Owner supervision in public undertakings and foundations

Audit report No. OSIV-2-1.4/07/4 of 5 April 2007

Summary

The purpose of the audit was to answer the question of whether owner and founder supervision in public undertakings and established foundations is organised purposefully and in a functional manner. The audit covered regulations, Ministers' activity in administration of holdings and exercising the rights of founders, as well as supervisory operations of the supervisory boards of companies and foundations. Audited authorities were the Ministry of Economic Affairs and Communications, Ministry of Agriculture and the Ministry of Finance.

At the end of 2005, the state participated in 50 companies. Total value of holdings was EEK 22 billion, which formed 16 % of monetarily appraisable state assets. EEK 852 million accrued to the state budget as dividends. At the end of 2005, the state exercised the right of a founder in 64 foundations. Last year, the volume of assets of state-established foundations amounted to EEK 5.7 billion.

The National Audit Office remains unsure whether the direction and supervision of public undertakings and established foundations is organised purposefully and in a functional manner. To decrease the risk of public undertakings experiencing what happened to AS Werol Tehased and AS Eesti Viljasalv, the functioning of the Minister-Supervisory Board management chain should be ensured, state holding policy with main goals unambiguously defined and supervisory duties of the Minister and Supervisory Board specified.

Main observations

Exists no single, agreed and disclosed holding policy. At the moment it remains unclear why the state participates in companies and what are its goals as an owner, i.e. how participation in companies is related to the public interest and strategic goals of the state. Everything related to state-established foundations is unclear as well: there are no known public mores why the state establishes foundations and what particular goals the established foundations should meet. Therefore, there is a danger of companies and foundations not pursuing the interests of the state as the owner and founder in their activity.

Ministers' activities in directing and supervising public undertakings and foundations are not transparent. Ministers' guidelines for the members of the Supervisory Board in relation to the management of the activity of a company or foundation and carrying out supervision over the activities of the Management Board are in most cases not given in writing. Generally, ministries communicate the viewpoints of the owner and founder directly to the Management Board, as opposed to the Supervisory Board via the Minister.

The role of the members of the Supervisory Board appointed by the Minister of Finance in companies is not clear. Sole responsibility for the prudent management of state companies belongs to the Minister engaged in the administration of holding. Thus, the role of the Minister of Finance and members of the Supervisory Board appointed by him in the immediate direction and supervision of state companies remains unclear. The NAO is of the opinion that it should be the supervision and guidance of the functioning of financial and internal control systems of state companies.

Minister's opportunities in supervising the subsidiary undertakings of state companies are limited. Participation in Legal Persons in Private Law by the State Act does not extend to the subsidiary undertakings of state companies, so the Minister administering the holding of parent undertaking and Supervisory Board appointed by him do not possess immediate opportunity to supervise the activities of the subsidiary undertaking. Supervisory Board's supervision over Management Board is uneven. State as the owner of companies and founder of foundations has failed to clearly establish the supervisory duties of the Supervisory Board as well as requirements for their implementation. Also, members of the Supervisory Board change often which is why the supervision carried out by supervisory boards is uneven: generally, systematic supervision is not carried out and supervisory co-operation with external and internal auditors remains on a minimum level. Generally, Supervisory Boards do not submit written periodic overviews on the content and scope of supervision performed over the Management Board to the governing Minister who is exercising the rights of a founder.

The requirement of establishing audit committees has not justified itself. European Union regulations do not require Estonia to establish an audit committee. The NAO does not consider it right that the content of the supervision of the Supervisory Board is disclosed as duties of the audit committee. This has lead to a situation where the audit committee duplicates the Supervisory Board in supervision and therefore the generated added value is small. The audit revealed that in most cases, audit committees have failed to meet the duty imposed on them to act as an adviser to the Supervisory Board upon performing supervision. Audit committees had submitted written recommendations and assessments on supervision only in a few cases. In several cases, the audit committee did not actually meet, or it was done with a great delay.

Recommendation to the Minister of Finance

- Initiate a draft Act to amend the Participation in Legal Persons in Private Law by the State Act, which would
  - establish the cases and conditions for the state to participate in companies and establish foundations;
  - establish the duties of the governing Minister and executer of the right of a founder as well as criteria for the management of holdings and assessment of the execution of the right of a founder;
  - impose a duty on the Minister of Finance to to appoint at least one financial specialist as a member of the Supervisory Board;
  - expand the rules on public undertakings in a way that the principles of the management of subsidiary undertakings of state companies would be approved in the general meeting of the parent undertaking;
  - establish the duties of the Supervisory Board in performing supervision and provide the Minister of Finance with provision delegating authority to specify said duties;
  - establish the duty of the Supervisory Board to submit a written overview of the performed supervision to the owner or founder along with the annual report;
  - establish the duty of the Minister of Finance to give an overview of the main problems in supervision in the annual consolidate report to the Government on state holding in legal persons in private law;
  - make the establishment of an audit committee voluntary.

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In their reply the Minister Economic Affairs and Communications and Minister of Agriculture generally concurred with the NAO's recommendations.

The Minister of Finance remained of the different opinion regarding several recommendations. Although the audit identified serious shortcomings in the organisation of supervision of state companies and foundations, the Minister of the Finance is mostly of the opinion that owner supervision of state companies and foundations is sufficiently regulated and there is no need to supplement said regulations. The Minister of Finance did not give out specific promises on the implementation of measures but he agreed to consider, and if possible, take into account, the recommendations of the NAO upon developing a new State Assets Act.

In several questions of principle the NAO remains of the different opinion than the Minister of Finance. Above all, the NAO does not agree with the Minister in the following:

- the state should not have a single, agreed and disclosed holding policy, which would clearly establish state interests in participating in companies and foundations;
- there is no need to specify the obligations and duties of the Minister of Finance as well as other ministers accompanying the administration of state holdings and execution of the right of a founder
- the law unambiguously establishes the duties of the members of the Supervisory Board and the state does not have to clearly express the requirements the activities of the member of the Supervisory Board representing the state in a company or foundation should comply with.

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