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**ADB Working Paper Series**

**ENHANCING THE TRANSPARENCY  
AND ACCOUNTABILITY OF  
STATE-OWNED ENTERPRISES**

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**Abstract**

This paper provides an overview of national practices for improving the accountability and performance of SOEs by examining relevant legislation, policies, and practices in Asian and other economies. It assesses these against internationally agreed good practices exemplified by the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

Nine Asian countries reviewed in this report demonstrate varying degrees of effort and progress in developing and putting in place a legal and regulatory framework for SOE disclosure and transparency. Some have made significant progress in terms of improving information disclosure by SOEs with an accelerated process of corporatization of SOEs and adoption of adequate accounting standards. More and more governments are establishing information reporting systems and performance evaluation systems through which they acquire financial and nonfinancial information from their SOEs.

However, some of the reviewed countries lack comprehensive systems for detecting fiscal risk linked to SOEs. A number of SOEs lack an internal audit function for SOEs and/or their financial statements are not systematically subject to independent external audits. At the level of the state, a majority of the countries do not publish aggregate ownership reports, which could potentially limit accountability and restrict the public from overseeing SOE performance. Establishing comprehensive legal and regulatory frameworks for public disclosure of financial and nonfinancial information about the activities of SOEs is critical.

**Keywords:** corporate governance, state-owned enterprises, disclosure, transparency, accountability, aggregate reporting practices, performance evaluation system

**JEL Classification:** L320, L380, G380

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## 1. INTRODUCTION

The presence of state-owned enterprises (SOEs) in the global economy, undertaking cross-border investment and trade in competition with private enterprises, has become prominent in recent years. A simple illustration is that in 2003 only 34 of the world's 500 largest companies were state owned. As of recently, this number had grown to 102. This mostly reflects the growing international presence of emerging market economies – particularly in Asia – where SOEs are more prevalent. State-owned enterprises are found well beyond the major utility providers, often representing a significant portion of the financial and manufacturing sectors. They also account for a significant share of the total stock market capitalization in Asia (OECD 2018).

As a result, the operations of SOEs have an important global economic impact, and higher standards of accountability and transparency are essential to maintain an open international investment climate and avoid unwarranted protectionism. In particular, the disclosure of both financial and nonfinancial information is critical for the government, which can therefore be an efficient owner; the Parliament, to assess the performance of the state as an owner; the media, to raise awareness of the effectiveness of SOEs; and taxpayers and the general public, to be informed about the performance of SOEs. At the same time, ownership entities should ensure that the additional reporting requirements imposed on SOEs, in addition to those imposed on private enterprises, do not place an undue burden on their economic activities.

In recent decades, many governments in Asia have made important progress regarding putting in place legal regulatory frameworks to improve the transparency and accountability of SOEs as part of the effort to align practices more with internationally recognized good practices. These include defining and clarifying the financial and nonfinancial objectives of SOEs, better coordination of ownership responsibilities within the public administration, measuring and assessing performance against quantifiable objectives, and undertaking regular reporting on the business activities and performance of SOEs. It is also worth noting that an increasing number of trade and investment agreements have been including chapters on enhancing the governance and transparency of SOEs.

This paper presents an overview of national approaches to enhancing the performance and accountability of SOEs by reviewing relevant legislation, policies, and measures applied to SOEs in Asian economies. It is based on desktop research complemented by key findings from recent OECD publications published in the context of the ongoing OECD-Asia Network on Corporate Governance of State-Owned Enterprises, which provides a forum for corporate practitioners, experts, and policy makers from the Asian region to identify policy challenges regarding the ownership and governance of SOEs, share good practices, and come up with recommendations for policy reform. The Asian jurisdictions analyzed in this paper are India, Indonesia, Kazakhstan, the Republic of Korea, Malaysia, Pakistan, the Philippines, Thailand, and Viet Nam. The paper is structured as follows:

It first briefly introduces internationally recommended practices for ownership entities in the area of SOE disclosure and performance management, introducing key relevant elements of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”). Then it takes stock of policy, legal, and regulatory measures for developing and implementing disclosure measures including aggregate reporting practices and performance management measures within the SOE sectors in the surveyed countries. It highlights related recent reform experiences and challenges and provides a stocktaking of relevant legal and regulatory frameworks including

centralization of the state ownership function; SOE-specific obligations on disclosure and reporting; internal and external audit functions; aggregate reporting practices; performance evaluation systems; and financial and nonfinancial indicators used to measure SOE performance. Lastly, the paper provides a list of issues and recommendations for the consideration of policy makers.

## **2. INTERNATIONALLY RECOMMENDED PRACTICES ON SOE TRANSPARENCY AND ACCOUNTABILITY**

SOEs are subject to different degrees of implementation and enforcement depending on their legal regulatory environment and the sector in which they operate. Nevertheless, there are common lessons on SOE governance and transparency that countries can extract from internationally recognized standards, such as the SOE Guidelines and the Accountability and Transparency Guide. The latest SOE guidelines were last revised in 2015, and a large number of emerging economies and developing countries, including those from Asia, made significant contributions to the revision process.

The SOE Guidelines state that SOEs should be as transparent to the general public as a publicly traded company should be to its shareholders (see Box I). The Guidelines posit that governments redouble their efforts to enhance transparency and accountability at both the corporate and state levels: on the state of the financial structure and conditions in order to contribute to the overall assessment of SOEs; and of activities that affect the economic performance of SOEs themselves as well as the national economy. With regard to financial information disclosure, the SOE Guidelines also require SOEs to maintain their accounts in accordance with internationally agreed accounting standards and submit their financial statements to an independent external audit based on relevant international auditing standards. Effective internal audit procedures should be established, and overseen by an audit committee within the board of directors or its functional equivalent.

The Guidelines also provide specific recommendations for performance monitoring and management. In particular, Chapter II of the Guidelines indicates that the main responsibilities of the state include:

- Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives, and risk tolerance levels;
- Setting up reporting systems that allow the ownership entity to regularly monitor, audit, and assess the performance of SOEs, and oversee and monitor their compliance with applicable corporate governance standards;
- Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

While the first two points are at the center of the issue of performance management as they relate to the monitoring of operational (financial and nonfinancial) objectives, the last point directly concerns the motivation of boards of directors with regard to meeting performance criteria. The newly launched OECD Anti-Corruption and Integrity Guidelines for State-Owned Enterprises (ACI Guidelines) also provide specific recommendations for the state as an enterprise owner on enhancing transparency and disclosure measures at both state and enterprise level (OECD 2019).

### **Box 1: Selected SOE Guidelines' Provisions on SOE Transparency and Disclosure Measures**

#### **Annotations relevant to recommendation from the Guidelines**

#### **Chapter VI. A. Reporting high-quality financial and nonfinancial information on SOEs**

All SOEs should disclose financial and nonfinancial information, and large and listed ones should do so according to high-quality internationally recognized standards. This implies that SOE board members sign financial reports and that CEOs and CFOs certify that these reports in all material respects appropriately and fairly present the operations and financial condition of the SOE.

To the greatest extent possible, the relevant authorities should carry out a cost-benefit analysis to determine which SOEs should be submitted to high-quality internationally recognized standards. This analysis should consider that demanding disclosure requirements are both an incentive and a means for the board and management to perform their duties professionally.

A high level of disclosure is also valuable for SOEs pursuing important public policy objectives. It is particularly important when they have a significant impact on the state budget, on the risks carried by the state, or when they have a more global societal impact. In the EU, for example, companies that are entitled to state subsidies for carrying out services of general economic interest are required to keep separate accounts for these activities.

SOEs should face at least the same disclosure requirements as listed companies. Disclosure requirements should not compromise essential corporate confidentiality and should not put SOEs at a disadvantage in relation to private competitors.

SOEs should report on their financial and operating results, nonfinancial information, remuneration policies, related party transactions, governance structures, and governance policies. SOEs should disclose whether they follow any code of corporate governance and, if so, indicate which one. In the disclosure of financial and nonfinancial performance, it is considered good practice to adhere to internationally accepted reporting standards.

With regard to the disclosure of remuneration of board members and key executives, it is viewed as good practice to carry this out on an individual basis. The information should include termination and retirement provisions, as well as any specific benefits or in-kind remuneration provided to board members.

#### **Chapter VI. B. Ensuring independent external audit**

SOEs' annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures are not a substitute for an independent external audit.

In the interest of the general public, SOEs should be as transparent as publicly traded corporations. Regardless of their legal status and even if they are not listed, all SOEs should report according to best-practice accounting and auditing standards.

In practice, SOEs are not necessarily required to be audited by external, independent auditors. This is often due to specific state audit and control systems that are sometimes considered sufficient to ensure the quality and comprehensiveness of accounting information.

These financial controls are typically performed by specialized state or "supreme" audit entities, which may inspect both SOEs and the ownership entity. In many cases they also attend board meetings and often report directly to the legislature on the performance of SOEs. However, these specific controls are designed to monitor the use of public funds and budget resources, rather than the operations of the SOE as a whole.

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**Box 1** *continued***Chapter VI. C. Establishing consistent reporting systems to monitor SOE performance**

The ownership entity should develop aggregate reporting that covers all SOEs and make it a key disclosure tool directed at the general public, the legislature, and the media. This reporting should be developed in a way that allows all readers to obtain a clear view of the overall performance and evolution of the SOEs. In addition, aggregate reporting is also instrumental for the ownership entity in deepening its understanding of SOE performance and in clarifying its own policy.

The aggregate reporting should result in an annual aggregate report issued by the state. This aggregate report should primarily focus on financial performance and the value of the SOEs, but should also include information on performance related to key nonfinancial indicators. It should at least provide an indication of the total value of the state's portfolio. It should also include a general statement on the state's ownership policy and information on how the state has implemented this policy. Information on the organization of the ownership function should also be provided, as well as an overview of the evolution of SOEs, aggregate financial information, and reporting on changes in SOEs' boards. The aggregate report should provide key financial indicators including turnover, profit, cash flow from operating activities, gross investment, return on equity, equity/asset ratio, and dividends.

The ownership entity should strengthen disclosure on stakeholder relations by both having a clear policy and developing aggregate disclosure to the general public. Information should also be provided on the methods used to aggregate data.

Source: OECD (2015), *Guidelines on Corporate Governance of State-Owned Enterprises*, OECD, Paris.

### **3. LEGAL AND REGULATORY FRAMEWORKS FOR IMPROVING TRANSPARENCY AND ACCOUNTABILITY OF SOEs**

#### **3.1 Centralization of State Ownership Function**

The SOE Guidelines call for the centralization of the ownership function or, if this is not feasible, coordination of the exercise of state ownership on a whole-of-government basis. This is primarily driven by the need to avoid conflicts of interest by separating the ownership from other government functions that may affect the operating environment of SOEs. The issue of ownership can also have significant implications for transparency and accountability.

Centralization of the ownership function can be a powerful tool for developing corporate governance measures specific to SOEs. It can also help strengthen and mobilize competences related to transparency and accountability, as it necessitates the creation of pools of experts with relevant expertise in areas such as financial reporting, disclosure, performance evaluation, and management or appointment to the board. Centralization can also help to ensure coordination across relevant national government entities as well as with subnational government entities and authorities on cross-cutting issues relevant to the accountability and transparency of SOEs.

Historically the most prevalent state ownership model in Asia was a decentralized model. The ownership of SOEs in Asia was predominantly exercised by a multitude of responsible line ministries without coordinating agency in place. Explanations on other kinds of government ownership models are included in Box 2.

### Box 2: Different Types of State Ownership Models

State ownership models can be broadly categorized into five types: a centralized model; a coordinating agency model; a dual model; a twin-track model; and a decentralized model. The countries with a centralized model for state ownership have established a central holding company for a significant portfolio of SOEs, or have established a central coordinating body, often responsible for monitoring performance or coordinating governance practices across the SOE sector. The coordinating agency model indicates countries where specialized government units operate in an advisory capacity to other shareholding ministries on operational and technical issues, and their policy priority is often to monitor SOE performance. Dual ownership occurs where two ministries (or equivalent state institutions) both exercise ownership functions such as objectives setting and board nominations. The features of the twin-track model can be considered functionally equivalent to the centralized model, but with two individual portfolios of SOEs overseen by two different government bodies.

Source: OECD (2016a, 2017, 2018).

A number of Asian governments have begun to implement some degree of policy coordination to further centralize the state ownership function by creating a central coordinating body or a holding company to oversee a portfolio of large SOEs. In late 2018, Viet Nam set up a special coordinating body called the Committee for State Capital Management (CMSC) to exercise the state's ownership role in 19 of the country's largest SOEs and state corporate groups; and the Philippines passed the Government-Owned and Controlled Corporations (GOCCs) Governance Act in 2011, which led to the creation of a commission to monitor the performance of GOCCs. The Republic of Korea consolidated a major part of all commercially important SOEs in the hands of one ownership unit – the Ministry of Economy and Finance – according to the 2007 Act on the Management of Public Institutions. Some examples of the reviewed countries with different ownership patterns are included in Table 1.

**Table 1: National Approaches to Exercising the Ownership Function**

	<b>Ownership Model</b>	<b>Institution(s) Responsible for Ownership Function</b>	<b>Objectives Set by Whole of Government, or by Individual Ministry</b>
India	Decentralized with coordinating agency	The Department of Public Enterprises (DPE) operates as the “nodal” agency for all SOEs. The DPE formulates all policies regarding performance improvement and evaluation, financial accounting, personnel management, and other relevant areas. However, its ownership model is different from a centralized model. The department is required to coordinate with a multitude of other government ministries and organizations in order to fulfill the tasks of the ownership function.	SOEs’ vision, mission, and long/short-term objectives developed by line ministry and SOE in a “consultative manner,” keeping in view the overall federal policy direction of the government.
Indonesia	Dual	The institutions that exercise state ownership rights in SOEs are the Ministry of Finance based on its authority given by Law No. 1 Year 2004 and the Ministry of State-Owned Enterprises based on its authority given by Government Regulation No. 41 Year 2003. As for the Ministry of SOEs, it currently supervises 114 SOEs where the government of Indonesia owns more than 50% of the companies’ shares.	The objectives for state ownership are articulated in the 2004 Law No. 1, the 2003 Government Regulation No. 41 and the 2003 Law No. 19 on State-Owned Enterprises.

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Table 1 *continued*

	<b>Ownership Model</b>	<b>Institution(s) Responsible for Ownership Function</b>	<b>Objectives Set by Whole of Government, or by Individual Ministry</b>
Kazakhstan	Centralized with exceptions (holding company model)	There are three separate holding companies in Kazakhstan that account for almost all of the SOE sector. Samruk-Kazyna is one of them and is also nominally referred to as a "sovereign wealth fund." It is the largest joint-stock national holding company 100% owned by the government of the Republic of Kazakhstan. It governs the equity stakes of national companies and other legal entities and subsidiaries owned by those companies.	The general objectives for a state's enterprise ownership are presented in Article 192 of the Entrepreneurial Code of the Republic of Kazakhstan.
Republic of Korea	Centralized under one ministry	The Ministry of Economy and Finance (MOEF) exercises the ownership rights over all public institutions, including SOEs, under the Act on the Management of Public Institutions, with the Ownership Steering Committee serving as its executive agent. At the same time, each line ministry controls a portfolio of businesses and related policies regarding SOEs under its jurisdiction. The Ownership Steering Committee makes decisions on the key policy issues regarding the oversight of SOEs. The Committee, led by the Minister of Economy and Finance, is composed of government representatives and no more than 11 civilian members with acknowledged expertise.	The MOEF is in charge of defining and promulgating managerial guidelines for public institutions, including SOEs, monitoring and assessing their enforcement and performance. The performance goals of SOEs are established taking into consideration government policies. By law, each SOE is required to develop medium- and long-term management goals and then submit them to the MOEF and the related line ministries.
Malaysia	Centralized with exceptions (holding company model)	Malaysia has placed a nontrivial portfolio of Government-Linked Companies (GLCs) under the purview of Kazanah Nasional Berhad, a sovereign wealth fund of the government, and several other large holding companies.	A reform programme titled Silver Book (2015) was introduced to facilitate policy coordination targeting the GLCs.
Pakistan	Decentralized	State ownership is exercised only by the line ministries charged with sectoral regulation in the relevant markets.	There is no explicit state ownership policy in place. Depending on their categorization and legal form, SOEs are subject to different regulations.
Philippines	Decentralized with coordinating agency	The Philippines has adopted some degree of policy coordination through the creation of the Governance Commission for Government-Owned and Controlled Corporations (GCG) for monitoring the performance of SOEs.	The 2011 GOCC Governance Act states that the President of the Philippines is the primary representative of the state as the owner of GOCCs and reinforces the capacity of the GCG, on behalf of the state, to: supervise SOE board selection and nomination processes; and evaluate and assess SOEs' performance. The GCG oversees 104 SOEs.
Thailand	Centralized under one ministry	The State Enterprise Policy Office (SEPO) under the Ministry of Finance exercises the state ownership rights in all SOEs. The SEPO is also secretariat to the committees that are responsible for monitoring and overseeing SOEs.	The 2002 Act on Reorganization of Ministries, Ministerial Bureaus, and Departments (B.E. 2545, 2002) stipulates the institutional arrangements for SOE ownership, oversight, and regulation.
Viet Nam	Decentralized with coordinating agency	Viet Nam set up a special coordinating body named the Committee for State Capital Management in 2018 to exercise the state's ownership role in 19 of the country's largest SOEs and state corporate groups. However, state ownership is still exercised by the line ministries, provincial committees, and State Capital Investment	The Viet Nam National Assembly promulgated the Law on State Capital Investment and Management in 2014, which plays a key role in exercising the state ownership function.

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Corporation (SCIC) charged with sectoral regulation and policy in the relevant markets.

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Source: OECD questionnaire responses from national authorities; OECD (2018); OECD (2017); OECD (2016a).

### 3.2 SOE-Specific Obligations on Disclosure and Reporting

Internationally recognized good practices call for the establishment of a comprehensive policy framework to ensure accountability and transparency in the SOE sector. All the countries studied except Malaysia have put in place SOE-specific reporting and disclosure guidelines or requirements while institutional features differ across countries (see Table 2).

**Table 2: SOE-specific Reporting Requirements or Guidelines**

India	Under the Companies Act 2013, companies are required to publish annual reports that include a separate section on Corporate Governance with information on compliance. All SOEs are subject to the disclosure norms put forward by the government. SOEs should hand in a quarterly compliance report to their administrative ministries. It requires disclosures regarding board reports, prospectuses, AGM notices, annual returns, director's responsibility statement, audit committee constitution, vigil mechanism etc. Central SOEs (CPSEs) are mandated to obtain a certificate from auditors/the company secretary with respect to compliance with these guidelines. CPSEs have a Central Vigilance Officer reporting to the Central Vigilance Commission of the central government. They are monitored and assessed following negotiation of a performance agreement between the SOE and its administrative ministry.
Indonesia	Under Law No. 14/2008 (Article 14), the Minister of SOEs' Regulation No. 9/2012 on Good Corporate Governance, SOEs are required to disclose some data and information to the general public. The Ministry of Finance and/or the Ministry of SOEs should have a communication and a hearing with the Parliament on a regular basis to discuss issues relevant to SOEs and their performance. Those ministries, as well as SOEs themselves, should also publish financial reports on their main activities and relevant information about their board of directors and board of commissioners and provide website links for inquiries. The information can be acquired through SOEs' individual websites as well as the website of the Ministry of SOEs.
Kazakhstan	SOEs are required to respect reporting requirements stated in the Law on Accounting and Financial Reporting and the Ministry of National Economy is required to undertake performance evaluation and monitoring of SOEs. SOEs are also required to abide by disclosure-related provisions of Kazakhstan's sovereign wealth fund Samruk-Kazyna's Corporate Governance Code dated 2015, which can be applied to all state-owned joint-stock companies in the portfolio of the holding company. The Code has a chapter specific to accountability and transparency. The Code also requires disclosure of these issues in the annual reports of the Fund and its subsidiaries. The information that follows is about the performance evaluation of Samruk-Kazyna, the state holding company that has shares in a significant portfolio of SOEs.
Republic of Korea	Under the Official Information Disclosure Act dated 1998, information on the activities of government bodies, public institutions, and SOEs should be disclosed. The Act mandates that all public institutions, including all SOEs, disclose and report corporate information to the general public through the Internet-based portal called ALIO (All Public Information in One) inventory system (see <a href="http://www.alio.go.kr">www.alio.go.kr</a> ). The information covered includes the number of executives, employees, financial statement, income and expense statement, audit report, tax, internal and external evaluation reports undertaken by the National Assembly, the Board of Audit and Inspection, and the Ministry of Economy and Finance (MOEF), among many others. With respect to board qualifications and selection processes, a new clause was added to the Act in 2016 to make meeting minutes of the Committee for Recommending SOE CEOs publicly available for inspection by the public unless the case is judged to be exceptional according to the Official Information Disclosure Act. Also, the Committee is mandated to disclose eligibility criteria for CEOs taking into account specialities and requirements of the corresponding corporation or institution. Another Article was newly added to the Act in 2018 to require the Minister of Economy and Finance or the minister of the competent agency to subject an executive of an SOE or public institution to an aggravated punishment and public scrutiny through resolution by the Steering Committee if she/he is found guilty in connection with employment fraud or employment irregularities. As part of the

efforts to address the issue of the gender pay gap in the SOE sector, an amendment of the “Act on the Management of Public Institutions” was made on 31 December 2018 to require all SOEs and public institutions to disclose the status of the gender wage gap. A disclosure that is intentionally false or noncompliance with the disclosure system results in heavy penalties for the relevant SOEs.

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**Table 2** *continued*

Malaysia	In terms of the SOEs that are publicly listed, they are subject to the listing requirements of Bursa Malaysia Securities Berhad. Examples of nonfinancial disclosures under this listing requirement include instances of change in management, borrowing of funds, and the making of a tender offer for another corporation's securities, among others. Fully corporatized SOEs should abide by relevant provisions of the companies act, and statutory SOEs are subject to individual reporting requirements.
Pakistan	Public Sector Companies (Corporate Governance) Rules 2013 require SOEs to disclose financial information in line with the International Financial Reporting Standards and outline rules for SOE board composition and independence.
Philippines	SOEs in the country are subject to disclosure requirements put forward by the ownership coordination entity (Governance Commission for GOCCs, or GCG). Section 25 of R.A. 10149 and specifically in GCG Memorandum Circular 2011-07 provides disclosure requirements of the GOCCs under GCG's jurisdiction. It states that all GOCCs shall develop a website and upload both financial and nonfinancial information about the GOCC for public disclosure. Other provisions are Section 43 of GCG M.C. 2012-07, Section 45 on Mandatory Reports and Section 46 on other periodical requirements. The Securities and Exchange Commission (SEC) of the Philippines also passed the Revised Corporation Code into law in 2019 in order to strengthen corporate governance and issue guidelines for GOCCs. In this respect, the SEC issued Memorandum Circular No. 15 Series of 2019, under which companies, including GOCCs, are required to disclose their beneficial owners.
Thailand	A Cabinet decision dated 2011 requires all nonlisted companies to be subject to the same disclosure requirements as listed companies. Nonlisted SOEs are governed by disclosure requirements placed upon them by the State Enterprise Policy Office (SEPO). SEPO publishes annual reports whose functions can be considered to be similar or equivalent to an aggregate report on the SOE sector. The reports are entitled State Enterprise Reviews and contain information and data on the status of the implementation of state policies by SOEs, financial ratios, and key performance indicators (KPIs). The degree of compliance with SEPO's disclosure requirements can be taken into account in the evaluation of the performance of SOEs.
Viet Nam	The disclosure requirements specific to SOEs are specified in Decree 81/2015/ND-CP (dated 18 September 2015), which mandates SOEs to publish: annual and bi-annual financial reports; five-year business strategies; annual plans for business operations; annual reports on management, salary, and income. SOEs should also produce audited financial statements on their websites, before sending them to the responsible line ministry and the Ministry of Planning and Investment. However, in practice, SOEs' compliance with the state's disclosure requirements is not consistent.

Sources: OECD 2016a, 2017, 2018.

### 3.3 Internal and External Audit Functions

Internationally recommended practices state that governments are encouraged to require their SOEs to follow the same auditing and accounting standards as listed companies. However, in general, the surveyed Asian jurisdictions lack comprehensive internal audit and control functions and do not have strong guidance on SOE corporate disclosure due to a relatively lower degree of corporatization.

In most of the Asian countries reviewed in this paper, auditing of financial statements of SOEs is often undertaken by the comptroller general or the supreme audit institution, rather than by an external auditor who is independent. With the exception of the Republic of Korea and Viet Nam, the surveyed countries request their SOEs to submit their financial statements to an independent external audit on an ad hoc basis.

Moreover, less than half of the surveyed countries have put in place requirements for SOEs to respect International Financial Reporting Standards (IFRS). SOEs in India, Malaysia, the Philippines, and Viet Nam are required to follow national accounting standards. In Kazakhstan, Pakistan, and Thailand, the majority of SOEs should keep their accounts aligned with IFRS, while in the Republic of Korea the largest SOEs are required to do so. In the Republic of Korea, financial statements of SOEs are subject to

both a state audit conducted by the Board of Audit and Inspection Committee and an external audit. With respect to internal audit measures, large Korean SOEs with asset values of at least 2 trillion Korean won should set up an audit committee.

The Indonesian government has shown some progress by requiring their SOEs to have an internal audit function, and the function to report directly to the CEO and Audit Committee under Law No. 19 2003. They are also required to have regular meetings with the Board of Commissioners (BOC). However, for unlisted or small SOEs, the standard of information transparency or disclosures varies, as the IT infrastructure differs across SOEs and not all information can be easily collected. Especially for some restricted industries related to defense, the data might be categorized as sensitive information in the country.

In India, SOEs' financial statements are required to be audited by the Supreme Audit Institution (CAG) and be subject to legal controls by an external auditor. The audits are undertaken according to the standards established by the Institute of Chartered Accountants of India. However, like Malaysia and Pakistan, Indian SOEs are not systematically required to set up an internal audit function. In the Philippines, the internal audit function is governed by a circular from the Budget and Management Department, which requires that the internal audit function in GOCCs report to their boards of directors.

In Kazakhstan, the corporate governance code of Samruk-Kazyna encourages its portfolio companies to set up both an external audit and an internal audit function. Compliance with the Code is voluntary. The Law on Joint Stock Companies also empowers SOEs with such a legal form to set up an internal audit function. The companies in Samruk-Kazyna's portfolio are required to be audited by the Accounts Committee for Control over Execution of the State Budget, which is a state controller charged with evaluating the use and the impact of public funds.

In Malaysia, only SOEs with the Government-Linked Company (GLC) status that are listed on the national stock exchange are required to set up an internal audit function as indicated by the Securities Commission and Bursa Malaysia (stock exchange). Auditing and accounting measures and information disclosure measures by unlisted SOEs differ according to the requirements of the relevant majority stakeholder.

In Thailand, financial statements of SOEs are audited by the Auditor General, who is required to directly report to the Prime Minister. All SOEs are mandated to set up an internal audit function that reports to the audit committee, in accordance with the regulations of the Ministry of Finance. In Viet Nam, under the 2005 Enterprise Law, SOEs are mandated to establish an internal audit function. It should report directly to the Management Board (CEO) and Supervisory Board designated by state ownership authorities.

### **3.4 Aggregate Reporting Practices**

The SOE Guidelines encourage the state as an owner of commercial enterprises to develop and undertake regular reporting on SOEs and publish an aggregate report on SOEs on an annual basis. They also promote web-based communications in order to ensure smooth access for the general public. At the same time, policy makers need to ensure that aggregate reporting creates an added value to existing reporting requirements like annual reports to the legislature. Some ownership entities could produce limited aggregate reports by only covering SOEs that are active in comparable sectors.

The SOE Guidelines further state that this aggregate report should focus on financial performance and the value of the SOEs, and should also provide information on performance related to key nonfinancial indicators.

Aggregate reporting could cover information items including the state ownership policy and information on the status of the implementation of this policy; the value of the state's portfolio (i.e. information about the size, value, and performance of the state sector); aggregate financial information and reporting on changes in SOEs' boards; key financial indicators (i.e. profit, turnover, cash flow from operating activities, return on equity, gross investment, dividends, and equity/asset ratio; the methods used to aggregate data; information on individual reporting on the most important SOEs; voting structures and stakeholder relations where there are nongovernment shareholders; related party transactions and risks (OECD 2015).

According to a recent OECD study (OECD 2018), to facilitate disclosure and transparency, more than half of the 52 countries studied around the world produce and publish online some form of aggregate reporting on SOEs. Most of them contain all or the majority of SOEs in the reports. It should also be noted that these countries have relatively more centralized (or coordinated) state ownership, which generally facilitates the overall reporting process. Of the countries with aggregate reporting, all SOEs in commercial operation regularly publish financial information, but the degree of disclosure of nonfinancial information (e.g. nonfinancial corporate objectives, risks, and corporate guarantees) varies considerably from country to country.

Aggregate reporting practices are less prevalent in Asian jurisdictions, which tend to have a more decentralized state ownership structure, where the relevant several line ministries exercise SOE ownership within their concerned sector, while other institutions play a coordinating role regarding governance of SOEs. Among the countries studied in this paper, India, the Philippines, and Thailand produce a comprehensive aggregate report on the entire SOE sector, which is made public. In India, the Department of Public Enterprises (DPE) is responsible for publishing an Annual Survey of SOEs that allows for a comprehensive landscape on the financial situation, operations, and performance of all SOEs. It also contains information on some individual SOEs. The report is disclosed online and is reviewed by the Parliament every year.

In the Philippines, the GCG produces an annual report on the performance and activities of GOCCs, which is presented to the President and to Congress and is disclosed online. In Thailand, the SEPO publishes several annual reports that are equivalent to an aggregate report on the SOE sector in terms of its functions. The reports are entitled "State Enterprise Reviews" and include information on the implementation of state policies by SOEs, financial ratios, and key performance indicators.

Malaysia, Pakistan, and Viet Nam do not produce any form of aggregate information on SOEs nor periodical reporting to the public on SOEs on a yearly basis. Disclosure of both financial and nonfinancial information by SOEs is implemented on an ad hoc basis and often public information is outdated and fragmented except for a few large equitized SOEs. The quality and volume of information (both financial and nonfinancial) differ depending on the responsible line ministry or controlling stakeholder. Achieving a better public disclosure system – in terms of quality and amount – could bring significant benefits.

In the Republic of Korea, although the government does not actually publish an annual aggregate report on SOEs per se in the entire SOE sector or for a large portfolio of SOEs,



the government's approach – the system of ALIO disclosure – can be viewed as functionally equivalent. All the individual SOEs have been mandated to disclose company-level information, including their performance, on the ALIO website since 2005. Kazakhstan does not yet provide an aggregate report, but the annual report is prepared by the state holding company Samruk-Kazyna, which reflects the performance of the companies in its portfolio.

### **3.5 Formalizing Performance Evaluation Systems**

Almost all the countries surveyed have implemented some kind of performance appraisal system for SOEs, aligning their practices more with the SOE Guidelines. In a majority of cases, the performance evaluation is annually conducted by the ownership entity or coordinating entity. Performance contracts and performance indicators are the main methods used to establish the performance evaluation process (OECD 2016b). However, the professionalization of boards of directors and the management capacity of supervisors are critical to ensure the efficiency of the performance evaluation process (C. J. Kim and Z. Ali 2017). At the same time, considering that the nature of many SOEs is to generate social welfare rather than profit, it is important to put in place a comprehensive evaluation system that takes into account different aspects of the performance of SOEs, including social and public policy objectives. While it is important for SOEs to make profits, having profitability as the only criterion can potentially mislead decision-makers (Taghizadeh-Hesary et al. 2019).

#### **Performance contracts**

India, the Republic of Korea, and the Philippines have established performance assessment systems through performance contracts or their functionally equivalent tools, such as memorandums or agreements. Generally, these are documents that include annual performance objectives agreed and signed by the ownership entity and the executive management. It can be argued that this approach has helped governments delineate goals, improve the accountability of SOE executives and managers for corporate performance, and enhance their ability to oversee day-to-day operations.

#### **Performance Indicators**

Defining the state's objectives through concrete performance indicators – including those related to financial performance, and also nonfinancial performance related to public policy objectives – is in line with good international practices for achieving greater transparency of the process of performance evaluation of SOEs.

India, Indonesia, the Republic of Korea, and the Philippines conduct performance appraisals against quantitative indicators in order to measure both financial and nonfinancial performance (Table 3). Examples include standard financial performance indicators, numerical indicators of customer satisfaction, and the number of beneficiaries served. These countries have also introduced qualitative indicators to assess financial and nonfinancial performance related to corporate governance practices or risk management. For instance, in Indonesia, the Ministry of State-Owned Enterprises has put in place an evaluation manual with quantitative indicators against which to undertake SOE performance appraisals, which are then mostly conducted by assessors from SOE boards of directors before being ultimately reviewed by the Ministry of State-Owned Enterprises.

As part of efforts to enable “public institutions and SOEs to maximize their social values under the new administration, the Korean government established in 2018 a group of indicators to monitor the performance of SOEs and new public institutions, with respect to human rights, ethical management, safety, environment conservation, social integration, and job creation.

In the Philippines, the state ownership entity established the Corporate Governance Scorecard (CGS) for SOEs in 2015 through the issuance of Memorandum Circular No. 2015-07. The CGS assesses the SOEs’ governance practices and their level of compliance with the standards in the areas relevant to the responsibilities of the board, disclosure and transparency, and stakeholder relationships. The CGS was first implemented in 2015, assessing the 2014 data of the SOEs to establish baseline data. Evaluating the effectiveness of individual indicators and performance measurement methods is beyond the scope of this paper.

In Kazakhstan, performance evaluation systems are applied to only a limited portfolio of SOEs under the purview of the country’s state holding companies. Pakistan, which is characterized by a decentralized ownership structure, does not yet have a formal performance appraisal system for SOEs. Line ministries undertake SOE performance evaluation on an ad hoc basis.

**Table 3: Examples of Performance Evaluation Indicators Used in Asia**

	Quantitative	Qualitative
Financial	<ul style="list-style-type: none"> <li>• Net profit (India)</li> <li>• Financial ratios (Indonesia)</li> <li>• Labour productivity (Republic of Korea)</li> <li>• Return on investment (Philippines)</li> </ul>	<ul style="list-style-type: none"> <li>• Quality of risk management (Indonesia)</li> <li>• Transparency of budgetary practices (Republic of Korea)</li> </ul>
Nonfinancial	<ul style="list-style-type: none"> <li>• Project cost overrun (India)</li> <li>• Number of corporate events (India)</li> <li>• Achievement of “core business targets” (Republic of Korea)</li> <li>• Percentage of beneficiaries served (Philippines)</li> </ul>	<ul style="list-style-type: none"> <li>• Commitment to corporate social responsibility (India)</li> <li>• Timely submission of reports to regulators (Indonesia)</li> <li>• Development of a gender equality policy, human rights, ethical management, safety, environment conservation, social integration, and job creation (Republic of Korea)</li> <li>• Certifications indicating compliance with international standards (Philippines)</li> </ul>

Source: State-Owned Enterprises in Asia: National Practices for Performance Evaluation and Management, OECD Publishing, Paris, <https://www.oecd.org/corporate/SOEs-Asia-Performance-Evaluation-Management.pdf>.

## 4. CONCLUSIONS AND KEY POLICY RECOMMENDATIONS

It is encouraging to note that a majority of the Asian countries reviewed in this report have made important progress regarding putting in place legal regulatory frameworks to improve the accountability and performance of SOEs, bringing their national practices more in line with internationally recognized good practices. To begin with, most of the reviewed countries have implemented some degree of policy coordination to further centralize the state ownership function through the creation of a central coordinating body or a holding company to oversee a portfolio of large SOEs. They have established some forms of SOE-specific disclosure and requirements and some form of performance

evaluation system for SOEs, by developing performance contracts or performance indicators.

However, common governance-related challenges to the SOEs include a lack of comprehensive legal and regulatory frameworks for public disclosure of information. It is notable that, while reporting standards of individual SOEs and some categories of SOEs have improved, half of the surveyed countries still lag behind when it comes to aggregate reporting on a whole-of-government basis. The autonomy of corporate boards and executive managers is also considered a common weak point. Policy makers could consider following issues in order to enhance accountability and transparency in the SOE sector.

### **Centralization of the Ownership Function**

International good practices hold that a centralization of the ownership function can be a useful tool for, and strong driver in, the development of aggregate reporting on SOEs. Centralization of the ownership function can help strengthen and mobilize relevant competencies as it necessitates creating pools of experts on key policy issues, such as board appointment and nomination or financial reporting.

### **Clarification of SOEs' Financial and Nonfinancial Performance Objectives**

Governments should set clear financial and nonfinancial performance targets for all state-owned companies through a state ownership entity or coordination unit in consultation with responsible line ministries and agencies. Objectives could be defined based on a classification of SOEs according to the nature of their main function – whether they aim at achieving a public policy function, a commercial function, or a combination of both. A comprehensive monitoring and performance evaluation mechanism should be implemented to define and follow up these company-specific performance objectives.

### **Good Practices for Aggregate Reporting**

Governments can ameliorate the quality of financial and nonfinancial reporting by SOEs through annual publication of an aggregate report covering all SOEs. In addition, good practice calls for the introduction of web-based communications to ease access for the general public. This reporting system could be developed in such a way as to provide the general public and the media with a comprehensive picture of the overall financial performance and evolution of the SOEs, including turnover, profit, cash flow from operating activities, dividends and changes in SOE boards, gross investment, equity/asset ratio, and return on equity.

### **Robust and Comprehensive Audit System**

Often, the credibility and quality of SOE corporate reporting is affected by the lack of comprehensive internal control systems, which are important for effectively monitoring compliance with regulations and laws, and reporting any irregularities or discrepancies to the board of directors. Sometimes, SOEs' financial statements are not subject to an independent external audit, which is another essential tool for the detection of irregular transactions. Only a few place importance on the role of the audit committee and the board of directors in approving related party transactions to prevent the abusive nature of such transactions. Moreover, when SOEs are subject to various audits, including state audits and external audits, respective roles of these audits are not always clearly delineated, and in some cases duplicate each other. The establishment of a robust audit system may necessitate a review and appraisal of the respective focus and roles of

internal, state, and external audits for SOEs, as well as the degree of corporatization of SOEs and their independence from the general government. Recurrent related party transactions may also be taken to the shareholders for approval.

### **Professionalizing Boards of Directors of SOEs**

The nomination and appointment framework should be rule based and overseen by a state function on a whole-of-government basis. This could involve various efforts, such as seeking expertise from external recruitment consultants, creating databases for pools of directors, and involving the incumbent board. The recruitment of competent and suitable board members should be based on formal eligibility rules and publicly advertised. This could include establishing formal processes to advise or validate ministerial candidates for appointment to the board or actual or de facto nomination committees proposing candidates for final ministerial decision. Strengthening requirements for the independence of outside directors and ameliorating public disclosure related to board nomination and election processes could be useful. In addition, requiring disclosure of information on the identity and the number of board candidates, and/or requiring disclosure of voting percentage results at the AGM, may improve the transparency of board practices.

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