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POSITION NOTE

On the transparency and disclosure of information on the economic activity of state-owned enterprises and trading companies from the Republic of Moldova

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Topicality of the Addressed Subject

The results of the state-owned enterprises and trading companies with the State participation from the Republic of Moldova show some gaps in transparency and implicitly highlight the need to strengthen the efforts in order to remove the misalignments that limit the public's access to information on the performance of these entities¹. Besides, these deficiencies are caused by gaps in the general regulatory framework (even the optional one) and by the lack of effective mechanisms needed to raise awareness among all stakeholders involved in the external reporting of information, aiming at strengthening the managerial discipline and making the public property management more efficient².

Despite the efforts made by the Government to privatize the public property, it still has an important share in many sectors of the national economy. Thus, the management, control and reporting of economic entities with State participation are very important, including in the light of certain sustainable practices of corporate governance. Simultaneously, a range of international organisations, such as OECD, World Bank, IMF highlight how important it is to ensure transparency of their activity for the general public, especially, given the more intense debates about public debt, corruption, conflict of interests, underground economy and tax burden. For instance, OECD Guidelines on Corporate Governance of State-Owned Enterprises clearly show that the lack of transparency may indicate the existence of some gaps related not only to the management of the economic entities in question, but also to the State's failure to manage efficiently the available resources.

In addition, the management of economic entities with State participation face many challenges that have an implicit impact on the transparency due to their close relationship with the executive/legislative power and policy makers (sometimes even political affiliation). Simultaneously, the relation may be deemed as a major risk for an effective corporate governance, which, *inter alia* might materialise in the following directions:

- Commitments and liability resulting from this interference create a favourable environment for corruption;
- In certain circumstances, the apriori favourable posture of economic entities with State participation may distort the market due to unfair competition or different conflicts of interests;
- The probability that other state-owned economic entities or bodies could act as both clients and suppliers creates a potential risk for a correct public procurement;
- A "relaxed" attitude from the part of bodies in charge of control towards actions undertaken to verify compliance with the legislation;
- The special status of economic entities with State participation in relation to the private sector implies an increased protection against certain major risks, even in the context of a deficient management;

¹ Conclusions and proposals included in the "Report on property management and privatization of public assets in 2015," Public Property Agency.

² The Audit report on implementation of tasks and activities by the Ministry of Finance in the process of financial monitoring of state-owned enterprises and trading companies with whole or partial participation of the State, approved by the Court of Accounts Decision No 3 of 25 February 2016.

- Last, but not least, if the society does not exercise any pressures on the management of these entities, “protected” by the State, the motivation to use efficiently the public financial flows could be undermined.

These risks are more visible especially when people have the feeling that the public property does not work as it should work or that it is not managed properly. Besides, the non-transparent management of public property makes nothing else than confirm these hypothesis, which could cause systemic problems at all levels.

Therefore, the transparency and disclosure of information about the economic activity of these entities are vital for an efficient management of public property, in accordance with the best corporate governance practices. Moreover, an effective system of transmission and dissemination of information in a quick and reliable manner to the general public may help not only ensure the integrity and efficiency of public property, but can also serve as a means to increase the credibility in authorities and their overall activity.

Which Gaps Exist in the Transparency of Economic Entities with State Participation in the Republic of Moldova?

Improving the reporting of state-owned enterprises and trading companies with State participation and disclosing information to the general public are often significant challenges, bigger than those encountered by their counterparts from the private sector of the Republic of Moldova. This is why, we are aware that certain publicly owned entities cannot be forced to disclose information to the public for some objective reasons or their low economic importance does not justify the administrative effort to ensure transparency. Nonetheless, as the management of these entities lack the will and the specialised authorities lack the tools to raise awareness, coupled with the low capacities to prepare or submit information in a proper manner, cause a fragmented and incomplete external communication.

Note that the state-owned economic entities have different ways of financial and non-financial reporting that can be measured by a large number of dimensions, including through the lens of completeness, accuracy, topicality and relevance. Despite this, and due to the optional regulatory framework, the public information on performance of state-owned economic entities is incomplete and its disclosure takes so much time that it loses its practical relevance. At the same time, the State’s efforts to manage efficiently the public property through the lens of corporate governance, especially through the perspective of implementing a certain degree of transparency in the field have not been sufficient so far:

- One of the main mechanisms of permanent supervision of the performances of state-owned economic entities, aiming to ensure transparency, is in the hands of the Ministry of Finance, which, in accordance with Government Decision No 875 of 21.10.2014, performs the financial monitoring of state-owned enterprises and trading companies with entire or majority State participation.

However, we draw attention to the fact that this tool has certain gaps, and the biggest one identified by the audit³, relates to the general provisions of the Regulation, which do not establish exhaustively the responsibilities of stakeholders at all stages of the monitoring. This leads to the failure to submit comprehensive and relevant information on the economic and financial results obtained by entities with entire or majority State participation, which doesn't give the whole picture of the actual situation in the public field, subordinated to financial monitoring.

At the same time, taking into account that the Regulation covers exclusively the "companies with entire or majority State participation", the Ministry of Finance does not have any regulatory support to monitor the entities with a State participation under 50%, which does not ensure the whole picture of the efficiency of public property management.

Last, but not the least, according to the same regulatory act, the Ministry of Finance must publish the results of the financial monitoring on its official website. However, these provisions are not fully observed, the delayed and incomplete publishing of information continues to be a common thing (the last report on the website is dated 2014⁴). In addition, the aggregated result of the financial monitoring can be found in the draft State Budget Law and in the Report on State Budget Execution (these documents are made public).

- More information on this can be found in the Report on Management and Privatization of State-Owned Public Assets, developed by the Public Property Agency, which is unfortunately not made public. This report contains data on the economic and financial results of the state-owned enterprises and joint-stock companies with a State participation over 25%.

At the same time, in order to ensure wide access to information on the results of the economic and financial activity of enterprises with a State participation over 25%, the annexes to the Report are published on the Open Data Portal of the Government www.date.gov.md.

Even in this context, the limited public data do not reflect clearly the economic activities performed by these entities and do not allow to compare their performances against the established objectives (which do not exist). Besides, the information is submitted in a format that is not friendly to the general public and does not allow monitoring trends in time.

- We cannot overlook the intentions to align the regulatory framework on corporate governance in joint stock companies from the Republic of Moldova to the international standards of corporate governance, under the National Action Plan for the Implementation of the RM-EU Association Agreement 2014-2016, approved by Government Decision No 808 of 07.10.2014.

Thus, the new Corporate Governance Code, approved by NCFM Decision No 67/10 of 24.12.2015, is based on the international practice of corporate governance, especially on the OECD Principles of Corporate Governance. Moreover, the joint stock companies (including those of public interest, except for state-owned enterprises) are encouraged to adopt and to align to the provisions of the new Code.

³ Court of Accounts Decision No 3 of 25 February 2016

⁴ <http://mf.gov.md/files/files/Arhiva/plasare%20monitoring%202014.doc>

Even though this document offers a broader range of provisions on disclosure of information, its optional character will not generate any obvious effects in terms of transparency of the public property management.

- The latest initiative that contains transparency provisions and is similar to the features of the new Corporate Governance Code introduced amendments to Law No 146-XIII of 16.06.94 on State-Owned Enterprises to ensure the disclosure of information on their economic and financial activity.

Thus, these entities should develop and publish reports that will contain annual financial statements, including the salaries of the members of administration, management and supervision bodies, the activity report of the management, an accurate and complete description of the enterprise's development and its economic and financial performances, as well as a description of the main risks. Besides, the enterprise will publish the audit report in full, together with its annual report.

Though it seems that the new legal framework (since 2016) requires high transparency from state-owned enterprises, including to publish reports until 30 May and keep them for at least a three-year period on their website, including on the website of the public authority they are subordinated to, such data haven't been made public so far.

Moreover, note that the new requirements relate exclusively to the state-owned enterprises that meet certain criteria (fulfil two of the following three criteria: share capital - MDL 500.0 thousand; total income - MDL 10000.0 thousand; average number of employees - 100 persons), which narrows the scope of the legal provisions⁵. Thus, basically only 80 entities are obliged to comply with the new requirements⁶, which accounts for only 30% of the total number of existing state-owned enterprises. This does not allow building a full picture about the performance of the entire sector.

- Compared to the "disclosure" of financial information mentioned above, the disclosure of non-financial information does not exist at all among economic entities with State participation. Such information, as the objectives or the mandate of these entities, social or political commitments, any exclusive privileges or powers that the state enjoys as owner, who are members of the Administrative Boards, their relationships with other entities of the State, risks they encounter and how they are managed, practically cannot be found anywhere. But, as mentioned in the OECD guidelines, such a disclosure, oftentimes of qualitative nature, can inform stakeholders about key visions related to the operation of public property and its prospects, as well as its relationship with the State and third parties.

Taking into account the above-mentioned, we could conclude that there is no system at present to disseminate the information on how the public property is managed, there are rather some attempts to comply with certain legal requirements. On the other hand, this situation can be explained by the lack of an

⁵ It is commendable that these criteria have been excluded from the new edition of the draft Law on State-Owned Enterprise and Municipal Enterprise, which could substantially extend the regulations on transparency of these entities, provided that these provisions are observed.

⁶ Report of the Committee for Economy, Budget and Finance on the draft law amending and supplementing the Law on State-Owned Enterprises.

exhaustive and mandatory legal framework, and of some processes that would form an attitude or change the managerial culture in the public sector, as well as of methodological rules (Guidelines of external communication and standard reporting formats) adjusted to the legal, cultural and economic framework from the Republic of Moldova. Though, the main obstacle is the reluctance of the management of the state-owned economic entities and their administrators to disclose information and willingness to maintain a “convenient” status-quo when it comes to transparency.

What Are the International Recommendations and Best Practices?

In order to support initiatives aiming at making the management of the public property more efficient, OECD published in 2005 (with some amendments in 2015) a complete set of recommendations on corporate governance of state-owned enterprises⁷, which also contain the fundamental principles of transparency. These recommendations go beyond the information requirements and present a range of specific proposals that promote the mandatory or voluntary publishing (depending on the national legislation) of the following information:

- A clear statement to the public of enterprise objectives and their fulfilment;
- Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives;
- The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes;
- The remuneration of board members and key executives;
- Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board;
- Any material foreseeable risk factors and measures taken to manage such risks;
- Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships;
- Any material transactions with the state and other related entities;
- Any relevant issues relating to employees and other stakeholders.

In addition, to ensure compliance with high standards of transparency, it would be appropriate to develop guidelines of external communication that would include standard reporting formats for entities with State participation, which would facilitate the dissemination of information to the general public. Also, OECD suggests that authorities should develop a web platform to centralise the information submitted by entities and then make them available to the public.

Despite all recommendations regarding transparency, given by different international organisation, especially by OECD, their volunteer character resulted in adopting some rules that differ from state to state as regards the field and the extent of application of regulations on access to information and proactive or passive disclosure of it. Moreover, as revealed by practice, the existence of appropriate

⁷ OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015

regulations does not necessarily guarantee their efficient implementation. Nonetheless, there are pioneers in the field, whose experience is worthy of being followed, such as:

- **Sweden**

In 2007, the Swedish Government readopted the Guidelines for External Reporting by State-Owned Companies⁸, which contain the reporting requirements and standard formats for the financial and non-financial information. These requirements include the annual report, intermediary reports, corporate governance report, statement on the internal control and sustainability report. This reporting presents a complete description of the economic activities of state-owned companies and offer an efficient platform to track and assess continuously the efforts made to achieve the set objectives.

Note that this document is based on the principle “comply or explain”, which implies that a company may avoid these requirements only when it justifies clearly the reason of these deviations. Moreover, this principle allows applying the document in all state-owned companies, regardless of their size or area of work, without affecting too much the internal reporting processes.

- **South Korea**

In 2005, the Korean Government launched an important initiative aiming at making the activity of the country's state-owned enterprises transparent and informing the population in real time about the country's state-owned enterprises. In order to comply with the new requirements, the Korean state-owned enterprises must submit regularly financial and non-financial information in 39 standardized categories (with new categories being constantly added).

Note that the information is submitted and collected via a consolidated system, in the form of a web platform⁹, which is managed and administered by the Government. This digital tool with an intuitive interface provides useful information for the civil society, academia, business associations and other entities from outside the Government.

Final Conclusions and Recommendations

It is incontestable the fact that the lack of transparency involves a high risk of corruption, and a deficient information can undermine the confidence of the public opinion in authorities and can lead to inactions or lack of initiatives in the field. Even so, the major task for authorities and economic entities managed by them will be to accept and be aware of some challenges in the public sector, which stem from the lack of transparency and integrity.

Though the Government's efforts to ensure transparency are welcome, especially when it comes to improve the legal framework, their general and discretionary character do not ensure the sustainability of these initiatives, and the tool used to make all stakeholders responsible for the management of property stays unexploited.

Therefore, the civil society also must support the necessary efforts to change the governance principles in the Republic of Moldova, which result from different international recommendations (OECD, WB, IMF

⁸ Guidelines for external reporting by state-owned companies, 2007

⁹ <http://www.alio.go.kr/>

etc.) and the best practices, aiming at implementing a range of actions that would ensure the sustainability of reforms on the transparency of state-owned enterprises and trading companies and reconfiguration of public perception, such as:

- Examine the existing regulatory requirements for transparency and disclosure of information, reviewing both elements subject to transparency and enforcement mechanism of these requirements;
- Align the existing requirements from the legal framework with the OECD recommendations and principles of corporate governance;
- Clarify the responsibilities and obligations of all stakeholders involved into the process of ensuring transparency and disclosing information;
- Include a mechanism to sanction entities and their managers for failing to observe the legal requirements for reporting and ensuring transparency.
- Make the regulatory framework on transparency and disclosure of information mandatory for economic entities with State participation;
- Draft specific methodological documents (Guidelines of external communication - similar to the Swedish model) aiming at complementing the regulatory framework, encouraging the economic entities' efforts of external reporting of performances recorded in a standard format;
- Ensure an active communication between the authorities and economic entities in order to fully understand the reporting obligations and rationale that serves as basis for such disclosure. This communication could target both economic entities in question and the general public and mass-media.
- Support the economic entities with State participation in their efforts to adjust to the transparency and reporting requirements. Thus, taking into account their low capacities, the most recommended action would be to create a web platform (similar to South Korea model) that would inform the general public about the results of public property management, which would cover all the information reported by the entities in question.

Changing thinking and implicitly the attitude of all stakeholders in the field to meet the transparency requirements and understand the positive results deriving from them is certainly a very slow process, which is mostly resisted by them, even if some efforts were made in this respect. However, we must be aware that the new way of thinking is difficult to be integrated in the public field as long as in the society the loyalty and corruption concepts still play an important role and their existence undermines the achievement of a successful change in the corporate culture.