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PRACTICES ON ACCOUNTABILITY AND TRANSPARENCY OF STATE-OWNED ENTERPRISES

Abstract: The accountability and transparency of state-owned enterprises have traditionally been criticized in theory and practice. This motivates us to conduct a study in which to select and summarize various practices of accountability and transparency of state-owned enterprises used in member countries of the Organization for Economic Co-operation and Development and other countries. These practices represent a useful basis for application in Bulgaria, which will contribute to reducing agency problem and improving the corporate governance of state-owned enterprises.

Keywords: information asymmetry; good practices; corporate governance; agency problem.

Introduction

The benefits for the society from the state ownership are determined mainly by the available information about the activity and the results of the state-owned enterprises. In parallel with the trend of increasing research on good practices in corporate governance, a new direction of empirical analysis is developing, related to the accountability and transparency of state-owned enterprises. In a sense, the public image of state property is formed by the disclosure of information by state-owned enterprises.

In addition to the poor performance, the low level of accountability and transparency of state-owned enterprises, are the often-cited differences from the private sector. The wide range of stakeholders further complicates the disclosure of information by state-owned enterprises. The application of international accounting and auditing standards provides an unclear and ambiguous advantage in disclosing information by state-owned enterprises. Private sector practices related to internal and external audit do not yield the same results in state-owned enterprises.

It can be argued that good corporate governance practices of state-owned enterprises start with accountability and transparency processes. Unlike the private sector, in the case of state-owned enterprises, the disclosure of non-financial information largely determines the nature and benefits of state ownership.

The article uses an integrated approach, based on the philosophy of the OECD Guidelines for Corporate Governance of State-Owned Enterprises, 2015. The application of an inductive approach is consistent with the volume of scientific theories and accumulated experience in the international aspect, and takes into account the recommendations for case studies for individual countries due to insufficiently studied state of state-owned enterprises[1]. The scientific approach of the article is based on the systematization of the literature on the topic, research and selection of good practices, experience

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[1] **Cahen, F.** Internationalization of state-owned enterprises through foreign direct investment. *Revista de Administração de Empresas*, 55(6), 645–659, 2015.

and ideas related to the implementation of the OECD guidelines for corporate governance of state-owned enterprises in other countries.

The purpose of the article is to present successful models and practices that will intellectually feed the discussion and support the development of corporate governance of state-owned enterprises in Bulgaria. Following this logic, the article systematizes and presents various practices and experiences that can be included in a kind of menu for selecting appropriate tools to promote and strengthen corporate governance of state-owned enterprises.

The criteria for selecting good practices and experiences used are the following:

• Existence of positive effects on corporate governance;

• Positive assessment from the literature and the research used;

• High degree of compliance with the OECD Guidelines for Corporate Governance of State-Owned Enterprises;

• Applicability in several countries (to date, OECD has conducted studies on the practices of five countries in corporate governance of state-owned enterprises: Argentina, Bulgaria, Colombia, Latvia and Lithuania).

In developing the article, information and knowledge from many sources were systematized:

• guidelines, manuals, studies and reports of the Organization for Economic Co-operation and Development, the European Commission, the International Monetary Fund, the World Bank.

• research of scientists, specialized teams and scientific organizations on the topic.

• regulations of corporate governance of state-owned enterprises in individual studied countries.

Accountability of state-owned enterprises

Accountability is one of the most frequently cited reasons for the unconvincing performance of state-owned enterprises, along with inaccurate targets and insufficient oversight[2]. It is no coincidence that public sector accountability is characterized as “elusive”[3]. World Bank report finds externalities of insufficient accountability: “Internal and external financial and non-financial reporting is incomplete and inaccurate, does not provide an adequate basis for decision-making by boards and executive managers, and misleads government owners, legislatures and the public.”[4]

The accountability of state-owned enterprises is based on information for generating the public good, for which they are established. Modern state-owned enterprises fulfill commercial and social goals[5]. A clear distinction between these two goals is a guarantee for adequate accountability of the results of state-owned enterprises. While the commercial goal has a material character and proven reporting methods, the social goal is specific to a particular enterprise and there are no generally accepted reporting methods for its achievement. An important feature in taking into account the goals is the information on the resources provided by the state under market conditions[6]. Taking into account both goals leads to improved public confidence.

For the completeness of the accountability of the state enterprises, it is necessary to conduct a comparative analysis between the set goals and the achieved results. As state ownership is often characterized by complex or conflicting goals, it is necessary for the state to publish its ownership participation policy[7].

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[6] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises. Latvia*. Paris, 2015.

[7] **OECD**. *Accountability and transparency: A guide for state ownership*. Paris, 2010.

The accountability of state-owned enterprises over time is divided into[8]:

– Preliminary accountability (*ex ante*). This information is available mainly to the principal. Preliminary accountability includes disclosure of the main characteristics of the enterprise, the most important of which are ownership structure, board composition, risk factors, strategies and future development plans. Good reporting practices cover information on all forms of state aid and preferences, including monopoly rights granted to state-owned enterprises and the existence of a "golden share".

– Subsequent accountability (*ex post*). International Financial Reporting Standards and International Accounting Standards are used in the preparation of subsequent accountability. The information is published and made available to the public. Subsequent accountability includes both financial and non-financial information, such as related party transactions, changes in the membership of the board, current composition of shareholders, methodology for selecting an external auditor and others. In most cases, the follow-up information is for a specific state-owned enterprise or for a specific sector of the economy. In Latvia, a summary annual report on all government assets is published[9]. Of interest is the practice in Estonia where each ministry individually prepares annual reports for the Ministry of Finance, which summarizes them and compiles a comprehensive document[10].

According to the frequency of accountability, state-owned enterprises use[11]:

– Periodic accountability. It is held at a pre-established period. The accountability period is usually one calendar year and in some countries, such as Lithuania, it is reduced to three months for large state-owned enterprises[12]. The purpose of this accountability is to inform about the end of the financial year and the formation of the budget for the next year. Periodic accountability can be on a single basis for an individual company to the line ministry-principal, as well as on a consolidated basis to the Ministry of Finance, the cabinet or the parliament.

– Extraordinary accountability (*ad hoc*). This form of accountability is related to the principal's right to request and receive information at any time, outside the accountability periods provided for. The scope of extraordinary accountability can be narrowed down to a specific issue of the activity of the state-owned enterprise.

– Accountability for approval. This accountability involves the provision of certain information for approval by the principal on a specific occasion. Such cases are provided for in the regulations, such as a request for increase or decrease of the equity, disposition of assets of the enterprise, conclusion of certain transactions and others.

Three forms of audit are used to ensure the accuracy of the information provided in the reports and to improve the quality of the accountability of state-owned enterprises:

– External audit is mandatory in most countries. Its function is to determine the quality of the information disclosed. International Standards on Auditing apply. The procedure for selection of an external auditor is initiated by the audit committee and approved by the general meeting of shareholders. Most legislation provides for accountability in the selection of an external auditor, for example, through public procurement procedures as in Latvia[13]. Another important disclosure information is the periodic change of the external auditor, for example, in Lithuania an auditor is required to rotate every seven years[14]. The practice in Argentina involves the selection of external auditors by the Big Four, which leads to high costs for state-owned enterprises[15]. In Chile, state-owned enterprises apply the same regulatory audit requirements as private companies listed on stock exchanges[16].

– The state audit body (Court of Auditors) conducts audits according to a plan previously approved by the parliament or incidentally (*ad hoc*). Unlike the external audit, the Court of Auditors audits non-

[8] **Robinett, D.** *Held by the Visible Hand. The Challenge of SOE Corporate Governance for Emerging Markets*. World Bank, Washington DC, 2006.

[9] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises*. *Latvia*. Paris, 2015.

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[15] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises*. *Argentina*. Paris, 2018.

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financial information, assesses the likelihood of meeting the goals of the state-owned enterprise and makes recommendations for corrective action, including the fulfillment of obligations to shareholders. In most countries, the Court of Auditors audits individual sectors of the economy or for a specific ministry-principal. Good practices are reported in Uruguay, where the Court of Auditors audits all state-owned enterprises and, in addition, by international audit firms[17].

– Internal audit is reflected in audit committees. The accountability is the provision of information on the nomination of members of audit committees, as well as on the activities they perform. The prevailing legislative practice is the restriction that executive management staff cannot be nominated to the audit committee. In Lithuania, the audit committee is envisaged as an advisory body on board[18]. In Colombia, the President of the Republic nominates heads of internal audit in state-owned enterprises[19]. In Argentina, audit committees have an advisory role to shareholders on risk management[20]. All state-owned enterprises are required to have an internal auditor under the laws of Chile and Israel, while in Estonia, only large state-owned enterprises are required to introduce it, and in Slovenia, each state-owned enterprise only has to decide on the need to introduce it[21].

Transparency of state-owned enterprises

Transparency for the activities of state-owned enterprises is a serious problem almost everywhere[22]. Therefore, it is difficult to analyze their advantages and disadvantages in relation to private enterprises. Transparency of state-owned enterprises is difficult to achieve due to their relative independence from the state, society's expectations of achieving commercial, social and environmental goals, and accountability to government as a principal and society as a stakeholder[23].

The information disclosed by state-owned enterprises is very diverse, making it difficult to summarize. International good practice reveals that public information provided relates to:

– Shareholder structure. Irrespective of the sole ownership of state-owned enterprises by the state, good transparency practices contain information about a specific state body-principal. In rare cases, the ownership involves minority shareholders, whose composition and dynamics are part of the process of transparency, as well as the methods of protection of their rights. For example, in Colombia, shareholders' meetings are broadcast live on the Internet and on television[24]. Transparency includes both shareholders and their voting and dividend distribution rights.

– Composition of the board. Transparency refers to the nomination process and the specific composition of the board members. The lowest level of information disclosure is in the formation of the board (according to data collected from the websites of 105 companies from 13 Latin American countries[25]). Other information that is disclosed is the separation of the functions of the chairperson of the board from the executive director. In Argentina, it is mandatory to announce the results of a nomination procedure for independent directors[26]. Information on the composition of the board is published on the

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[17] **International Bank of Reconstruction and Development/The World Bank Group**. *Corporate Governance of State-Owned Enterprises in Latin America*. Current Trends and Country Cases. Report No.: 89468-LAC. Washington DC, 2014.

[18] **OECD**. OECD *Review of the Corporate Governance of State-Owned Enterprises*. *Lithuania*. Paris, 2015.

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[26] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises*. *Argentina*. Paris, 2018.

website of the state-owned enterprise and practices vary widely – from scarce information to detailed biographical references.

– Remuneration of board members. Remuneration information reflects not only the activities of the board, but also the risks taken, and possibly the need for additional capital to rescue a state-owned enterprise. In most countries, the practice of state-owned enterprises differs from that of the private sector ("say-on-pay" principle) and information is provided in accordance with the minimum requirements of the law. In very rare cases, the details of the remuneration (fixed and variable component, compensation with shares and options of the enterprise), the ways and terms for their payment are disclosed individually named. In Argentina, the total remuneration of board members is published on the website of the National Securities Commission[27].

– Stakeholders. Stakeholder relationships are subject to disclosure. For example, in Argentina, information is published on relations with staff, creditors, suppliers and local communities, as well as on the impact on the environment[28]. In some cases, information on the corporate social responsibility strategy is provided. Last but not least, information is shared about the risks and their management. In Lithuania, information is provided on donations made by state-owned enterprises[29]. An essential part of the transparency is the data on the remuneration paid to the external auditor separately for consulting and audit services.

– Organizational structure. Each structure increases transparency in a different way and provides the opportunity to exercise control[30]. Most state-owned enterprises use a linear-functional structure, which is mainly in line with budget absorption and inefficient in internal and external communication. The organizational structure is considered to be properly developed if it allows the movement of information and timely reporting of the achieved results. Another advantage of the structure is the distinction between commercial and social purpose, as well as the division between long-term and short-term goals. Last but not least, the organizational structure reduces information asymmetry[31].

– Good practices. Transparency is formed in compliance with the "comply or explain" principle. For example, in Lithuania, "Guidelines for Transparency" have been adopted by the Ministry of Economy, and in the event that a state-owned enterprise does not comply with the provisions of these guidelines, the frequency of reporting is increased[32].

– State policy for ownership. To build public confidence in the state, it is advisable to publish the rationales and motives of the state for the purposes of state-owned enterprises. In most cases, the policy is developed by the government, approved and reported to parliament, and updated on a periodic basis with the participation of stakeholders. A positive example is the practice in Lithuania where the main legal acts and other documents applicable to state-owned enterprises, as well as information on state ownership reforms, standardized financial results of individual state-owned enterprises, biographical data on CEOs and board members, including for independent directors are published on the website of the Center for Government Communications[33]. At the other pole is the practice in Colombia, where the lack of a centralized unit for government administration and institutionalized coordination of the various ministries responsible for these enterprises leads to fragmented governance, and the information received from state-owned enterprises is not consolidated and there is no publish a summary report for results and situation of state ownership[34]. The situation is similar in Argentina, where there is no national strategy for public policy disclosure and only some state-owned enterprises disclose information they deem appropriate, and various institutions disseminate financial and non-financial information on state-

[27] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises*. *Argentina*. Paris, 2018.

[28] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises*. *Argentina*. Paris, 2018.

[29] **OECD**. *OECD Review of the Corporate Governance of State-Owned Enterprises*. *Latvia*. Paris, 2015.

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[32] **OECD**. OECD *Review of the Corporate Governance of State-Owned Enterprises*. *Lithuania*. Paris, 2015.

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owned enterprises. For example, separate budget implementation reports are published monthly on the website of the National Budget Service, while information on some state-owned enterprises is published on the website of the National Securities Commission[35].

External accountability goes beyond contractual obligations and responsibilities and is likened to less formal public accountability – customs and expectations[36]. For state-owned enterprises, accountability extends beyond bilateral arrangements and reaches stakeholder relationships[37]. For example, in Lithuania, all government acts on state ownership are presented to the public for comments and opinions. It is external reporting that distinguishes state-owned enterprises from private ones and brings them closer to financial intermediaries (commercial banks, insurance companies and pension companies).

Conclusions

An established opinion in society is the similar responsibility of the boards of state and private enterprises. This view is a consequence of the effects of the global financial crisis and the addition of another goal for state-owned enterprises – a commercial goal in addition to the social goal. In order to reduce the costs of taxpayers for maintaining state ownership, a new form of liability has been introduced, which is related to the achieved financial results. In this sense is the state policy regarding ownership – the formation of organizational structure and composition of the boards to achieve high financial results.

Agency problem is reduced through the accountability of the enterprise itself. For state-owned enterprises, accountability is expressed in the generation of information on the degree of achievement of the social goal and gaining public confidence in the benefits of state ownership. Given the nature of state-owned enterprises, their accountability differs from private ownership in the difficulty of clearly and precisely defining a leading goal, and the low degree of supervision given the combination of ownership and control functions in the face of the state. Last but not least, the accountability is aimed at competitive access to resources in the economy and preferences for some enterprises, incl. monopoly rights.

In addition to a commercial goal, state-owned enterprises also have a social goal and should therefore not be considered and directly compared to private enterprises. The low degree of transparency characteristic of state-owned enterprises is a consequence of the dependence of enterprises on state authorities in forming and achieving their goals. An additional difficulty in the transparency of state-owned enterprises is measuring the results of the social goal and their perception by society. To a large extent, the level of democratic maturity shapes society's expectations of the meaning of state ownership and the needs for transparency of state-owned enterprises. In modern society, state-owned enterprises provide information about the need for state ownership and act as a litmus for test for economic development, incl. reveal the existence of market defects and a monopoly in the generation of social goods.

External and internal audits are applied to obtain objective information on the situation of state-owned enterprises. Audit companies or the Court of Auditors conducts the external audit. Internal audit is a function of the audit committees of the boards of state-owned enterprises.

The public information most often disclosed by state-owned enterprises relates to their shareholders, the composition and remuneration of board members, the organizational structure, good practices and the state's ownership policy.

The study of foreign practices in corporate governance will find practical application in the new law on state-owned enterprises in Bulgaria (Law on public enterprises, 2019), as well as in the activities of the new agency for state-owned enterprises (Agency for Public Enterprises and Control). The expectations are focused on the preparation of a state policy on the need and scope of state ownership.

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