern framework of SOE corporate governance practices for the enterprises which were not subject to privatization. There were important achievements realized at the end of this initial three year reform initiative, including: (i) the establishment of a sound policy, legal regulatory and operational SOE frameworks which underpinned improving corporate governance practices; (ii) transparent and proper fiscal treatment of SOE's public service obligations; (iii) improved financial performance as a result of implementing modern corporate governance practices, standards and codes; (iv) improved transparency and disclosure of SOE objectives and performance/results; and (v) gradual divestment of state shares in 15 SOEs resulting in significant budgetary inflows to the national treasury.<sup>50</sup>

## TRANSPARENCY AND DISCLOSURE

*State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance (Chapter 5).*

121. Transparency is a cornerstone of any governance reform. Open or public access to information establishes the basis for accountability. Without accurate and detailed information it is difficult to set targets, allocate resources efficiently and assess company performance. In almost all OECD countries, SOEs follow the regulatory provisions of the company commercial code, Company Law, listing requirements and/or corporate governance principles/codes. It is in the state's interest that other shareholders do not perceive it as an opaque or unpredictable owner. Good corporate governance must be seen to be practiced, which is done through compliance with high standards of disclosure.

122. Apart from the requirements for SOEs to be transparent and publicly disclose financial and operational performance reports, governments themselves should also adopt more transparent practices. In many OECD countries, governments publicly disclose guidelines for SOE oversight - including how and when the government intervenes into SOE operations. Governments should also publish the objectives and goals for SOEs along with the periodic assessments on SOE performance in an effort to build public confidence.

123. The OECD guidelines note three distinct but inter-related types of SOE reporting which contribute to improving oversight and governance: (i) *ex-ante*, (ii) *ex-post* and (iii) aggregate reporting. While *ex-post* reporting is common between SOEs and listed companies, *ex-ante* and

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<sup>49</sup> The functions of CCMAU, formerly an independent quasi-governmental agency, have been transferred to the Crown Ownership Monitoring Unit (COMU) within the New Zealand Treasury.

<sup>50</sup> 2009 "Indonesia State-Owned Enterprise Governance and Privatization Program" Asian Development Bank Independent Evaluation Report

aggregate reporting are unique to the SOE sector – though aggregate reporting is rare even among OECD countries.

- *Ex-ante* reporting is in addition to the basic reporting requirements as set in the Company Law, and is primarily focused on setting clear objectives and performance targets. This is commonly found through management performance contracts or statements of corporate intent (SCI).
- At a minimum, timely and full *ex-post* disclosure requirements (usually through the issuance and publication of an annual report) should include, *inter alia*: (i) statement of company objectives, including public policy/social or non-commercial objectives; (ii) financial performance and financial statements with clear explanations of unusual transactions; (iii) total compensation of all directors and management, including board members; (iv) details of major events and changes which materially impact its results; (v) auditor report; and (vi) minutes from shareholder/annual meetings. In OECD countries, SOEs are increasingly reporting (*ex-post*) in as much detail as joint-stock and listed companies.
- Aggregate reporting covers all forms of reporting on the overall sector and is usually done by the supervising ministry, supreme audit institution or other oversight body. This form of reporting aims to inform the Parliament and general public of the performance and annual results of the SOE portfolio.

124. In most OECD countries, SOEs are required to apply the same accounting and financial reporting standards used by listed companies. This is predominantly International Financial Reporting Standards (IFRS) as many countries have converged national standards with the international benchmark. Likewise, in most OECD countries, SOEs are subject to the same audit requirement as listed companies (audits based on International Standards of Auditing or ISA). This requires that the company's financial statements are audited by a qualified external audit firm providing assurance that the financial statements are free from error or misrepresentation. In many countries, the selection auditors of SOEs is endorsed (if not chosen directly) by the SOE's board of directors.

125. In Ukraine, while joint-stock and listed companies are subject to stricter financial reporting and audit requirements<sup>51</sup>, unitary SOEs are not required to produce financial statements based on international standards. Furthermore, unitary SOEs are not required to be audited on an annual basis. More often than not, SOE financial information is not publicly available – neither through a central repository (e.g., Ministry of Economy) nor through an enterprise's own website.

126. SOEs in Ukraine which are joint-stock companies follow the Law on Accounting and use National Accounting Standards (NAS) as the basis to prepare their financial statements. While there is a higher degree of transparency with regard to reporting requirements for joint-stock

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<sup>51</sup> The 2008 Law of Ukraine On Joint stock Companies No. 514-VI, the 2006 Law of Ukraine On Securities and Stock market No. 3480-IV and the 1996 Law of Ukraine On State Regulation of Securities Market in Ukraine No. 448/96-BP.

companies as compared to unitary SOEs, the 2008 Accounting and Auditing ROSC study found not only significant differences between NAS and IFRS, but also significant issues related to the lack of compliance with NAS<sup>52</sup>. While Ukraine's NAS had largely been based on IFRS, the key differences were that NAS do not entirely reflect the latest developments in IFRS and the disclosure requirements of NAS are less demanding than IFRS. The result of the material differences between the two standards makes comparability of financial statements difficult. The MOF has recently (November 2010) taken several steps to upgrade NAS and to eliminate the remaining differences with IFRS. Furthermore, there is limited usefulness of financial statements to professional users of financial information with limited knowledge of Ukrainian NAS.<sup>53</sup>

127. Additionally, the 2008 Accounting and Auditing ROSC study note that many SOEs have rudimentary accounting and reporting systems and lack capacity to apply NAS and produce financial reports. Consequently, the quality of financial information produced by SOEs varies significantly and often inadequately reflects the economic and financial performance of the company. Unitary and *kazenni* SOEs, which lack a corresponding incentive to produce or lack the demand for reliable and comprehensive financial reporting and disclosure, merely submit the required financial data and self-reported indicator to the supervising line ministry and produce information for the state tax administration.

128. **International Developments and Practices.** As noted earlier in this section, the *European Union* has undertaken several recent initiatives to upgrade its financial reporting and accountability framework. In the context of Transparency and Disclosure requirements, the EU has prepared a special paper<sup>54</sup> proposing to incorporate additional dimensions of corporate governance into EU company law, broaden the coverage of governance issues into the external auditor's framework, and upgrade disclosure requirements (particularly with respect to the functions of the board of directors or supervisory board<sup>55</sup>).

129. OECD countries, in addition to strengthening their financial reporting architecture, have responded to recent crises (e.g., notable international cases of accounting scandals such as Enron, Siemens, Société Générale) to further upgrade their corporate governance frameworks and to include an annual disclosure of a company's compliance with national law. Increasingly, listed companies as well as SOEs are required to issue a formal Corporate Governance Statement in the annual report (some countries require a separate Corporate Governance Report to be issued annually). The content of this additional disclosure and reporting includes information on: (i) board composition and nomination process; (ii) resources available to directors for external advice or high-level/executive advisory services; (iii) procedures for elaborating and reviewing compensation schemes for the CEO and board members; (iv) procedures for nominating/contracting external auditors; (v) enterprise risk management and (vi) ethics policy.

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<sup>52</sup> Significant findings of non-compliance with NAS included: (i) non-disclosure of related party transactions; (ii) non-disclosure of accounting policies adopted; (iii) failure to include cash flow statements; (iv) assets carried at historical cost despite evidence of impairment; (v) non-disclosure of earning per share

<sup>53</sup> 2008 ROSC Accounting and Auditing.

<sup>54</sup> *Discussion Paper for Auditor's Role Regarding Providing Assurance on Corporate Governance Statements*, Federation of European Accountants, Brussels, November 2009.

<sup>55</sup> In some European countries, the Supervisory Board is part of a two-tier oversight system and is placed organizationally, between the Executive Board and Management.

***Good Practices in Ex-Ante Reporting***

130. SOEs in ***Korea*** are required to submit the “Report on Actual Results of Operation” with financial and non-financial information on the SOE’s objectives, as well as “concerns of public interest”. This report is submitted to all supervising entities (e.g., line ministry, Ministry of Finance, etc.) and the National Assembly (Parliament).

131. In ***Australia***, all SOE develop a Statement of Corporate Intent which is used as planning and accountability document specifying financial and non-financial performance targets for the subsequent three year period. The purpose of this document is to enhance *ex-ante* accountability and to provide clarity as to the SOE’s mandate and objectives.

132. In ***New Zealand***, the management and boards of SOEs develop a strategy and financial performance plans (including targets and performance indicators) for a three year period – and which is captured in the Statement of Corporate Intent. These statements of intent establish the scope and nature of the SOEs activities and operations and are used as a reference document against which SOE boards (and management) are held accountable.

133. In ***Poland***, the Ministry of Treasury prepares an annual “Report on the Economic and Financial Conditions of State Assets” which is submitted for Parliamentary review and approval.

***Good Practices in Ex-Post Reporting***

134. While a country may impose specific and unique requirements for SOE *ex-post* reporting, overwhelmingly there are numerous similarities and common principles observed across countries. Financial reporting (including accounting policies and standards) should comply with international standards and all but the smallest SOEs should produce and public disclose accurate annual financial reports. SOEs should also report on non-financial information including related party transactions (especially transactions with other SOEs), changes in board membership and company management, and changes in ownership structure. Typically the audited financial statements are included in the SOE’ Annual Report. As part of the annual reporting obligation, many countries require the inclusion of performance indicators which attempt to reconcile with the company’s objectives and targets as reported *ex-ante*.



## CONCLUSIONS AND RECOMMENDATIONS

135. The global and economic crisis has hit Ukraine particularly hard as GDP contracted 15 percent in 2009. State-owned enterprises continue to represent a significant share of Ukraine's economy (particularly rail, transport, utilities, energy and telecommunications), and the crisis further expanded the public sector through nationalization and state recapitalization of banks. As fiscal measures continue to increase, rationalization and improved allocation of fiscal resources has become a priority.

136. While the government of Ukraine has taken some measures to improve its system of management and oversight of state-owned enterprises, several fundamental issues remain unresolved and which continue to limit the effectiveness and efficiency of the government's oversight function. This paper analyzed the current system of SOE oversight with an objective to propose measures to align Ukraine's system with international benchmarks, standards and good practices.

137. **Summary of Findings.** Ukraine's SOE sector has a wide range of ownership and management schemes. The basic legal framework for SOE management and oversight, defined in the Commercial Code of Ukraine, provides for the delegation of responsibilities across several ministries/agencies. As a result, there are overlapping roles across different government institutions, and gaps with regard to active monitoring and oversight.

138. In practice, the SOE oversight function of the line ministries is primarily exercised through a review of the reports submitted by the SOEs on the implementation of financial plans. However, the review is typically light. And its efficiency is undermined by the limited clarity of the operating objectives for SOEs, and limited usefulness of the performance management framework. Moreover, the underlying data used to measure performance indicators is not validated and its reliability is uncertain. Even though the current performance management framework can be improved, performance evaluations are not conducted for a substantial number of SOEs which seriously undermines the effectiveness of management and oversight.

139. Transparency and disclosure requirements are in need of significant strengthening and should first be clearly established in a modern legal framework. Many of the deficiencies in Ukraine's current financial reporting architecture, in particular incomplete consolidations and the absence of appropriate or complete disclosures relating to related parties and owners, make it difficult for users to make a proper assessment of the financial position and performance of an SOE. There is no requirement for entities to be subject to an annual external audit. Additionally, SOEs are not required to disclose or publish basic financial information, corporate results, or other non-sensitive company information. There is also a need to enforce the proper application of transparency and disclosure policies and ensure that public access to information is guaranteed.

140. **Recommendations.** The recommendations focus on three interrelated and critical areas which underpin any effort to reform or improve SOE performance: (i) legal framework, (ii) state ownership policy, and (iii) transparency and disclosure. A strong legal framework not only requires the implementation of modern corporate governance practices within an enterprise, but it also supports the development of clear objectives and goals against which performance can be objectively measured. In trying to improve the performance of SOEs, it is also necessary to ensure that they are insulated from political interference, clarify the government's oversight and monitoring role, and establish an arms-length relationship between government and SOEs in terms of managing an enterprise's. Lastly, transparency is the cornerstone of any governance reform and open access to information provides the basis for accountability and enhances the ability to assess performance and allocate capital and resources effectively.

141. **First and foremost, there is an urgent need to establish a single and comprehensive database or registry of all SOEs operating in Ukraine.** The fact that such a system or registry does not fully exist is not only worrisome but also demonstrates that the difficulty in trying to obtain complete data on the SOE sector or even information on a specific enterprise.

142. **Second, once a complete enterprise database is established, it would be important to segment the sector – distinguishing large SOEs from small and medium enterprises.** While this is apparently contemplated in the CCU (Article 63, part 7), an alternative and practical approach would be to apply the methodology used by the International Federation of Accountants (IFAC), which is the global standard setting body for accounting, auditing and financial reporting standards, including IFRS. This would allow the government to initially focus its attention and efforts to improve the performance of those enterprises, whose mandate and nature of activities are commercially oriented, which represent either significant value to the economy (or to a specific sector) or which represent significant risk (e.g., fiscal risk) to the government.

143. **Third, all large SOEs (which are primarily commercially oriented) should be subject to process that utilizes the principles of corporatization with a clear purpose to improve the enterprise's internal management structures.** This effort would also include strengthening internal controls, and modernizing (or implementing) operational and risk management systems and practices. For all large SOEs, the primary oversight function should be delegated to autonomous, professional and competent boards of directors.

144. **Legal Framework.** While there have been recent advances in improving the legal framework for SOEs which are joint-stock companies, there is a need to modernize and upgrade the legal framework for unitary and *kazenni* SOEs. In revising the legal framework for SOEs, it is advisable to establish a single, unifying and basic set of regulations which would be applied evenly across all sectors. This effort should strive to reduce, or eliminate entirely, the current differences between regulations applicable to joint-stock companies and those which apply to unitary and *kazenni* enterprises. It is also important to simultaneously better define what the role of government oversight entail as well as clarify which government ministry/agency is responsible for a specific function. The legal framework should establish a clear arms-length relationship between government and an SOE and should include specific limits on the government's role or influence regarding an SOE's access to finance and credit. Modern

corporate governance practices (including establishing independent and professional boards of directors, including board committees for all large SOEs) should be integrated into the revised and upgraded framework. Lastly, SOEs should be required to establish clear operating objectives as this would establish the basis on which performance can be objectively evaluated.

145. **State Ownership Policy.** Ukraine has essentially relied on a decentralized model of ownership. Though given the sheer number of SOEs operating in the country this approach conceptually is valid, it has resulted in a dilution of basic responsibilities and effectively, little oversight is actually performed.

146. In revising the state's ownership function, which should be underpinned by a strong corporate governance framework, the government of Ukraine should first develop a clear ownership policy which separates the regulatory function from management and oversight, and which provides the general public with a clear understanding of the state's objective as an owner. In attempting to strengthen accountability, the government, as the ultimate guarantor of SOE debt and liabilities, should develop clear limits with regard to its financial obligations and exposure. There should also be clear criteria which would help evaluate SOE proposals or requests to access financial instruments.

147. While Ukraine has implemented a performance management framework, there is a need to improve both the quality of indicators as well as the quality of information used for measurement. Moreover, given that there are significant gaps in compliance with performance evaluations and even with remittance of dividends to the national treasury, it will be important to develop mechanisms by which to better monitor and enforce compliance with these requirements.

148. While KRU is currently implementing a series of reforms to align with the EU model of internal audit, its role with respect to conducting inspections and audits of SOEs should be carefully revised to ensure it will be compatible with its new organizational form and mandate. Additionally, the government should seek to strengthen the role of the Accounting Chamber (Ukraine's SAI) by empowering it to regularly audit (or sub-contract such audits to private sector audit firms) at least the largest SOEs on a periodic basis. The scope of its work should not be limited to reviewing compliance with budgetary regulations and directives but rather it should be focused to conducting comprehensive financial or performance audits of the enterprise, including its subsidiaries.

149. **Transparency and Disclosure.** There is a need to significantly strengthen basic transparency and accountability requirements and practices for all SOEs. SOEs should be required to *ex-ante* publicly disclose/publish the enterprise's operating objectives (including both commercial and non-commercial objectives) as well as financial plans. The government should also be required to publicly disclose the annual reports on SOE performance – both in aggregate as well as for individual enterprises.

150. Large SOEs (whose business activities are commercially oriented) should be required to fully comply with Ukrainian National Accounting Standards (NAS), including with respect to standards on disclosure, related party transactions, asset valuation, contingent liabilities, etc. The

introduction and application of IFRS should remain as a medium to longer term objective. SOEs which can be classified as small and medium-sized enterprises (SMEs) should be allowed to take advantage of reduced accounting requirements. Large SOEs should also be required to report comprehensively, including consolidation of financial information for its subsidiaries. Upgrading the underlying standards of financial reporting would also significantly help improve the reliability and usefulness of data used for performance measurement. The current draft Law on Accounting, which covers the standards and practices for the private sector, should be amended to also include this category of SOEs.

151. All large SOEs should have their financial statements audited by statutory auditors in accordance with International Standards on Auditing (ISA) – and all SOEs should be subject to some form of independent annual financial audit. Over a 5 year period other entities could be brought within the scope of a required ISA-compliant audit, but the number of audits required should not exceed the potential capacity of the audit profession in Ukraine to provide ISA-compliant quality audit services. The audit requirement would also help to ensure that company financial data and results, which are used for performance measurement, is validated and reliable. The draft Law on Auditing should be amended as to also incorporate SOEs within its scope and regulation.

152. In terms of disclosure, all SOEs, especially the large SOEs, should be required to make their audited financial statements publicly available in a timely manner. There is a need to significantly strengthen and enforce compliance with the Law on Information to ensure that the general public, including interested users of financial information, has unrestricted access to company information that is not determined to be commercially sensitive.

153. The recommendations described above are consistent with prevailing international standards and practices. In particular these standards and practices are endorsed by the OECD and have been incorporated into the EU's body of law and regulations. Implementation of these recommendations will bring Ukraine's statutory framework into much greater alignment with the *acquis communautaire*. The EU's Second, Fourth, Seventh and Eighth Company Law Directives and the Transparency Directive should be taken as examples to guide amendments to legislation, but the specifics of Ukraine's environment should also be considered. The process of reform should be seen as part of the cooperation of Ukraine with the EU envisaged as part of the European Neighborhood Policy, and support for the reform can be sought from the international community supporting Ukraine's development agenda.

154. In attempting to tackle the range of issues and problems posed by the overall SOE sector, the government may wish to consider a sequencing of activities. This could approach can be considered as platform or process through which momentum can be built and sustained in order to confront the more complex and difficult challenges.

**BOX 5: SEQUENCING OF REFORMS**

**Short-term**

- ③ Establish a single and comprehensive database of all SOEs (including their financial indicators, assets and liabilities) which would enable a segmentation of the SOE sector into more manageable sub-sectors
- ③ Develop and implement a plan of corporatization of large SOE (natural monopolies) as a way to improve overall quality of operations and to enable them to attract private capital and joint venture opportunities
- ③ Require all large SOEs to be subject to an annual independent or external financial audit and to publish their annual reports, including the results and opinion of the annual audit
- ③ Require all large SOEs to publish their operating objectives, including non-commercial objectives
- ③ Amend the existing performance management framework, and accompanying underlying requirements and regulations, to incorporate standard measures and methodologies for the assessment of SOE performance
- ③ Develop and implement a fiscal framework for SOEs to establish a level-playing field for access to credit and to be applied to assess an enterprise's request to access loans, guarantees and other financial instruments

**Medium to longer-term**

- ③ Require all small and medium-sized SOEs to publish their operating objectives, including non-commercial objectives, as well as annual reports and financial results
- ③ Incorporate the requirement that all SOE non-commercial or policy objectives be fully disclosed and financed by the state budget
- ③ Develop a clear and comprehensive state ownership policy which devolves the close supervision of SOEs to Boards of Directors (for large SOEs) and allows the government to focus on monitoring overall performance of the SOE sector and its compliance with laws and regulations
- ③ Develop a framework to establish the creation of professional and independent Boards of Directors, including board committees, for all large SOEs
- ③ Implement and enforce the Law on Auditing, which now incorporates large SOEs within its scope
- ③ Implement and enforce the draft Law on Accounting to require all large SOEs to apply IFRS in the preparation of their annual financial statements
- ③ Implement a framework for the competitive selection of professional management for SOEs – similar to the recent framework enacted for joint-stock companies

## ANNEX 1: SOE LEGAL FRAMEWORK AND REGULATIONS

### A. General Laws (Applicable to all SOEs)

1. Law of Ukraine. “On Privatization of State Property”. (“Про приватизацію державного майна”).
2. Law of Ukraine “On Property”. 7 February, 1991. #697-XII. (last amended: 21 January, 1995).
3. Law of Ukraine “On Enterprises in Ukraine”. Last amended: February 7, 2002.
4. Law of Ukraine “On List of State-Owned Legal Entities, That Are not Subjects to Privatization” (“Про перелік об’єктів державної власності, що не підлягають приватизації”). July 7, 1992 (last amended: February 7, 2002). #847-XIV. Annex: List of State-Owned Legal Entities, That Are not Subjects to Privatization.
5. Law of Ukraine “On Companies” (“Про господарські товариства”), September 19, 1991 (last amended: March 7, 2002). #1576-XII.

### B. Laws Applying to Non-incorporated State-Owned Proprietorships

1. Law of Ukraine “On Property”. 7 February, 1991. #697-XII. (last amended: 21 January, 1995).
2. Law of Ukraine “On Enterprises in Ukraine”. Last amended: February 7, 2002.
3. Law of Ukraine. July 7, 1992 (last amended: February 7, 2002). #847-XIV “On List of State-Owned Legal Entities, That Are not Subjects to Privatization” (“Про перелік об’єктів державної власності, що не підлягають приватизації”). Annex: List of State-Owned Legal Entities, That Are not Subjects to Privatization.
4. Cabinet of Ministers. Decree. 15 December, 1992. #8-92. “On Management of National Property” (“Про управління майном, що є у загальнодержавній власності”).
5. Cabinet of Ministers. Resolution. 19 March, 1993. #203 (last amended: 25 July, 2001). “On Application of Contract with Head of State-Owned Enterprise” (“Про застосування контрактної форми трудового договору з керівником підприємства, що є у державній власності”).
6. Cabinet of Ministers. Decree. 10 May, 1993. #48-93. “On Order of Income Disposal of State Enterprises, Establishments and Organizations” (“Про порядок використання прибутку державних підприємств, установ та організацій”).
7. Cabinet of Ministers. Resolution. May 19, 1999. #859. “On Conditions and Amounts of Wages for Heads of State and Communal Enterprises and Mergers of State Enterprises” (“Про умови та розміри оплати праці керівників підприємств, заснованих на державній, комунальній власності, та об’єднань державних підприємств”).
8. Cabinet of Ministers. Resolution. August 2, 1995 (last amended: July, 26, 2001). #597. “On Typical Form of Contract with Head of Non-Incorporated SOE” (“Про типову форму контракту з керівником підприємства, що є у державній власності”). Annex: Typical Form of Contract with Head of Non-Incorporated SOE.

9. Ministry of Economy, Ministry of Labor and Ministry of Finance, State Property Fund of Ukraine. “Typical Statute of Non-Incorporated State-Owned Proprietorship” (“Типовий статут державного підприємства”). May 10, 1993. #43.
10. Ministry of Economy. Decree. December 25, 2000. #277. “On Approval of Regulations towards Order of Annual Financial Plan Composition by SOE” (“Про затвердження Положення про порядок складання річного фінансового плану державним підприємством”). Annex: Financial Plan of SOE.
11. Ministry of Industrial Policy of Ukraine. Decree. 26 July, 1999. #272. “Order of Contract Approval with Heads of Non-Incorporated, Kazenni and Communal SOEs and Their Mergers, That Are Subordinated to the Ministry of Industrial Policy” (“Порядок укладення контракту з керівниками підприємств, заснованих на державній, комунальній власності, у тому числі казенних, об’єднань державних підприємств, організацій та установ, що входять до сфери управління Мінпромполітики України”.
12. Ministry of Industrial Policy of Ukraine. Decree. 28 March, 2002. #138. “On Amendments to Form of Contract with Heads of Companies, Organizations and Establishments” (“Про внесення змін до форми контракту з керівниками підприємств, організацій та установ”).

### C. Laws Applying to *Kazenni* SOEs

1. Law of Ukraine “On Enterprises in Ukraine”. Last amended: February 7, 2002.
2. Cabinet of Ministers. Resolution. 22 July, 1998. #1129. “On Some Issues of Management of *Kazenni* State-Owned Proprietorships” (“Про деякі питання управління казенним підприємством”). Annex: Form of Financial Plan for *Kazenni* State-Owned Proprietorship).
3. Cabinet of Ministers. Resolution. 30 June, 1998. #987 (last amended: October 15, 2001). “On Conversion of Non-Incorporated SOEs into *Kazenni* SOEs” (“Про перетворення державних підприємств у казенні”). Annex: List of SOEs, which are to be converted into *Kazenni* SOEs.
4. Cabinet of Ministers. Resolution. 18 June, 1998. #914. “On Typical Charter of *Kazenni* State-owned Proprietorship” (“Про типовий статут казенного підприємства”). Annex: Typical Form of Charter of *Kazenni* State-Owned Proprietorship.
5. Ministry of Industrial Policy of Ukraine. Decree. 12 October, 1998. #371. “On Approval of Contract Form with Head of *Kazenni* State-Owned Proprietorship” (“Про затвердження форми контракту з керівником казенного підприємства”). Annex: Form of Contract with Head of *Kazenni* State-Owned Proprietorship; Form of Report of Head of *Kazenni* State-Owned Proprietorship
6. Ministry of Industrial Policy of Ukraine. Decree. 28 March, 2002. #138. “On Amendments to Form of Contract with Heads of Companies, Organizations and Establishments” (“Про внесення змін до форми контракту з керівниками підприємств, організацій та установ”).
7. Ministry of Industrial Policy of Ukraine. Decree. 26 July, 1999. #272. “Order of Contract Approval with Heads of Partially, *Kazenni* and Communal SOEs and their Mergers, That Are Subordinated to the Ministry of Industrial Policy” (“Порядок укладення контракту з керівниками підприємств, заснованих на державній, комунальній власності, у

тому числі казенних, об'єднань державних підприємств, організацій та установ, що входять до сфери управління Мінпромполітики України”.

#### **D. Laws Applying to Fully State-Owned Companies**

1. Law of Ukraine “On Companies” (“Про господарські товариства”), September 19, 1991 (last amended: March 7, 2002). #1576-XII.
2. Presidential Decree June 15, 1993 (last amended: August 28, 2001). #210/93. “On Incorporating of Companies” (“Про корпоратизацію підприємств”).
3. Presidential Decree “On Drastic Measures on Ordering of Activities of Fully State-Owned Corporations and State Holding Companies”, November 7, 2001. #1049/2001. Annex: List of Fully State Owned Corporations and State Holding Companies.
4. Cabinet of Ministers. Resolution. 5 July, 1993. #508 (last amended: 22 April, 1997). “On Approval of Regulations towards Order of Incorporating of Companies” (“Про затвердження Положення про порядок корпоратизації підприємств”).
5. Cabinet of Ministers. Resolution. 19 July, 1993. #556 (last amended: 7 February, 2001). “On Approval of Regulations towards Board of Directors” (“Про затвердження Положення про спостережну раду”).
6. State Property Fund of Ukraine. Order. April 6, 2000 (last amended: June 15, 2001). #695. “On Approval of Regulations towards Order of Negotiation or Re-negotiation of Contract with CEO of Open Joint Stock Company, Holding Company and Fully State-Owned corporation and Typical Form of Contract with CEO”. ( “Про затвердження Положення про порядок укладання контракту з головою правління відкритого акціонерного товариства, холдингової компанії та державної акціонерної компанії і Типової форми контракту з головою правління ВАТ”). Annex: Typical Form of Contract with CEO.
7. State Property Fund of Ukraine. Ministry of Economy of Ukraine. Order. June 25, 2001 (last amended: October 15, 2001). #1129/134. “On Approval of Typical Charter of Open Joint Stock Company, Created by Incorporating of State Enterprise, Not Subject to Privatization”. (“Про затвердження Типового статуту відкритого акціонерного товариства, створеного шляхом корпоратизації державного підприємства, яке не підлягає приватизації”). Annex: Typical Charter of Fully State-Owned Corporation”.
8. State Property Fund of Ukraine. Order. February 21, 2002. #343. “On Approval of Form of Financial Plan of Corporation, More Than 50% of Shares of Which Is Owned by State and Methodological Recommendations on Order of Composition and Approval of Annual Financial Plan” (“Про затвердження форми фінансового плану господарського товариства, у статутному фонді якого більше 50 відсотків акцій належать державі та Методичних рекомендацій щодо порядку складання та погодження (затвердження) річного фінансового плану”). Annex: Financial Plan of Corporation, More Than 50% of Shares of Which Is Owned by State.
9. Ministry of Finance. Order. August 21, 1996. #172. “On Approval of Order of Inflow to Budget of Dividends from State-Owned Shares”. (“Про затвердження Порядку зарахування до Державного бюджету України дивідендів, одержаних від акцій, що належать державі в акціонерних товариствах”).

#### **E. Laws Applying to State Holding Companies**



1. Law of Ukraine “On Companies” (“Про господарські товариства”), September 19, 1991 (last amended: March 7, 2002). #1576-XII.
2. Presidential Decree “On Drastic Measures on Ordering of Activities of Fully State-Owned Corporations and State Holding Companies”, November 7, 2001. #1049/2001. Annex: List of Fully State Owned Corporations and State Holding Companies.
3. Presidential Decree “On Holding Companies, That Are Created Through Incorporating and Privatization”, May 11, 1994. #224/04.

#### **F. Laws Applying to Joint-Stock Corporations with State Share**

1. Law of Ukraine “On Companies” (“Про господарські товариства”), September 19, 1991 (last amended: March 7, 2002). #1576-XII.
2. Presidential Decree “On Drastic Measures on Speeding the Privatization in Ukraine” (“Про невідкладні заходи з приватизації майна в Україні”), December 29, 1999 (last amended: December 25, 2000) . #1374/2000.
3. Cabinet of Ministers. Resolution. 3 June, 1999. #951 (last amended: 29 November, 2001). “On Delegation of Rights to Manage State Corporate Shares to Cabinet of Ministers of Crimean Autonomous Republic, Ministries and Other Central and Local Executive Bodies” (“Про передачу повноважень з управління державними корпоративними правами Раді міністрів Автономної Республіки Крим, міністерствам, іншим центральним і місцевим органам виконавчої влади”). Annex: Lists of Corporations with State Shares, Rights of Management for Which Are Delegated to Certain Ministries.
4. Cabinet of Ministers. Resolution. 15 June, 2000. #791 (last amended: 16 May, 2000). “On Management of State Corporate Rights” (“Про управління державними корпоративними правами”). Annex: Report of Authorized Representative.
5. State Property Fund of Ukraine. Order. May 24, 2000. #1065. “On Approval of Typical Form of Contract of Delegation of Rights to Manage State Shares” (“Про затвердження Типової форми договору доручення на виконання функцій управління пакетом акцій, що належить державі”). Annex: Typical Form of Contract of Delegation of Rights to Manage State Shares.
6. State Property Fund of Ukraine. Order. May 25, 2000. #1067. “On Approval of Typical General Agreement on Delegation of Rights to Manage State Shares to State Executive Bodies” (Про затвердження Типової Генеральної Угоди про передачу повноважень на здійснення функцій управління державними корпоративними правами органам виконавчої влади“).
7. State Property Fund of Ukraine. Order. May 29, 2000. #1109. “On Approval of Instruction on Order of Report Filling-Out by Representative of Body, Authorized to Manage State Corporate Shares” (“Про затвердження Інструкції про порядок заповнення звіту представником органу, уповноваженого управляти відповідними державними корпоративними правами в органах управління господарських товариств“).
8. State Property Fund of Ukraine. Order. August 7, 2000. #1647. “On Approval of Typical Contract of Delegation of Management of State Corporate Rights to an Authorized Entity” ( Про затвердження

- Типового договору доручення на здійснення уповноваженою особою функцій управління державними корпоративними правами”).
9. State Property Fund of Ukraine. Ministry of Economy. Order. October 20, 2000. #227/2181. “On Approval of Criteria, Upon Which Open Joint Stock Companies Are Recommended to Be Classified As of Regional Importance” (“Про затвердження критеріїв, за якими пропонується відносити відкриті акціонерні товариства до тих, що мають регіональне значення”).
  10. State Property Fund of Ukraine. Order. September 11, 2001. #1647. “On Approval of Typical Contract of Delegation of Management of State Corporate Rights to an SPFU Representative” (“Про затвердження Типового договору доручення на здійснення представником ФДМУ функцій управління акціями (частками) господарського товариства, які перебувають у державній власності”).
  11. State Property Fund of Ukraine. Order. May 4, 2001. #781. “On Corporate Dividend Policy” (“Про корпоративно-дивідендну політику”).

## ANNEX 2: MINISTERIAL SOE PORTFOLIOS

SOE Governing Body	2007	2008
<b>Number of SOEs, total in Ukraine</b>	<b>3,252</b>	<b>3,589</b>
- <i>kazenni</i> enterprises	43	43
- state commercial enterprises	2,765	3,126
- joint-stock companies with state's stake exceeding 50%	444	420
<b>Cabinet of Ministers of Ukraine</b>		
- joint-stock companies with state's stake exceeding 50%	0	3
<b>Line Ministries</b>		
<b>Ministry of Agrarian Policy, total</b>	<b>383</b>	<b>360</b>
- state commercial enterprises	381	358
- joint-stock companies with state's stake exceeding 50%	2	2
<b>Ministry of Regional Development and Construction, total</b>	<b>40</b>	<b>41</b>
- state commercial enterprises	39	40
- joint-stock companies with state's stake exceeding 50%	1	1
<b>Ministry of Housing and Communal Services</b>	<b>28</b>	<b>30</b>
- state commercial enterprises	27	29
- joint-stock companies with state's stake exceeding 50%	1	1
<b>Ministry of Internal Affairs, total</b>	<b>39</b>	<b>47</b>
- <i>kazenni</i> enterprises	1	1
- state commercial enterprises	38	46
<b>Ministry of Coal Industry, total</b>	<b>412</b>	<b>413</b>
- state commercial enterprises	247	258
- joint-stock companies with state's stake exceeding 50%	165	155
<b>Ministry of Economy</b>	<b>16</b>	<b>17</b>
- state commercial enterprises	16	16
- joint-stock companies with state's stake exceeding 50%	0	1
<b>Ministry of Culture</b>	<b>38</b>	<b>62</b>
- state commercial enterprises	38	62
<b>Ministry of Defense</b>	<b>181</b>	<b>169</b>

- <i>kazenni</i> enterprises	2	2
- state commercial enterprises	179	167
<b>Ministry of Environmental Protection</b>	<b>0</b>	<b>33</b>
- state commercial enterprises	0	33
<b>Ministry of Health</b>	<b>28</b>	<b>29</b>
- state commercial enterprises	28	28
- joint-stock companies with state's stake exceeding 50%	0	1
<b>Ministry of Natural Resources</b>	<b>46</b>	<b>52</b>
- <i>kazenni</i> enterprises	3	3
- state commercial enterprises	41	47
- joint-stock companies with state's stake exceeding 50%	2	2
<b>Ministry of Fuel and Energy</b>	<b>108</b>	<b>111</b>
- state commercial enterprises	106	106
- joint-stock companies with state's stake exceeding 50%	2	5
<b>Ministry of Social Policy and Labor</b>	<b>25</b>	<b>25</b>
- <i>kazenni</i> enterprises	11	11
- state commercial enterprises	14	14
<b>Ministry of Industrial Policy</b>	<b>304</b>	<b>291</b>
- <i>kazenni</i> enterprises	18	18
- state commercial enterprises	277	266
- joint-stock companies with state's stake exceeding 50%	9	7
<b>Ministry of Communication and Transport</b>	<b>186</b>	<b>280</b>
- state commercial enterprises	171	265
- joint-stock companies with state's stake exceeding 50%	15	15
<b>Ministry of Emergency Situations</b>	<b>29</b>	<b>33</b>
- state commercial enterprises	29	33
<b>Ministry of Youth Policy and Family</b>	<b>20</b>	<b>20</b>
- state commercial enterprises	20	20
<b>Ministry of Finance</b>	<b>11</b>	<b>11</b>
- <i>kazenni</i> enterprises	7	7
- state commercial enterprises	4	4
<b>Ministry of Justice</b>	<b>3</b>	<b>4</b>
- state commercial enterprises	3	4

<b>State Committees and Agencies</b>		
<b>State Committee for Supervision in Engineering</b>	<b>30</b>	<b>30</b>
- state commercial enterprises	30	30
<b>State Agency on Land</b>	<b>29</b>	<b>29</b>
- state commercial enterprises	29	29
<b>State Agency on Nuclear Regulation</b>	<b>3</b>	<b>3</b>
- state commercial enterprises	3	3
<b>State Committee on Water Resources</b>	<b>31</b>	<b>11</b>
- state commercial enterprises	31	11
<b>State Committee on Forestry</b>	<b>362</b>	<b>338</b>
- state commercial enterprises	362	338
<b>State Reserve Committee</b>	<b>33</b>	<b>27</b>
- state commercial enterprises	33	27
<b>State Statistics Committee</b>	<b>6</b>	<b>5</b>
- state commercial enterprises	6	5
<b>State Committee on Television and Radio</b>	<b>31</b>	<b>31</b>
- state commercial enterprises	30	30
- joint-stock companies with state's stake exceeding 50%	1	1
<b>State Committee on Consumer Standards</b>	<b>39</b>	<b>40</b>
- state commercial enterprises	39	40
<b>State Committee on Financial Monitoring</b>	<b>1</b>	<b>1</b>
- state commercial enterprises	1	1
<b>State Property Fund</b>	<b>n/a</b>	<b>219</b>
- state commercial enterprises	0	10
- joint-stock companies with state's stake exceeding 50%	232	209
<b>State Space Agency</b>	<b>31</b>	<b>28</b>
- <i>kazenni</i> enterprises	1	1
- state commercial enterprises	22	19
- joint-stock companies with state's stake exceeding 50%	8	8
<b>National Commission on Regulation of Communication</b>	<b>1</b>	<b>1</b>
- state commercial enterprises	1	1
<b>Pension Fund</b>	<b>1</b>	<b>2</b>
- state commercial enterprises	1	2

<b>Security Service of Ukraine</b>	<b>2</b>	<b>3</b>
- state commercial enterprises	2	3
<b>State Service of Automobile Roads</b>	<b>15</b>	<b>16</b>
- state commercial enterprises	14	15
- joint-stock companies with state's stake exceeding 50%	1	1
<b>Anti-Monopoly Committee</b>	<b>1</b>	<b>1</b>
- state commercial enterprises	1	1
<b>State Securities' and Stock Market Commission</b>	<b>10</b>	<b>10</b>
- state commercial enterprises	10	9
- joint-stock companies with state's stake exceeding 50%	0	1
<b>State Border-Security Service</b>	<b>2</b>	<b>2</b>
- state commercial enterprises	2	2
<b>State Court Administration</b>	<b>6</b>	<b>5</b>
- state commercial enterprises	6	5
<b>State Committee on Fishery</b>	<b>38</b>	<b>34</b>
- state commercial enterprises	38	34
<b>National Agency on Energy Regulation</b>	<b>1</b>	<b>10</b>
- state commercial enterprises	1	10
<b>State Tax Administration</b>	<b>34</b>	<b>34</b>
- state commercial enterprises	34	34
<b>State Committee on Entrepreneurship</b>	<b>1</b>	<b>1</b>
- state commercial enterprises	1	1
<b>State Service for Special Communication</b>	<b>0</b>	<b>4</b>
- state commercial enterprises	0	4
<b>State Department for the Execution of Sentences</b>	<b>0</b>	<b>121</b>
- state commercial enterprises	0	121
<b>State Administrative Department</b>	<b>0</b>	<b>41</b>
- state commercial enterprises	0	39
- joint-stock companies with state's stake exceeding 50%	0	2
<b>Local Governments</b>	<b>76</b>	<b>86</b>

### ANNEX 3: EXTRACT FROM THE OECD GUIDELINES

<b>CHAPTER 1: AN EFFECTIVE LEGAL AND REGULATORY FRAMEWORK</b>
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 in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.
<b>Principle A:</b> There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for SOEs enterprises, particularly with regard to market regulation.
<b>Principle B:</b> Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.
<b>Principle C:</b> Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.
<b>Principle D:</b> SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.
<b>Principle E:</b> The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.
<b>Principle F:</b> SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.

<b>CHAPTER 2: THE STATE ACTING AS AN OWNER</b>
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.
<b>Principle A:</b> The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.
<b>Principle B:</b> The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
<b>Principle C:</b> The state should let SOE boards exercise their responsibilities and respect their independence.
<b>Principle D:</b> The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralization of the ownership function.
<b>Principle E:</b> The coordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.
<b>Principle F:</b> The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include: <ol style="list-style-type: none"> <li>1. Being represented at the general shareholders meetings and voting the state shares;</li> <li>2. Establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards;</li> <li>3. Setting up reporting systems allowing regular monitoring and assessment of SOE performance;</li> <li>4. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;</li> </ol>

5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.

### CHAPTER 5: TRANSPARENCY AND DISCLOSURE

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

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

**Principle B:** SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.

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

**Principle D:** SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognized standards.

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

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



## ANNEX 4: BENCHMARKING UKRAINE AGAINST THE OECD FRAMEWORK

OECD Guidelines	Ukrainian framework	Observations and Issues
<b>1. Ensuring an Effective Legal and Regulatory Framework for SOEs</b>		
<p><b>The legal and regulatory framework for SOEs should ensure a level-playing field in markets where SOEs and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.</b></p> <p>A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for SOEs enterprises, particularly with regard to market regulation.</p> <p>B. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.</p> <p>C. Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm</p>	<p>A. The Ukrainian legal framework does not support full administrative separation of responsibilities for ownership and industrial policy. The legal framework does not institutionalize a single state coordinating agency for SOE management and oversight.</p> <p>B. Operational practices and legal form under which SOEs operate are simplified, creditors allowed to press their claims and to initiate insolvency procedures, except for <i>kazenni</i> enterprises (which are protected by their special legal status).</p> <p>C. Obligations and responsibilities that SOEs are required to undertake in terms of public services are not clearly mandated by laws and regulation.</p>	<p>A. Lack of clear legal delineation of functions results in confusion between industrial policy and the ownership functions of the state - the state functions simultaneously as the major market player and arbitrator.</p> <p>B. SOEs where the state's share is greater than 25% are protected from creditors' claims. In reality there are numerous direct and hidden subsidies from the state to support SOEs which enables a large number of SOEs to continue operating. There exist some limitations on the activities that SOEs allowed to carry out according to their legal form.</p> <p>C. This allows retaining a large number of companies with no special responsibilities and obligations for social and public policy purpose</p>

OECD Guidelines	Ukrainian framework	Observations and Issues
<p>should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.</p> <p>D. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.</p> <p>E. The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.</p> <p>F. SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.</p>	<p>Such obligations and responsibilities are not disclosed to the general public.</p> <p>D. SOEs are not exempt from the application of general laws and regulations, including competition law. SOEs are not protected from court challenges/lawsuits in cases where they infringe the law.</p> <p>E. The legal and regulatory framework allows sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.</p> <p>F. The current legal framework gives SOEs a competitive advantage regarding access to finance. SOEs' relations with state-owned banks, financial institutions and companies should be based on purely commercial grounds.</p>	<p>in state ownership. General public has no access to information of public services provided by SOEs and is not aware of their actual costs.</p> <p>D. The weak judicial system creates difficulties for creditors in enforcing their contracts and in obtaining overdue payments from SOEs.</p> <p>E. The state as an owner has no general policy and uses simple mechanisms to make necessary changes in SOEs' capital structure as needed.</p> <p>F. For some large SOEs, state-owned banks are the main creditors. In many instances, decisions to extend credits to the SOEs are made not by the board of state-owned bank but by the government. SOEs prefer to conduct business with the government and state-owned banks than to raise capital in financial markets.</p>
<b>2. The state Acting as an Owner</b>		
<p><b>The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.</b></p> <p>A. The government should develop and issue an</p>	<p>A. The government has no clear and consistent</p>	<p>A. The state has neither clear definition of objectives of state ownership, nor specific</p>

OECD Guidelines	Ukrainian framework	Observations and Issues
<p>ownership policy that defines the overall objectives of state ownership, the state’s role in the corporate governance of SOEs, and how it will implement its ownership policy.</p> <p>B. The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.</p> <p>C. The state should let SOE boards exercise their responsibilities and respect their independence.</p> <p>D. The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralization of the ownership function.</p> <p>E. The coordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.</p>	<p>ownership policy that defines the overall objectives of state ownership.</p> <p>B. Legal framework restricts the government from day-to-day involvement into SOE management and provides SOEs the autonomy to achieve their objectives.</p> <p>C. Normally, SOE boards enjoy independence (from the state) in exercising their responsibilities.</p> <p>D. The exercise of ownership rights is not clearly identified. The ownership function is not centralized in a single strong coordinating entity.</p> <p>E. The Cabinet of Ministers and SPF report annually to the Parliament on effectiveness of management of state assets. All coordinating entities and “owners” (ministries with SOE portfolios) report on SOE performance to the Cabinet of Ministers, except for SPF (SPF, which is responsible for joint-stock companies, is accountable to the Parliament).</p>	<p>targets in different sectors of the economy.</p> <p>B. In reality, the lack of a clear and consistent strategy, not clearly delineated and overlapping functions result in excessive interference of the government in day-to-day SOE activities.</p> <p>C. Lack of a clearly defined government policy results sometimes in contradicting objectives assigned to SOEs by different state agencies.</p> <p>D. Overlapping functions of different coordinating entities and “owners” make system more complicated, ineffective and less transparent.</p> <p>E. Ownership entities report on SOEs performance through aggregated performance indicators. In many aspects the aggregated report of ownership entity could be misleading reporting hides the real picture in the sector. For instance, targets on dividends could be met by few best performing companies in the sector and consolidated report might overlook the lack of compliance by the remainder of the portfolio. In reality, neither government nor the public have a complete picture on performance in a given sector. Some ownership entities, other than SPF, do not make reports on SOEs performance publicly available nor do they report their own performance in exercising state ownership and in</p>

OECD Guidelines	Ukrainian framework	Observations and Issues
<p>F. The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:</p> <ol style="list-style-type: none"> <li>1. Being represented at the general shareholders meetings and voting the state shares.</li> <li>2. Establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards.</li> <li>3. Setting up reporting systems allowing regular monitoring and assessment of SOE performance.</li> <li>4. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.</li> <li>5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.</li> </ol>	<p>F. Legal framework allows the state to act as an active owner and to avoid political interference and passive state ownership through the following mechanism:</p> <ol style="list-style-type: none"> <li>1. Procedures exist for state representation in general shareholders meeting.</li> <li>2. Structured and competitive nomination process for joint-stock companies' board and managers for unitary or kazenni companies.</li> <li>3. Reporting systems envisages regular monitoring and assessment of SOE performance by ownership entity.</li> <li>4. The government can easily maintain dialogue with external auditors and special state control organs.</li> <li>5. Existing remuneration system permits to bring salaries of SOE managers closer to private sector practices. However, some restrictions for civil servants appointed to the board exist.</li> </ol>	<p>achieving the state's objectives.</p> <p>F. There is evidence that the government either plays a passive role or interferes company's business based on a political agenda:</p> <ol style="list-style-type: none"> <li>1. At shareholders' meetings representatives of different state bodies may have opposite views and vote against each other.</li> <li>2. As a rule, selections are traditionally won by preferred candidates nominated by the ownership entity itself.</li> <li>3. Existing systems (reporting, monitoring and evaluation) do not result in better understanding of the SOEs' issues or in improved performance. The M&amp;E system is vague and allows for the subjective evaluation of SOE and manager's performance.</li> <li>4. Ownership entities believe that they are in a better position to know issues of their SOEs. There were cases when the Cabinet of Ministers ignored valid recommendations of external auditors.</li> <li>5. Performance-based remuneration system for SOE managers does not work properly. The problem of remuneration for civil servants representing the state in the board is to be resolved.</li> </ol>
<b>3. Equitable Treatment of Shareholders</b>		
<b>The state and SOEs should recognize the</b>		

OECD Guidelines	Ukrainian framework	Observations and Issues
<p><b>rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.</b></p> <p>A. The coordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.</p> <p>B. SOEs should observe a high degree of transparency towards all shareholders.</p> <p>C. SOEs should develop an active policy of communication and consultation with all shareholders.</p> <p>D. The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.</p>	<p>A. Ukrainian legislation ensures that all shareholders are treated equally.</p> <p>B. SOEs should observe a high degree of transparency toward all shareholders and the general public.</p> <p>C. The law envisages mechanism for communication through establishing special committees on communication.</p> <p>D. The law and government regulations do not specify any mechanism to facilitate minority shareholders participation.</p>	<p>A. The rights of shareholders are protected by law. In some cases the state may abuse its role as a dominant shareholder, for example by pursuing objectives that are not in the interest of the company and thereby to the detriment of other shareholders.</p> <p>B. The law provides access to information by all shareholders, however, the application of the law is not consistent and often information is not made publicly available on the basis of “state secrets” or national security.</p> <p>C. In some cases the state holds consultations with minority shareholders to improve decision making process and the acceptance of key decisions.</p> <p>D. In some cases the state reassures minority shareholders that their interests are taken into consideration.</p>
<b>4. Relations with Stakeholders</b>		
<p><b>The state ownership policy should fully recognize the SOEs’ responsibilities toward stakeholders and request that they report on their relations with stakeholders.</b></p>		

OECD Guidelines	Ukrainian framework	Observations and Issues
<p>A. Governments, the coordinating or ownership entity and SOEs themselves should recognize and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.</p> <p>B. Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.</p> <p>C. The board of SOEs should be required to develop, implement and communicate compliance programs for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.</p>	<p>A. The law requires recognition and respect stakeholders' rights from all players.</p> <p>B. Large SOEs and SOEs pursuing important public policy do not provide reports on stakeholder relations.</p> <p>C. Internal codes of ethics for SOEs board or management have not been developed and implemented.</p>	<p>A. Special mechanisms and procedures to protect stakeholders' rights are not established. In some cases conflicts occur between the state and other stakeholders; the government may force SOEs to pursue goals which differ from those that apply to the private sector without any compensation.</p> <p>B. SOEs or coordinating entities do not provide reports on stakeholder relations.</p> <p>C. Evaluations of SOE boards and managers performance do not include an assessment (by employees, civil servants, etc.) of their conduct and ethical behavior.</p>
<b>5. Transparency and Disclosure</b>		
<p><b>State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.</b></p> <p>A. The coordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.</p>	<p>A. The MOE is mandated to prepare an annual consolidated report on SOE performance. The report is primarily focused on financial performance and the value of SOEs' assets, and includes limited, aggregated financial indicators such as turnover, profit, cash flow, gross investment and dividends. Data (or indicators) such as return on equity, equity/asset ratio are not provided.</p>	<p>A. Transparency and public disclosure of SOEs performance is limited. The consolidated report is deemed by government as confidential document and is unavailable to general public. In addition, important data (such as return on equity, equity/asset ratio) are not provided in the report. The aggregated data contained in the report distorts the true performance of the SOE portfolio as few profitable enterprises mask the poor performance of other SOEs.</p>

OECD Guidelines	Ukrainian framework	Observations and Issues
<p>B. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.</p> <p>C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.</p> <p>D. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognized standards.</p> <p>E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.</p> <p>Examples of such information include:</p> <p>1. A clear statement to the public of the</p>	<p>B. The corporate law requires that joint-stock companies, including those that are SOEs, establish internal audit and internal controls. Their reporting is important for the board's ability to evaluate actual company operations and performance.</p> <p>C. The corporate law only requires an annual independent external audit of joint-stock companies (including those that are SOEs).</p> <p>D. The law with regard to the SOEs has no requirements of high quality auditing standards, disclosure and transparency as in case for publicly traded ones.</p>	<p>B. The internal audit function in SOEs (other than joint-stock companies) is subordinated directly to the enterprises' management. Recently, the government introduced a new mechanism of internal controls at 42 largest and most important SOEs – auditors" from KRU monitor the financial transactions of these SOEs and to report to the central government and central KRU management.</p> <p>C. In rare circumstances do external audits comply with international standards and no adequate procedures exist to ensure the selection of qualified external auditors. The quality of audit reports is poor in many cases, and many SOEs do not comply with the audit requirement. It is unclear whether audit conclusions and auditor recommendations are acted upon by SOE management.</p> <p>D. There is a very low level of disclosure and transparency for SOEs, even when they have significant impact on the state budget, carry high risk borne by the state or have significant societal impact.</p> <p>1. The government, coordinating entities and</p>

OECD Guidelines	Ukrainian framework	Observations and Issues
<p>company objectives and their fulfillment.</p> <p>2. Transparent ownership and voting structure of the company.</p> <p>3. Disclosure of any material risk factors and measures taken to manage such risks.</p> <p>4. Disclosure of any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE.</p> <p>5. Disclosure of any material transactions with related entities.</p>		<p>SOEs have not completed this work yet. Anecdotal evidence: some SOEs have not even statutes yet;, in some of them statutes and other documentation does not comply with the law.</p> <p>2. In some cases ownership structure is unclear, i.e. which entity retains legal ownership of the state's stake and who has responsibility for exercising the state's ownership. In some cases representatives of different state bodies vote in opposition to each other at shareholder meetings on strategic issues.</p> <p>3. The existing system of identifying, assessing and reporting on risks is weak and inadequate.</p> <p>4. Disclosure of mutual obligations, financial assistance, guarantees or risk sharing mechanisms does not include all details that might be important.</p> <p>5. The level of disclosure of information is very low and transactions between SOEs and related entities are undisclosed.</p>
<b>6. Responsibilities of the Boards of SOEs</b>		
<p><b>The boards of SOEs 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 action.</b></p> <p>A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the</p>	<p>A. SOE boards have the same responsibilities and liabilities as board of private enterprises</p>	<p>Most of SOEs (except for those which are joint-stock companies) do not have Boards of Directors.</p> <p>A. In practice, SOE board members liability can be reduced upon instruction by government. Collective and individual liability of board</p>



OECD Guidelines	Ukrainian framework	Observations and Issues
<p>company's performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.</p> <p>B. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.</p> <p>C. The boards of SOEs should be composed so that they can exercise objective and independent judgment. Good practice calls for the Chair to be separate from the CEO.</p> <p>D. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.</p> <p>E. When necessary, SOE boards should set up specialized committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.</p> <p>F. SOE boards should carry out an annual evaluation to appraise their performance.</p>	<p>(stipulated in company law), and are assigned a clear mandate and responsibility for the company's performance.</p> <p>B. An SOE board is entitled to exercise guidance and oversight of the CEO, subject to the objectives set by the government and ownership entity. Boards have power to appoint and remove CEOs and to sign contracts with them.</p> <p>C. According to the law, boards should protect shareholders' rights, monitor senior management and take strategic decisions.</p> <p>D. Some SOE boards may have employee (or trade union) representation.</p> <p>E. When necessary, SOE boards may set up specialized committees to support the full board in performing its functions, particularly in respect to audit or communication. The board may also elect a corporate secretary responsible for the communication with shareholders.</p> <p>F. SOE boards should carry out an annual evaluation to appraise their performance.</p>	<p>members is not clearly stated. There is no system in place to assess the impact of government intervention on SOE performance.</p> <p>B. Despite the fact that their responsibility is to define the overall objectives of an SOE, the government and ownership entities tend to be heavily involved in daily operations of an SOE. In practice, boards have little authority in establishing remuneration and in removing CEOs.</p> <p>C. Diversity of board composition is not maintained and few of them are recruited from the private sector. Civil servants do not receive remuneration for their work as board members. It weakens the ability of the board to be efficient institute in SOE governance system.</p> <p>D. SOE boards may include employee representatives as voting or non-voting members.</p> <p>E.</p> <p>F.</p>



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#### **Sweden**

<http://www.sweden.gov.se/sb/d/8908;jsessionid=aD6C6s7D6XF->

#### **New Zealand**

[www.ccm.govt.nz](http://www.ccm.govt.nz)

#### **Canada**

[www.tbs-sct.gc.ca/ccpi-pise/index\\_e.asp](http://www.tbs-sct.gc.ca/ccpi-pise/index_e.asp)

#### **Finland**

<http://www.ktm.fi/index.phtml?l=en&s=8>

#### **Poland**

[http://www.msp.gov.pl/index\\_eng.php?dzial=39&id=151](http://www.msp.gov.pl/index_eng.php?dzial=39&id=151)

#### **UK**

[www.shareholderexecutive.gov.uk](http://www.shareholderexecutive.gov.uk)

#### **Germany**

[www.bundesfinanzministerium.de](http://www.bundesfinanzministerium.de)

## ANNEX 6: CORPORATE GOVERNANCE LANDSCAPE QUESTIONNAIRE

1. Ownership and Control				
№	Question	Y/N	Response/Comments	Legal Reference or Source
	<b>(I) The Structure of Ownership and Its Concentration</b>			
1.	Please provide data and statistics showing the total size of the SOE sector (kazenni, unitary and corporatized), and the total of Joint-Stock companies. Please further provide tables showing the breakdown: by type of SOE (kazenni, unitary and corporatized) and by state share in JSC, (ii) industrial sector; (iii) for SOEs, by commercial vs. non-commercial (e.g., public good, public interest such as research enterprises, etc.) orientation			
2.	In addition to the data required for point #1 above, please also provide data for SOEs and JSC indicating revenue, profit, earnings by enterprise, by sector, by commercial vs. non-commercial			
3.	Using most recent available data please provide for the largest ten companies:			
	a. Market capitalization as a percent of total market capitalization.			
	b. Trading volume as a percent of total trading volume.			
	c. Names of the first, second, third and fourth biggest shareholders, and specify their ownership positions. Please use ultimate shareholder information, if available.			
	d. The size of the board (supervisory and management boards) for each company.			
4.	For each of the last five years (and the most recent available month), please provide:			
	a. The number of public enterprises (SOEs, JSCs, etc.) that are candidates for new listings. Indicate how are they are expected to be listed on the exchange (obligatory listing by state, IPO or secondary offer, listing by shareholders and brokers).			
5.	In general is ownership concentrated in the hands of a few families/investor groups/oligarchs?		<i>(If yes, how many?)</i>	

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6.	If there are any available academic or market research reports on the ownership structure of SOEs, Joint-Stock companies, public enterprises, please provide them in English. If not available in English, please summarize.			
	<b>Capital Market Background</b>			
7.	For each type of company form, including listed companies, please provide any available data on:			
	a. The total number of companies/economic entities.			
	b. Number of employees			
	c. Economic activity carried out by each company form (depending on available data, e.g. GDP, turnover, total sales/revenues, and exports).			
	d. Provide any other meaningful statistic which, in your opinion, provides information regarding the role of the listed sector in the country's economy.			
8.	For each of the last five years (and the most recent available month), please provide a table containing the following data. Please note sources for each.			
	a. The level of the most widely used equity market index at the end-of-period.			
	b. Number of listed companies at end-of-period (please provide separate details for different listing tiers or types of listed companies).			
	c. Market capitalization at end of period, in local currency and in US\$.			
	d. Market capitalization to GDP ratio at the end of period (please indicate source of GDP estimates).			
	e. Trading volume for each period.			
	f. Market turnover ratio for each period (trading volume divided by market capitalization at end of year).			
9.	Are any SOEs, Joint-Stock companies or public enterprises listed on foreign exchanges?			
	a. If so, please specify whether ordinary shares, GDRs or ADRs are listed on foreign exchanges.			
	b. Please specify if these are Level I, II, III or SEC Rule 144A/Reg S Depositary Receipts.			
	c. Please compare the trading volume for all dual listed companies on foreign markets vs. aggregate volume for these firms on the dominant local exchange.			
10.	Are multiple listings permitted on domestic exchanges?			
11.	How many companies offer bonds on the market?			

12.	Is there an informal market/economy in the country? If so, what is its trading volume?			
13.	Please comment on the prevalence of pyramid structures <sup>2</sup> and cross shareholdings <sup>3</sup> . Include quantitative data for the market as a whole, if available.			
14.	Can companies issue shares with varying voting rights (for example preferred shares, founders shares, non-voting shares, multiple voting rights, removable voting rights)? Please explain the typical rights of each class of shares			
	a How frequently is each of these types of shares used in practice?			
5.	Describe the main requirements of the stock exchange for a company to become listed, including the initial requirements and continuing obligations.			

## 2. Legal and regulatory framework

*Please provide copies in English of relevant laws and regulations or a reference to the websites from where they can be downloaded.*

No	Question	Y/N	Response/Comments	Legal Reference or Source
1.	Provide a brief summary of the legal framework and institutions governing listed companies. Please list all laws relevant to the governing of listed companies.			
2.	Summarize recent significant legal developments affecting corporate governance (especially company law, securities law and listing rules).			
3.	What are the securities market regulator's main registration requirements for companies?			
	a How do these vary for non-listed public and listed companies?			
4.	Are there different listing segments on the stock exchange?			
	a. If yes, please describe, focusing on corporate governance			



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6.	Does a corporate governance code of good practice exist?			
	a. If yes, who participated in the code's preparation (e.g. securities market regulator, stock exchange, Center for Corporate Governance, etc.?).			
	b. Who issued the code?			
	c. Is it voluntary or mandatory?			
	d. Must corporations disclose their degree of compliance ("comply or explain")?			
	e. On average/in percentage, how many companies comply with the code?			
	f. How effective is it in practice?			
	g. Is there any precedent of non-compliance?			
	h. What are the legal and pecuniary consequences/sanctions in case of non-compliance?			
	i. Are the sanctions adequate/meaningful according to the operational costs of the company?			
7.	Which bodies in the public and private sectors (both domestic and foreign) have been active in promoting corporate governance reform? (For example, institutes of directors, centers / institutes of corporate governance, associations of shareholders, or chambers of commerce).			
8.	Please briefly describe their objectives, activities and achievements, and provide their contact details.			
9.	Please list in a table the different corporate forms which are allowed under the law.			
	a. Explain the main differences (e.g. partnerships, limited liability, joint-stock, public limited).			
	b. Which types can be listed?			
	c. Which entities oversee other company forms?			
10.	Please indicate which authority supervises the different company forms (including listed companies).			
11.	According to the company law and/or corporate governance framework, please describe how powers are distributed in the company among board, general assembly, and senior management.			
	Please describe any serious corporate governance scandal that has occurred in the past four years in the country, and provide written analyses in English.			

	a. Please list any key court ruling in the area of corporate governance that sets precedent on the interpretation of the law.			
	b. How transparent is the legal reform process? Does it allow all affected parties to fully understand the new laws and regulations?			

### 3. Historical influences on the current corporate governance system.

No	Question	Y/N	Response/Comments	Legal Reference or Source
1.	If there are any available academic or market research reports on privatization trends, please provide them in English. If not available in English, please summarize.			
2.	If there are any available academic or market research reports on industrial policies please provide them in English. If not available in English, please summarize.			
3.	If there are any available academic or market research reports on fiscal policies in general, and in particular tax treatment of inter corporate dividends and capital gains, please provide them in English. If not available in English, please summarize.			
4.	If present, please indicate legal and regulatory provisions governing ownership and control relationships of listed companies with banks and other financial institutions. Please, also indicate academic or market research reports on the related governing policies.			

## ANNEX 7: ASSESSMENT QUESTIONNAIRE FOR FINANCIAL OVERSIGHT OF SOES

### ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK

Corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory, and enforcement authorities.

**A Corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for the market participants and the promotion of transparent efficient markets.**

No	Question	Y/N	Response/Comments	Legal Reference or Source
1.	Do authorities have a strong commitment to improve the strength of corporate governance in public sector companies/enterprises?			
2.	Do authorities develop policy, laws and regulations etc., for the corporate governance framework on the basis of effective and ongoing consultations with the public, corporations and shareholders?			
3.	Please describe the consultation process for recent pieces of laws related to corporate governance.			

**B The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.**

No	Question	Y/N	Response/Comments	Legal Reference or Source
1.	Are laws, regulations, and voluntary codes clearly written and well understood?			
2.	Are corporate governance regulations predictable (i.e. not subject to important temporary decrees and back-dated amendments)?			
3.	Are laws and regulations consistent with one another, or do you know of cases where a law or regulation contradicts or is inconsistent with another law or regulation?			
4.	Do you think laws and regulations related to corporate governance are enforceable? Are they difficult to enforce for some reason: complicated, vague, overreaching, etc?			
5.	Does the market consider that the authorities responsible for overseeing the corporate governance framework (including the courts) act arbitrarily, or in a manner that sometimes seems to indicate that they are not acting in accordance with the rule of law?			

**C The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.**

№	Question	Y/N	Response/Comments	Legal Reference or Source
1.	Have Memorandums of Understanding been signed among the supervising ministries/agencies?		<i>If so, what are they?</i>	
2.	Which are the main tenets of the memorandums?			
3.	To what extent are the memorandums effective?			
4.	How often do the supervisory authorities share information about companies?			
5.	Is there any precedent of examinations jointly coordinated by two or more supervisory authorities? Please describe.			
6.	Does the division of supervisory responsibility lead to weak enforcement?			
7.	If enforcement is weak, please comment on the reasons (e.g. lack of effective powers or sanctions, shortage of qualified personnel or monitoring capacity).			
8.	Please comment on the effectiveness of coordination of the supervisory authorities in your jurisdiction.			
9.	Are there key inconsistencies/overlaps in the laws and regulations which apply to Joint-Stock companies, SOEs, etc.? Please describe them.			
10.	Is the cost of compliance proportionate and appropriate? Does it often create duplications? Please provide three examples (i.e., accounting standards, disclosure, etc.)			
11.	In your opinion, is the legal framework efficient?			
12.	If any oversight over the corporate governance framework has been delegated to self-regulatory organizations (e.g. stock exchanges), does the market consider that these organizations work transparently and in the public interest?			
13.	Overall, what are the main supervisory concerns/complaints listed companies tend to express?			

<b>D Supervisory, regulatory, and enforcement authorities should have the authority, integrity, and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent, and fully explained</b>				
<b>№</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
	<b><i>On Companies Registry/Companies House</i></b>			
1.	Is there a centralized institution(s) where companies (JSCs, SOEs, etc.) have to file their fundamental documents (such as by-laws, initial board members, shareholder registry) as well as company financial information?			
	a. Please describe the nature of the documentation lodged as well as who has access to it and how.			
	b. What are the costs (if any) associated with consulting/copying/reviewing this information?			
	c. What are its enforcement powers in cases of non-compliance with filing requirements?			
	d. Please indicate on average number, and categories/types of sanctions and the total amount for the past two years.			
2.	To whom does the Companies Registry report to?			
3.	Please comment on the institution's overall effectiveness.			
	<b><i>On Regulatory Oversight</i></b>			
4.	As an indicator of regulatory capacity, state how many employees work for the securities regulator?			
5.	Have there been any changes in the number of specialized/skilled employees?			
6.	What is the relative pay scale in relation to: comparable private sector employment and to other regulatory bodies, like the Central Bank?			
7.	How is the securities market regulator funded? (i.e. is it funded through budget allocation from the government, or does it retain its fees and fines?)			
8.	Are employees of securities market regulator regularly trained? If available, please name three mandatory trainings employees have been required to attend.			

*Annex 7*

9.	Have employees been required to attend specific corporate governance trainings as well?			
10.	What role does the securities market regulator have in the recommendation, drafting and proposing of rules, regulations and statutes?			
	a. Does it have the power to issue prudential rules and other regulations?			
	b. Are those rules posted for public consultation before they go into effect?			
	c. What are the means market participants have to have their voice heard in the consultation process?			
	d. Have they been effective in producing regulatory changes? Please name two instances.			
11.	How many employees in the securities market regulator act as “inspectors”?			
12.	Does the securities market regulator have full access to a registrant's books and records?			
13.	Can the securities market regulator subpoena documents from registrants and their employees, even if located off-site?			
14.	Can the securities market regulator subpoena documents from issuers, non-registrants or third parties, such as phone records, email records or bank records?			
15.	Can the securities market regulator question registrants and their employees regarding their activities?			
16.	Describe the internal procedures for an administrative proceeding in the securities market regulator:			
	a. Who adjudicates the proceeding?			
	b. Is a finding appealed administratively or through the court system?			
	c. Describe the appeal process and whether it is used frequently/almost always and whether decisions are reversed.			
	d. Is the administrative sanction enforced/collected (e.g. does the fine have to be paid) before the appeal process?			
17.	Describe the type and range of sanctions that can be imposed:			

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	a. Directly by the securities market regulator (such as suspensions of licenses, fines, injunctions, and receiverships).			
	b. By other entities on the advice of the securities market regulator.			
	c. By other entities, on their own decision, without the advice of the regulator, for violations of the securities market regulator's laws and regulations.			
18.	Does the securities market regulator publish enforcement statistics in its annual report?		(Please provide a copy of the annual report.)	
19.	Please provide statistics on investigations and proceedings, answering the following questions:			
	a. Average length of time from inception of violation to investigation, to initiation of proceeding and end of proceedings.			
	b. Number of investigations by type over the last three years.			
	c. Number of administrative proceedings, civil cases and criminal prosecutions by type over the last three years.			
	d. Please provide statistics over the last three years regarding the imposition of sanctions by year, type and severity.			
	e. Please provide statistics over the last three years the percentage of sanctions paid partially or in full, length of time for payment, number of violations of suspensions and injunctions.			
	f. Are rulings publicly available (i.e. on the website) and are they explained?			
20.	What government entity brings criminal cases for violations of the securities and corporate laws?			
	a. Over the last three years, please provide how many cases were brought, the nature of the violation and the penalty imposed.			
21.	Do commercial, corporate or securities arbitration exist?		(If yes, how does it work?)	
22.	How commonly is it used as a means of action against board members or controlling shareholders?			
23.	Are arbitration decisions binding and final?			

**DISCLOSURE AND TRANSPARENCY**

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

<b>A. Disclosure should include, but not be limited to, material information on:</b>				
<b>№</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
<b>A1. The financial and operating results of the company.</b>				
1.	Please prepare a schedule of the requirements for periodic disclosure of financial and non-financial information by issuers.			
	a. Specify the origins of these provisions in each case (statutory, regulatory, company articles of association).			
	b. Explain to whom these disclosures should be made and with what frequency (annually, semi-annually, quarterly).			
2.	Are companies required to publish an annual report?			
3.	Does the annual report include:			
	a. Balance sheet.			
	b. Profit and loss statement.			
	c. Cash flow statement.			
	d. Statement of changes in ownership equity.			
	e. Notes to the financial statements.			
	f. Audit report.			
4.	Are companies required to submit a board report with the annual report (sometimes called a chairman's review, directors' report, management discussion and analysis, etc.)? Please provide a detailed description of the required contents (if any) of the board report. Does the board report specifically include:			
	a. Management assessment of the factors that affected the company's financial condition,			
	b. Known trends that may affect company's financial condition in the future.			



5.	Are companies required to file consolidated financial statements?			
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<b>A. Disclosure should include, but not be limited to, material information on:</b>				
<b>No</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
6.	How does the securities market regulator monitor the compliance of listed companies with reporting requirements (e.g., on-site inspection/sampling)?		<i>(Please comment and provide examples.)</i>	
7.	a. What are the sanctions for non-compliance? E.g. warning, fines, suspension of trading, public reprimand, restatements, civil penalties, criminal penalties, etc.			
8.	b. How frequently are they applied in practice? Please provide statistics over the past five years by type of sanction.			
9.	Are there effective mechanisms for those harmed by inadequate disclosure?			
10.	How do investors perceive the general adherence of companies to the rules regarding reporting of financial and non-financial information? Please provide data on compliance, if available.		<i>(Please rate as "Poor," "Fair" or "Excellent.")</i>	
<b>A2. Company objectives.</b>				
11.	Does the legal and regulatory framework require companies to disclose in detail their commercial and non-commercial objectives?			
<b>A3. Major share ownership and voting rights.</b>				
12.	Please describe the requirements for ownerships information to be disclosed by owners/shareholders.			
	a. Who has the responsibility to disclose and to whom?			
	b. How is the information disclosed and disseminated?			
	c. What are the ownership thresholds of disclosure?			
	d. Do the disclosure requirements cover direct and indirect shareholding structures, including situations where shareholders are acting in concert?			
13.	Can regulatory and enforcement agencies obtain information about ultimate ownership?			

<b>A. Disclosure should include, but not be limited to, material information on:</b>				
<b>No</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
14.	Please describe the requirements for the disclosure of ownership and control by companies in their periodic disclosures:			
	a. Are companies required to disclose their significant shareholders? What are the thresholds of disclosure?			
	b. Do disclosure requirements cover direct and indirect shareholding structures, including situations where shareholders are acting in concert?			
	c. Voting rights attached to different classes of shares			
	d. Caps on voting rights			
	e. Cross share holdings			
	f. Inter-group shareholdings (if part of a group)			
	g. Who controls the company?			
	h. When and how do companies disclose this information?			
15.	Do the rules allow shareholders to understand the mechanisms of the company?			
16.	Please describe any information or impression on company compliance with these regulations.			
<b>A4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.</b>				
17.	Do companies disclose (in annual reports or shareholder's meetings) about board members:			
18.	a. their qualifications and other memberships?			
19.	b. the selection process?			
20.	c. their independence?			
21.	d. other material information?			
22.	Does the corporate governance framework require or recommend that board members and key executives periodically disclose their ownership stakes in the company?			

23.	Are board members and key executives required to disclose transactions in their company's securities on a timely basis (including transactions by their close family members or associates)?			
24.	Is disclosure of remuneration of board members and key executives required in the annual report? Please explain which elements of remuneration must be disclosed (salary, benefits, bonuses, share awards, stock options, loans and SARs <sup>5</sup> ) and whether these are disclosed for each individual, or in the aggregate.			
<b>A. Disclosure should include, but not be limited to, material information on:</b>				
25.	Are companies required to disclose their remuneration policies?			
26.	Are companies required to disclose the link between remuneration and company performance?			
27.	Are companies required to disclose the different forms of requirements such as pension benefits and deferred remuneration?			
<b>A5. Related party transactions.</b>				
28.	Are there any requirements for companies to disclose potential related party transactions before they take place?			
29.	Is there a requirement for companies to disclose information on related party transactions on a periodic basis?			
30.	Are companies required to disclose the identity of controlling shareholder(s) (even if there were no transactions between the related parties)?			
31.	When related party transactions are disclosed, are listed companies required to describe:			
	a. Type of transactions with related parties. <sup>6</sup>			
	b. Details of the transaction(s) including whether it was at market price.			
32.	What are the administrative penalties the company may incur if it does not observe related party transaction rules?			
33.	Is there a requirement to disclose borrowing from a related bank (a bank with a major shareholder in common with the company) or other related financial institution in the annual report or through another channel?			
34.	In your professional opinion, do related party transactions take place under transparent conditions, and are they sufficiently disclosed in practice? Please explain and provide examples.			

<sup>5</sup> Stock Appreciation Rights.

<sup>6</sup> Under IAS items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

<sup>7</sup> The following questions are based on IAS 24.

<b>A. Disclosure should include, but not be limited to, material information on:</b>				
<b>No</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
35.	Are the following entities treated as related parties? <sup>7</sup> Please indicate the legal source for each requirement (e.g. securities law, accounting regulations, listing rules, etc.)			
	a. Controlling shareholder / holding company / controlling entity			
	b. Company subsidiaries			
	c. Fellow subsidiaries (i.e. an entity under common control with the reporting entity).			
	d. Associates (i.e. an enterprise, other than a subsidiary or a joint venture, over which the investor has significant influence. Significant influence means the power to participate in financial and operating policy decisions. Such influence is presumed to exist if the investor owns more than 20 percent of voting rights).			
	e. Individuals who, through ownership, have significant influence over a company and close members of their families.			
	f. Key management personnel (including executive and non-executive board members) and their close families.			
	g. Enterprises in which a substantial interest is owned by any of the individuals included above.			
	h. Parties with joint control over the reporting enterprise, co-ventures with the reporting enterprise in joint venture, and close family members of those parties if they are individuals.			
	i. Linked Pension plans.			
<b>A6. Foreseeable risk factors.</b>				
36.	Is there a requirement for companies to disclose in their annual reports:			
	a. their policies and procedures on risk management			

	b. the their material foreseeable risk factors, including risks that are specific to the industry or geographical areas in which the company operates; dependence on commodities; financial market risk including interest rate or currency risk; risk related to derivatives and off-balance sheet transactions; and risks related to environmental liabilities			
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<b>A. Disclosure should include, but not be limited to, material information on:</b>				
<b>No</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
<b>A7. Issues regarding employees and other stakeholders.</b>				
37.	Is there a requirement or recommendation to disclose material issues regarding employees (e.g. human resources policies and information on other stakeholders (e.g. creditors, suppliers or local communities)?			
	a. To whom and through what channels should disclosure be made?			
<b>A8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.</b>				
38.	Are there requirements for disclosure relating to company governance structures and policies? (In particular, the division of authority between shareholders, management and board members.)			
39.	Do companies regularly disclose their compliance with a code of corporate governance?			
	a. How frequently is this disclosure made?			
	b. Do they have to explain areas of non-compliance?			
	c. Does any authority confirm or audit this disclosure?			
<b>B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.</b>				
<b>No</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
1.	What accounting standards are required for listed companies?			
	a. How do these compare to International Financial Reporting Standards (IFRS)? Are they a recent translation, an old translation, harmonized in some other way, or distinct?			
	b. Are there any reports or other research that compare national standards to local standards, if so please provide.			
	c. Please comment on compliance of listed companies with the Accounting Standards.			

2.	How are the domestic accounting standards determined? How often are they reviewed? When the standards were last redrafted?			
3.	What determines <i>non-financial</i> disclosure by companies: accounting standards, company law, a corporate governance code, something else?			
4.	What are the mechanisms used to effectively punish companies which disclose accounting information in inadequate or misleading fashion?			

**C. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.**

No	Question	Y/N	Response/Comments	Legal Reference or Source
1.	Is there a requirement that listed companies have their annual financial statements externally audited?			
2.	What are audit standards used?			
	a How do local Auditing Standards differ from the International Audit Standards?			
3.	Is the independence of the external auditor defined? If so, specify how and by which law or institution.			
4.	How do independence requirements differ with the IFAC independence requirements of the code of ethics?			
5.	Are listed firms required to rotate auditors every certain number of years?		<i>(If yes, does this apply to the specific partner in charge or to the firm?)</i>	
6.	Please describe any restrictions on non-audit services that may be carried out by auditors for their audit clients			
7.	Is there a cooling-off period before a member of the audit engagement team may accept employment with the client?		<i>(If yes, how long is this period?)</i>	
8.	Is there a second tier of reputable and quality auditing firms?			
9.	Are company's boards (or Audit Committees or equivalent body) by law or regulation required or recommended to report to the shareholders on:			
	a. Actions taken and bases upon which the oversight body deems the auditor independent and qualified?			
	b. Actions taken and bases upon which the board deems the auditor to have acted with due professional care?			
	c. The value of non-audit work completed by the auditor for the company?			



**D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.**

№	Question	Y/N	Response/Comments	Legal Reference or Source
1.	Does the corporate governance framework clearly provide that external auditors are accountable to the company's shareholders in respect to the performance of their audit functions?			
2.	Who has the final authority to approve the appointment and dismissal of the external auditor (e.g. management, board, audit committee, General Meeting of Shareholders)?			
	a. In case the appointment is made by the General Meeting of Shareholders, is it your perception that shareholders always approve board recommendations?			
	To which company organ do auditors report (i.e. management, board, audit committee of the board)?			
3.	Is there a requirement for external auditors to inform the board, shareholders and/or the supervisory authorities about any involvement of board members or senior management in illegal activities, fraud or insider abuse?			
4.	Are auditors required to purchase an insurance policy against lawsuits?		<i>(If so, please provide details and illustrate how common it is.)</i>	
5.	Are the following liable for false or misleading statements? Please differentiate between civil and criminal liability, and between company and personal liability.			
	a. Board members/directors.			
	b. External auditors.			
	c. Senior management (CEO, CFO, etc.).			
6.	Can shareholders and/or stakeholders sue external auditors?			
	a. Are there examples of auditors being sued successfully or unsuccessfully under these rules?			
	b. Are there preset liabilities or maximum penalties in case of negligence or fraud?			
7.	Do shareholders have the right to request an independent audit at company expense if they doubt the accuracy of the auditor's findings?			

<b>E. Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.</b>				
<b>No</b>	<b>Question</b>	<b>Y/N</b>	<b>Response/Comments</b>	<b>Legal Reference or Source</b>
1.	Does the corporate governance framework prevent selective disclosures by companies, board members and other insiders of material non-public information except for clearly defined exceptions?			
2.	Is there a requirement in securities regulations or listing rules for companies to continuously disclose all material information?			
	a. How is materiality defined?			
	b. How much time do issuers have to make disclosure of material information and to whom?			
	c. Is the announcement pre-vetted by the stock exchange?			
	d. Is trading suspended?			
	e. How do investors perceive the general adherence of companies to the disclosure requirements?			
	f. Are there effective mechanisms for those harmed by inadequate disclosure?			
3.	Please describe how can shareholders obtain the following types of information. Please comment on cost, ease of access, and availability of information.			
	a. Annual Report.			
	b. Material evident disclosure.			
	c. Articles of association.			
	d. Minutes of board meetings.			
	e. Board attendance.			
	f. General Meeting of Shareholder minutes.			
4.	In practice, do companies publish the full financial information on their websites?			
5.	Does the Stock Exchange maintain a website with information disclosed by companies?			
6.	Does the Security and Exchange Commission maintain website information disclosed by companies?			

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