analytical
review

Corporate Governance of State-Owned Companies in the Context of Cooperation with the IMF and other Development Partners

Institute of Analytics and Advocacy

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During the last 7 years, the Ukrainian authorities have been trying to implement the reform of corporate governance of state-owned companies. After the start of the full-scale russian invasion, structural changes are temporarily of less priority, instead, the main task of the authorities is to ensure the functioning of the main life systems of the country and its population.

At the same time, the International Ukraine Recovery Conference in Lugano demonstrated that one of the priorities on the way to the recovery of Ukraine is also the improvement of corporate governance.

In this material, we highlighted Ukraine's commitments to the IMF regarding the corporate governance of state-owned companies, determined the level of their implementation, and outlined the main forecasting trends in this area, which could theoretically become the basis for future development, in particular, the basis for potential programs with the IMF.

Particular attention was paid to the issue of compliance of the Ukrainian system of corporate governance of state-owned companies with the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

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Methodological caveats:

- the analytical review covers the analysis of programs with the IMF for the period from 2015 to 2022;
- the focus of the analytical review does not cover:
  - commitments regarding corporate governance of state-owned banks;
  - issues of privatization of state-owned enterprises and management of fiscal risks.

Abbreviations:

VRU	Verkhovna Rada of Ukraine
SOC	State-Owned Company
SOE	State-Owned Enterprise
EBRD	European Bank for Reconstruction and Development
EC	European Comission
EU	European Union
CMU	Cabinet of Ministers of Ukraine
IMF	International Monetary Fund
MGU	Main gas pipelines of Ukraine
IFRS	International Financial Reporting Standards
IFI	International Financial Institutions
GTSOU	Gas Transmission System Operator of Ukraine
OECD	The Organisation for Economic Co-operation and Development
SB	Structural Benchmark
KSE	Kyiv School of Economics

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1. Ukraine's Commitments to the IMF regarding the Corporate Governance of SOC

1.1. Extended Fund Facility, 2015

General Information about the Program

Timing	Agreed Amount, billion SDR	Amount Received, billion SDR	Number of Tranches
11.03.2015 – 17.12.2018	**12,3** *about US$17.5 billion*	**6,2** *about US$8.7 billion*	**4**

Ukraine's Commitments to the IMF and their Assessment by the Fund Staff

Staff Report	In the Staff Report dated February 27, 2015, it is noted that the authorities have taken the first steps to improve the operational efficiency of the SOE. In particular, a concept paper on comprehensive reform of state enterprises was developed; new guiding principles of transparency and accountability for SOEs have been prepared; recommendations were prepared to improve the procedure for approving financial plans, and an action plan was developed to conduct an audit of the 50 largest SOEs. To improve corporate governance, the authorities changed the procedure for appointing Heads of key SOEs and elected members of an independent selection committee. At the same time, the Fund experts noted that the mechanisms for owning and managing state assets are very decentralized, fragmented and characterized by numerous conflicting functions and responsibilities at different levels of government. The report notes that in order to improve the efficiency of SOEs and reduce fiscal risks, the authorities are working on a broad sector reform strategy. It is also expected that efforts will be made to improve corporate governance standards at individual enterprises by adopting international standards and conducting fiscal risks.

Memorandum dated February 27, 2015	In the Memorandum dated February 27, 2015, the Ukrainian side identified the following commitments: ▪ financial recovery of NJSC Naftogaz of Ukraine. A significant restructuring of the company was envisaged in order to strengthen corporate governance and increase operational efficiency; ▪ reforming state-owned energy companies. With the help of the EBRD, it was planned to improve the shareholding of key state owned companies (not limited to them): NPC Ukrenergo, SE NNEGC Energoatom, NJSC Naftogaz of Ukraine and its subsidiaries - by introducing advanced international standards and practices based on the OECD Guidelines into their corporate management.			
Structural Benchmarks	While consulting with IMF and World Bank experts, the Government: ▪ will adopt a strategy for reforming the state-owned enterprises sector in accordance with par. 36 of the Memorandum, providing for the measures necessary to strengthen budgetary supervision, develop a comprehensive policy on ownership, and improve corporate governance; ▪ will identify the priority enterprises that should be subjected to restructuring; ▪ will analyze options for improving the management of other state assets.	**Responsible Executive**	**Timing**	**Implementation Status**
		Unknown	End of May 2015	**Implemented** * the status of implementation is determined in accordance with the information specified in the Memorandum dated July 21, 2015

Staff Report	According to the result of the first review of the program, the representatives of the Fund noted in the Staff Report dated July 22, 2015 that since the adoption of the program, the authorities have made progress in implementing structural reforms. The following measures were implemented regarding the reform of the State Enterprises: ▪ the first annual report on the 100 largest state-owned enterprises of Ukraine was published; ▪ a strategy for reforming state enterprises was adopted; ▪ a draft law on corporate governance was prepared and a new procedure for appointing heads of state-owned enterprises through an independent committee was introduced. At the same time, the Report also points out shortcomings in the field of corporate governance of SOEs. According to the Fund experts, serious problems of inefficiency in the sector are rooted in weak corporate governance systems. Ukrainian SOEs, as a rule, do not have proper corporate governance structures aimed at increasing operational efficiency, such as Supervisory Boards or independent Executive Directors. Due to this, the appointment of SOE management lacks transparency and accountability, which leads to unpreparedness of the owners. In addition, the financial statements of state-owned enterprises are considered unreliable, as most of them are not subject to independent audit. The legislative framework for state-owned enterprises in Ukraine also has significant shortcomings, and cumbersome and fragmented legislation contributes to governance gaps.
Memorandum dated July 21, 2015	In the next Memorandum dated July 21, 2015, the Ukrainian side, to a greater extent, notes the measures already implemented in the field of corporate governance. It was also expected to continue to implement the previously approved strategy of reforming the state-owned enterprises. This includes actions necessary to: ▪ implement a comprehensive policy of the owner and ensure a clear division of the functions of the owner and the regulator; ▪ strengthen the corporate governance, in particular through the adoption of a new law on corporate governance. In addition, it is necessary to review changes to the remuneration policy of state-owned enterprises to better align the interests of shareholders and management. In view of this, the Ukrainian side declares its desire to strengthen the legislative framework in order to increase transparency and improve corporate governance through the creation of Supervisory Boards at unitary enterprises.

Structural Benchmarks	The Memorandum dated July 21, 2015 contains no structural benchmarks regarding the corporate governance of SOEs.
Staff Report	In the Staff Report dated September 2, 2016, significant attention was paid to Naftogaz. To promote transparency and good governance at Naftogaz, the results of an independent audit of accounts receivable were published in September 2015, and a comprehensive corporate governance action plan was developed with the assistance of the EBRD. A new Naftogaz Supervisory Board with independent members was appointed. The Fund experts note that the creation of a Supervisory Board to reform corporate governance at Naftogaz will contribute to the further promotion of transparency and good governance. The IMF representatives also noted that efforts aimed at accelerating SOE reform include the creation of a single national holding company with an effective management system, which is expected to manage strategic commercial SOEs.
Memorandum dated September 01, 2016	In the next Memorandum dated September 1, 2016, the Ukrainian side largely notes the measures already taken in the field of corporate governance. Specific short-term measures that have been implemented and are still planned for implementation include the following: ▪ the Law of Ukraine "On Amendments to Certain Legislative Acts of Ukraine on the Corporate Governance of State Owned Objects" was adopted, which introduces amendments to the Law of Ukraine "On the Management of State-Owned Objects", aimed at strengthening the structure of corporate governance of state-owned enterprises and the transparency of their activities. By the end of September 2016, the CMU will adopt a decision that will regulate the processes of creating Supervisory Boards, selecting their members, and other procedural issues. Following this, it is planned to appoint independent Supervisory Boards in at least five large state-owned enterprises by the end of October 2016 and in another 10 large state-owned enterprises by the end of December 2016. The first audit reports of these enterprises based on financial statements as of the end of 2015 will be completed by the end of October 2016; ▪ an independent Supervisory Board of NJSC Naftogaz of Ukraine was appointed, consisting of five members, three of whom are independent, and two of whom are appointed at the request of the President and the CMU, which is consistent with the Corporate Governance Action Plan; ▪ the CMU adopted a resolution that introduces criteria for selecting auditors for state-owned enterprises depending on the size of these enterprises. It is planned to complete the audit reports of 20 large state-

	owned enterprises and to publish these reports in accordance with the order by the end of October 2016, and for at least 30 other large state owned enterprises by the end of December 2016. ▪ the Ministry of Economic Development and Trade, in consultation with three IMF specialists, will, by the end of September 2016, develop an action plan with deadlines for their implementation, which will outline: ▪ the corporate governance structure of the single national holding company, whose task will be the management of strategic commercial state-owned enterprises, in particular the procedure for appointing Supervisory Boards, managers and executive boards, the powers of management bodies, as well as the procedure and requirements for subordination; ▪ the steps required to establish a Holding Company, including the necessary legal framework and timetable. In the future, it is planned to continue moving forward towards the implementation of the strategy of reforming state owned enterprises. The main elements of the strategy, in particular, include strengthening the corporate governance of state-owned enterprises.
Structural Benchmarks	The Memorandum dated September 01, 2016 contains no structural benchmarks regarding the corporate governance of SOEs.
Staff Report	In the Staff Report dated March 7, 2017, it is noted that the EBRD, together with the EU, the World Bank, the IMF and the EIB, have been actively participating in a joint political dialogue with the Ukrainian authorities for several years in a row with the aim of providing technical and financial assistance for the reform and restructuring of the gas sector. The key goals of the transition period of the joint action plan of the IFI in the energy sector include the restructuring of NJSC Naftogaz of Ukraine in accordance with EU Directive 2003/55/EC, in particular through the Corporate Governance Action Plan, which provides for the creation of a Board of Directors with a majority of independent Directors, separation of the NJSC gas sector through effective separation of transportation activities from activities not related to transportation and ensuring the independence of the gas transportation network operator.
Memorandum dated March 02, 2017	In the next Memorandum dated March 2, 2017, the Ukrainian side notes that after the adoption of the law on corporate governance of state owned enterprises, the CMU will adopt a decision regulating the creation of Supervisory Boards by the end of March 2017. It is planned to complete the appointment of independent Supervisory Boards in the 15 largest-state owned enterprises by the end of June 2017. It is also expected that by the end of June 2017, the audit reports of the largest SOEs, prepared by auditors with

	a good reputation and selected on the basis of the CMU resolution regarding the criteria for selecting SOE auditors, will be completed. In addition, the Ukrainian side notes in the Memorandum that it will continue to study the options for creating a single national holding company, whose task will be to manage strategic commercial SOEs.
Structural Benchmarks	The Memorandum dated Mach 03, 2017 contains no structural benchmarks regarding the corporate governance of SOEs.

We note that within the framework of the program, certain commitments were transferred from one Memorandum to another. For example, it was assumed that the Cabinet of Ministers would make a decision regulating the creation of Supervisory Boards, first by the end of September 2016, and then by the end of March 2017. In addition, in the Memorandum dated September 1, 2016, it was planned that the Ukrainian side would develop the necessary steps to create a single national holding company, whose task will be the management of strategic commercial state-owned enterprises. However, based on the content of the 2017 Memorandum, the Ukrainian authorities were unable to develop the necessary algorithm, so it is noted that the options for creating a holding company will continue to be identified.

Within the framework of program implementation, the Fund experts have repeatedly pointed out shortcomings in the area of corporate governance of state-owned companies. In particular, in their opinion, serious problems of inefficiency in the sector are rooted in weak corporate governance systems, therefore, the Strategy for Improving the Efficiency of Business Entities of the Public Sector of the Economy (hereinafter referred to as the Strategy) and its Implementation Plan became an important document adopted during the implementation of the specified program. The strategy defines the main issues that must be resolved by the Cabinet of Ministers in order to carry out the reform on the management of state property. The main goal of the reform is to increase the efficiency of business entities of the state sector of the economy, which will be achieved by improving the corporate management of business entities.

The program also provided for the introduction of advanced international standards and practices based on OECD principles into the corporate governance of key state-owned companies.

In the Staff Report prepared in December 2018, the Fund experts stated that the EFF 2015 program was aimed to help Ukraine transform the economy, a key goal of the authorities after the Revolution of Dignity on the Maidan. Despite some initial success in advancing reforms in the energy and banking sectors, as well as in establishing anti-corruption institutions, reforms increasingly encountered resistance (e.g., anti-corruption, restructuring of state-owned enterprises, land reform), causing delays in the completion of reviews. Within the framework of the EFF 2015 program, only three revisions were completed, instead of the originally planned 15. Since the EFF 2015 program ended in March 2019, the Fund experts stated that there was not enough time left to achieve the goals of this program.

1.2. Stand-By Arrangement, 2018

General Information about the Program

Timing	Agreed Amount, billionSDR	Amount Received, billionSDR	Number of Tranches
18.12.2018–17.02.2020	**2,8** *about US$3.9 billion*	**1** *about US$1.4 billion*	**1**

Ukraine's Obligations to the IMF and their Assessment by the Fund Staff

Staff Report	In the Staff Report dated December 7, 2018, it is noted that the management of Ukrainian SOEs should continue to improve. The Fund experts also state that after the appointment of new independent Supervisory Boards with a majority in the state-owned companies Naftogaz, Ukrzaliznytsia and Ukrenergo, the process of selecting independent Supervisory Boards for some other large state-owned enterprises, including Boryspil Airport and Ukrposhta, is in the final stage. In order to clarify and strengthen the powers of these newly appointed Supervisory Boards, as well as to provide legal immunity and indemnity to their members, the Ukrainian authorities will seek the parliamentary approval of the law on the governance of state-owned enterprises by the parliament. It is also assumed that the external audit of the largest state-owned enterprises will be conducted by reputable international companies.

Memorandum dated December 05, 2018	In the Memorandum dated December 5, 2018, the Ukrainian side declares its expectation that the Verkhovna Rada by the end of June 2019 will adopt the law on the governance of state owned enterprises (draft law No. 6428), which will define and strengthen the powers of Supervisory Boards, provide legal immunity and insurance against losses to members of such boards. In addition, it is expected that the selection of supervisory boards with a majority of independent members for the largest SOEs, including such enterprises as Ukrenergo, Boryspil and Ukrposhta, will be completed by the end of December 2018. External audits of the largest SOEs, prepared by international reputable companies, will be conducted by the end of December 2019.
Structural Benchmarks	The Memorandum dated December 05, 2018 contains no structural benchmarks regarding the corporate governance of SOEs.

The first review of the program implementation took place in May 2019. As a result, the IMF mission did not approve it and noted that the discussion would continue after the parliamentary elections, but in fact, even before the end of the program in September 2019, the Ukrainian side initiated the discussion of a new one.

We assume that the lack of successful revisions within the program affected the small number of commitments compared to the 2015 and 2020 programs. Therefore, the Memorandum under the program was not updated; accordingly, structural benchmarks regarding corporate governance within the specified program are generally absent.

We note that certain commitments within the program have not been fulfilled. For example, draft law No. 6428, which was defined in the Memorandum and the adoption of which was expected by the Government, has not been adopted as of March 2023.

1.3. Stand-By Arrangement, 2020

General Information about the Program

Timing	Agreed Amount, billion SDR	Amount received, billion SDR	Number of Tranches
June 9, 2020– June 30,2022	**3,6** *about US$5 billion*	**2** *about US$2.8 billion*	**2**

Ukraine's Obligations to the IMF and their Assessment by the Fund Staff

<table>
<tr><td>Staff Report</td><td colspan="4">The Staff Report dated June 2, 2020 states that recent changes to Naftogaz's charter have undermined the corporate governance reform, therefore the Ukrainian authorities should adopt a new Naftogaz corporate charter to align it with OECD recommendations.</td></tr>
<tr><td>Memorandum dated July 2, 2020</td><td colspan="4">In the Memorandum dated June 2, 2020, the Ukrainian side promises to continue to strengthen the corporate governance of the SOE:
▪ revising corporate governance structures for SOEs with the assistance of the OECD and the EBRD to align them with the OECD Guidelines;
▪ adopting the draft law on corporate governance of SOEs to expand the powers of supervisory boards to appoint managers and approve financial plans;
▪ adopting a general policy on state property.</td></tr>
<tr><td rowspan="2">Structural Benchmarks</td><td rowspan="2">Strengthen corporate governance at state-owned enterprises, in particular, adopt a new corporate charter for NJSC Naftogaz in accordance with OECD corporate principles, recommendations on corporate governance and other applicable legislation, including the law on Joint Stock Companies.</td><td>Responsible Executive</td><td>Timing</td><td>Implementation Status</td></tr>
<tr><td>Ministry of Economy</td><td>End of September 2020</td><td>Implemented late (October 2020)

* resolution of the Cabinet of Ministers on amendments to the Charter of NJSC Naftogaz</td></tr>
<tr><td>Staff Report</td><td colspan="4">In the Staff Report dated November 8, 2021, the Fund experts note that compliance with corporate governance standards has worsened since the program was approved. A number of government interventions in the activities of state-owned enterprises did not correspond to the spirit of proper corporate governance, for example: the introduction of a special salary cap for management and board members, which in some cases led to the dismissal of such officials; bypassing the corporate governance system of the state owned enterprise in order to replace the CEO, as in the case of Naftogaz; the recent revision of the sale contract between MGU (the new owner of OGTSU) and Naftogaz, while neither of the state - owned enterprises had a Supervisory Board. These developments undermine an important risk mitigation mechanism within the program, which aims to minimize risks to fiscal and financial stability in an economy where SOEs play a large role.</td></tr>
</table>

	At the same time, the Fund experts also add that the authorities are taking certain steps to strengthen the legislative framework of corporate gover - nance, but only the experience of its compliance will ensure the availability of appropriate guarantees. The authorities have presented a draft law on corporate governance of state-owned enterprises, which contains some improvements that bring the legalislative framework closer to the OECD guidelines on corporate governance of state-owned enterprises. One important step is to expand the powers of supervisory boards of economically important state-owned enterprises so that they have the final authority to appoint and dismiss Executive Directors.
Memoran- dum dated October 8, 2021	In the Memorandum dated October 8, 2021, the Ukrainian side undertakes to introduce measures to strengthen corporate governance at Energoatom. In particular, it is expected that the law on the corporatization of Energoatom will come into force by the end of December 2021, including the requirement to prepare financial statements in accordance with international standards. In addition, the Ukrainian side promises to ensure the operation of SOEs on market conditions independent of the state, preserving the progress achieved in strengthening corporate governance by maintaining supervisory boards, the majority of whose members are independent. In addition, it was assumed to: ▪ ensure full functionality of the Supervisory Board of Ukrenergo by the end of December 2021, NJSC Naftogaz by the end of January 2022, and Energoatom by the end of May 2022 on the basis of transparent and competitive selection procedures; ▪ adopt a law on corporate governance of SOEs to further strengthen SOE corporate governance principles and align them with the OECD Guidelines on the Corporate Governance of State Owned Enterprises, strengthening accountability and expanding the power of Supervisory Boards so that they have the final authority to appoint and dismiss Executive Directors. The Memorandum also states that a general accounting policy has already been adopted in accordance with IFRS, which should be implemented by SOEs. In the future, it is expected to adopt a general policy on state property.

Structural Bench-marks	Appoint a supervisory board at Energoatom with a majority of independent members elected through a transparent and reliable procedure.	**Responsible Executive**	**Timing**	**Implementation Status**
		Ministry of Economy	End of May 2022	**Implementation status is unknown** * On March 10, 2022, the Ukrainian authorities canceled the stand-by agreement due to the war with russia.

Analyzing the obligations within the current program, we see that, as in the 2015 program, a significant part of them concerns the appointment of Supervisory Boards in the largest state-owned companies.

It is important that the Memorandums mention several times the need to align the corporate governance system with OECD principles.

It should also be noted that by the end of December 2021, the Law on the Corporatization of Energoatom was expected to come into force. However, the law was adopted only in February 2023.

Relations with the IMF after the Start of a Full-Scale russian Invasion

In March 2022, the Ukrainian authorities asked the IMF to cancel the current agreement and declared their intention to return to cooperation in order to develop an appropriate economic program aimed at recovery and growth when possible.

At the same time, the IMF continued to support Ukraine, providing about US$2.7 billion within the framework of the Rapid Financing Instrument (RFI). It should be noted that this instrument provides an opportunity for quick access to financial assistance to those countries that are faced with urgent needs to solve the balance of payments, in particular as a result of military conflicts. The rapid financing instrument is designed for cases where the initiation of a full-fledged program of economic reforms is not possible, that is, financial support is provided without prior program conditions or revisions.

In addition, the IMF accumulated about US$2.2 billion, which were directed to Ukraine through a special account administered by the IMF.

The IMF Staff Report dated October 19, 2022 states that in order to maintain the trust of donors and pave the way to the final recovery of the economy, it is extremely important to implement policies that do not reverse the hard-won results of previous programs supported by the Fund. ***Main measures should be aimed at promoting transparency in procurement, expenditures and investments, preserving the key functions of the anticorruption system and supporting proper corporate governance, in particular at state-owned enterprises.***

1.4. Program Monitoring with Board Involvement, 2022

Negotiations with the Fund at the end of 2022 did not lead to a new financial program. Instead, the parties agreed on a 4-month Program Monitoring with Board involvement (PMB), which is designed to help Ukraine maintain stability and stimulate donor funding in conditions of large balance of payments needs and extremely high risks. Key measures within the program include strengthening revenue mobilization and revitalizing the domestic debt market, preparing a financial sector strategy, and improving transparency and governance quality.

General Information about the Program

Timing	Agreed Amount, billion SDR
4 months	No funding

Ukraine's Commitments to the IMF and their Assessment by the Fund Staff

Staff Report	In the Staff Report dated December 08, 2022, the commitments of the Ukrainian authorities to ensure proper corporate governance at the SOE was positively assessed. Steady progress, particularly in this area, will be a critical element for potential future participation in a full program. In addition, the representatives of the Fund note the new law "On Joint-Stock Companies" (came into force in January 2023), aimed at improving the corporate governance system in Ukraine, and the law on the corporatization of Energoatom, which passed the first reading in the Verkhovna Rada. Also in the Report, the Fund experts note that effective mechanisms of transparency and accountability, as well as good governance, are key to preparing for a financial agreement with the IMF, and also help to ensure the readiness of institutions for post-war reconstruction.

<table>
<tr><td>Memorandum dated December 12, 2022</td><td colspan="4">In the Memorandum dated December 8, 2022, the Ukrainian side declares its intentions to continue and support recent corporate governance reforms and undertakes to:
ensure the operation of SOEs independently of the Government by maintaining a majority of independent members in their Supervisory Boards;
continue efforts to strengthen corporate governance at SOEs. It is noted that a new Law “On Joint-Stock Companies” was recently adopted, which improves the corporate governance system in Ukraine, and the law on the corporatization of Energoatom has already passed the first reading in the Verkhovna Rada;
refrain from any decisions that would undermine the system of corporate governance, as well as governance at key state-owned enterprises, particularly in the energy sector.</td></tr>
<tr><td rowspan="2">Structural Benchmarks</td><td rowspan="2">Appoint the Supervisory Board of Naftogaz on the basis of transparent and competitive selection procedures and bring it into full working order.</td><td>Responsible Executive</td><td>Timing</td><td>Implementation Status</td></tr>
<tr><td>Unknown</td><td>End of January 2023</td><td>Implemented on time

* On January 24, 2023, the Cabinet of Ministers appointed the supervisory board of NJSC Naftogaz.</td></tr>
</table>

We note the considerable attention of the Fund representatives to the commitments in terms of corporate governance, which are an important prerequisite on the way to a full-fledged program. The researchers also defined that the issue of adopting the law on the corporatization of Energoatom actually came from the previous program.

On February 17, 2023, IMF staff and representatives of the Ukrainian authorities reached an agreement at the staff level regarding the revision of the Program Monitoring with the involvement of the Fund Board. According to the Head of the IMF mission, Gavin Gray, the completion of the first and final review, which must be approved by the IMF management, paves the way for the start of discussions on a full-fledged program with IMF support. The IMF representative also highly praised the results of Ukraine’s

fulfillment of commitments within the framework of the monitoring program and noted the implementation of all five structural benchmarks established at the end of January.

On February 20, 2023, a significant event for Ukraine also took place: the Managing Director of the IMF visited Ukraine just before the anniversry of the full-scale russian invasion. As a result of the visit, Kristalina Georgieva noted the IMF's unwavering commitment to supporting Ukraine and positively assessed the progress within the Program Monitoring with the involvement of the Fund Board, which opens the way for the discussion of a full-fledged IMF financing program.

According to Bloomberg, the IMF can approve a new credit program for a period of 3-4 years by the end of March. The program will be calculated for US$14-16 billion, from which US$5-7 billion can be received in the first year.

2. Technical Assistance from the IMF regarding the Corporate Governance of State-Owned Companies

At the request of the Ministry of Economic Development and Trade of Ukraine and the Ministry of Finance of Ukraine, a technical assistance mission visited Kyiv from January 27 to February 11, 2015. The task of this mission was to provide the authorities with recommendations on the finalization of the SOE reform strategy. As a result, in March 2015, IMF staff prepared a Technical Assisstance Report — Reforming Management and Oversight of State Assets (hereinafter referred to as the Report).

The Report notes that reforming the state-owned enterprise sector is of primary importance for the Government. In particular, the National Strategy 2020 calls for the "state property management reform" and related reforms in such areas as the organization of government agencies, public procurement, competition policy and the corporate regulatory framework.

In their Report, IMF experts stated that **various functions of the Government in the public sector of the economy are scattered among various institutions and organizations, which often perform the same functions or, on the contrary, have opposing interests, which undermines the effectiveness of control.** The government simultaneously acts as a shareholder, source of financing, regulator, control body, customer and supplier. The same institutions are involved in the development of public sector policies, the appointment of management, the analysis/approval of financial plans of enterprises and are engaged in the evaluation of performance results. This leads to the multiplication of control structures with cross-functional and internally contradictory functions. **Improvement of external governance of state-owned enterprises cannot be achieved without solving institutional problems.**

According to the Fund staff, it is necessary to create proper corporate governance mechanisms by improving activity management systems and placing responsibility on state enterprises in case of unsatisfactory work results, as well as by strengthening financial and budgetary discipline. This should also lead to increased tax revenues and greater clarity about the level of dividend transfers that can be expected from the sector.

The creation of independent Boards of Directors to perform the functions of general management and control over state sector enterprises and organizations, increasing transparency and improving reporting to Parliament and the general public should become the cornerstones of the reform strategy for all state-owned enterprises.

The Report also contains a list of recommendations that directly relate to the improvement of the corporate governance of SOEs.

Recommendations from the 2015 IMF Report on Improving SOE Governance

- Eliminate the dual approach to the corporate governance structure of SOEs by ensuring a standardized approach to the governance of all SOEs consistent with private sector approaches.
- Amend the Official Secrecy Act to increase transparency and improve corporate governance in the sector.
- Strengthen the role of Parliament in the governance of SOEs.
- Define clear criteria for the creation and liquidation of DPs, etc.

Other recommendations related to the improvement of governance mechanisms and supervision of public assets/finances can be found here.

In addition, in the Report, the Fund experts evaluated the draft concept note of the Ministry of Economy on reforming the governance of state-owned assets (hereinafter referred to as the concept note) in terms of its compliance with the OECD Guidelines on Corporate Governance at State-Owned Enterprises (hereinafter referred to as the OECD Principles).

IMF representatives positively assessed the fact that the draft concept note identified OECD principles as a guide to strengthening governance mechanisms.

At the same time, the Report provides recommendations on bringing the procedure for disclosing information about the activities of SOEs into compliance with the OECD principles. For example, it is necessary to continue the codification of uniform reporting and disclosure requirements for all SOEs. The current system of corporate governance of SOEs provides for different reporting standards for joint stock and unitary enterprises; only joint-stock enterprises are subject to the same reporting requirements as for the private sector. This is inconsistent with OECD recommendations (and international best practice) that all SOEs should be subject to reporting requirements similar to those of the private sector.

The Report also states that reporting and disclosure of non-financial information are not mandatory. Although disclosure of non-financial information is not a recommendation of the OECD guidelines, it is a growing trend in the private sector. A reporting system that facilitates the disclosure of non-financial information will increase SOEs' accountability regarding their social and environmental impact and bring them into line with best practices.

3. OECD Guidelines on Corporate Governance at State-Owned Enterprises in the Context of Cooperation with the IMF

Within the framework of Ukraine's cooperation with the IMF, the OECD Guidelines on Corporate Governance at State-Owned Enterprises (hereinafter referred to as the OECD Principles) are often mentioned. This is an internationally agreed standard that contains recommendations for state government authorities to ensure efficient, transparent and responsible functioning of state-owned enterprises.

In the Memorandums with the IMF, the Ukrainian side has repeatedly noted the obligation to implement certain steps aimed at harmonizing national legislation with the OECD principles on corporate governance. In the Memorandum dated November 8, 2021, the Ukrainian side promised to adopt a law on corporate governance of state-owned enterprises in order to harmonize the principles of corporate governance with the OECD principles. In the Memorandum dated June 2, 2020, there is an obligation to review the structure of corporate governance for SOEs in order to bring it into line with OECD principles.

The IMF, for its part, has also repeatedly emphasized the need to implement OECD principles. For example, in the Staff Report dated June 2, 2020, IMF experts note that the Ukrainian authorities should adopt a new corporate charter for Naftogaz in order to align it with OECD principles.

In the latest Memorandum dated December 08, 2022, the Ukrainian side declares its intention to continue and support the recent corporate governance reforms, which was positively assessed by the Fund experts in the Staff Report. In addition, IMF representatives noted that steady progress, particularly in this area, will be a critical element for potential future participation in a full-fledged program.

Therefore, the OECD principles are the guideline towards which Ukraine is gradually trying to move in the field of corporate governance.

In May 2021, the OECD published a Review of the Corporate Governance Structure of State-Owned Enterprise Sector in Ukraine (hereinafter referred to as the OECD Overview) for compliance with OECD principles.

The OECD Review notes that over the past 6 years Ukraine has taken several steps towards reforming corporate governance in the largest SOEs and aligning its practices with OECD principles. At the same time, **OECD experts note that corporate governance reform is still at an initial stage.** The reform efforts of previous governments were sometimes fragmented, often unfinished, and in some cases even counterproductive. Many legal requirements and established policies are not implemented or violated.

The OECD review includes recommendations for the near future and the long term. The recommendations are intended to improve the institutional and legislative environment in Ukraine that relates to corporate governance to ensure its implementation in an effective, transparent and accountable manner.

Recommendations from the OECD Report on the Corporate Governance of SOEs

Short-term Priorities	
1.	Eliminate the inconsistency in the legislative and regulatory framework.
2.	Continue corporate governance reforms in the 15 largest state-owned enterprises.
3.	Apply best practices for transparency and information disclosure in economically important SOEs and improve financial and non-financial reporting.
4.	Develop a comprehensive property policy with clear justifications for state ownership.
5.	The state must ensure that the governance of SOEs is transparent and accountable.
6.	Return to the practice of preparing annual aggregated reports while simultaneously updating the ProZvit platform.
7.	Professionalization of state ownership functions as a means of fighting with corruption, avoiding excessive political interference and unnecessary day-to-day interference in SOE operations, with the ultimate goal of increasing the efficiency and profitability of SOEs.
Long-term Priorities	
8.	Create a centralized property coordination body.
9.	Ensuring equal conditions with private companies.

10.	Continue to strengthen anti-corruption regulations applicable to SOEs.
11.	Reform the rest of the SOE portfolio in accordance with the ownership policy and fully centralize ownership.

It should be added that in July 2022, at a conference in Lugano, the Prime Minister of Ukraine, Denys Shmyhal, on behalf of Ukraine submitted an application for the country to join the OECD. In October 2022, the OECD announced the start of an initial dialogue on Ukraine's accession.

In addition, in January 2023, the Government approved a draft law on the ratification of the Agreement between the Government of Ukraine and the OECD.

Consequently, Ukraine has a lot of work ahead of it to change the system of corporate governance in accordance with OECD principles, in particular within the framework of programs with the IMF.

4. Reforming the Corporate Governance of the State-Owned Companies in the Context of EU Integration

1)	**EC report on the implementation of the Association Agreement between Ukraine and the EU for the period from December 12, 2019 to December 8, 2020.**	The Report notes that despite the publication by the Ministry of Economy at the end of 2019 of a plan to bring the corporate governance practices of the 10 largest SOEs in line with OECD principles, **developments in the field of SOE reform have undermined the chances of its success.** In the first six months of 2020, certain steps had a negative impact on the reform. In particular, several members of Supervisory Boards and CEOs were fired or pressured to resign. This was followed by obstacles to the participation of independent foreign members of Supervisory Boards due to the introduction of commitments regarding electronic declaration, salary reductions and salary restrictions at the same level as civil servants during the quarantine measures caused by the COVID-19 pandemic (in October 2020, the Ukrainian Government removed restrictions on remuneration for members of Supervisory Boards). The Report also states that corporate governance reform in the defense industry has not progressed. In conclusion, EC experts noted that further concerted efforts should be made, in particular in the sector of corporate governance of SOEs. EU macro-financial assistance and IMF programs require progress in several areas of SOE corporate governance.
2)	**EC report on the implementation of the Association Agreement between Ukraine and the EU for the period from December 1, 2020 to February 24, 2022.**	EC representatives noted that the new draft law on corporate governance of state-owned enterprises was adopted in the first reading in July 2021. It aims to bring Ukrainian legislation into line with OECD recommendations and strengthen the role and independence of Supervisory Boards. At the same time, EC representatives noted that in 2021 the Government continued to interfere in the Supervisory Soard of the state energy company Naftogaz, which raised concerns about Ukraine's compliance with European principles and standards of corporate governance.

		In July 2021, theParliament adopted a law on the corporatization of the state defense industrial complex. In October 2021, Volodymyr Zelenskyy signed it, introducing corporate governance reform in accordance with OECD principles. The law on defense procurement, adopted in July 2020, has not yet been implemented.

Also in February 2023, the EC published an analytical report on the compliance of Ukrainian legislation with EU law (hereinafter referred to as the Report). The Report identifies positive steps in the corporate governance sector and shortcomings that should be taken into account. In particular, EC experts noted that in 2020, a code of corporate governance developed in accordance with the principles of the Organization for Economic Cooperation and Development (OECD) was adopted. At the same time, **gaps remain in terms of compliance with the latest EU legislation regarding shareholder rights, the use of digital tools and processes, as well as the disclosure of financial reporting.** There are also no provisions harmonizing Ukrainian company legislation with EU legislation on cross-border mergers and divisions, as well as rules on the statute of a European company or European association of economic interests.**The continued interference of authorities and companies in the corporate governance of transmission system operators also remains a problem.**

5. Participation of the EBRD and the World Bank in Improving the Corporate Governance of the State-Owned Company

Within the framework of programs with the IMF, the EBRD also provides important technical support. For example, in the Memorandum dated February 27, 2015, it was stated that with the help of the EBRD, it is planned to improve the shareholding of key SOEs by introducing advanced international standards and practices based on OECD principles into their corporate governance. In the Memorandum dated June 2, 2020, the Ukrainian side promises to further strengthen the corporate governance of SOEs by reviewing corporate governance structures for SOEs with the assistance of the OECD and the EBRD.

In the context of cooperation with the EBRD, it is worth mentioning the Memorandum of Understanding between the Government of Ukraine and the EBRD on preventing corruption and promoting transparent and efficient management in the public sector. It was signed on October 7, 2020.

The main provisions of the Memorandum relate to:

- implementation of the best standards of corporate governance in accordance with the OECD Guidelines on Corporate Governance at State-Owned Enterprises;
- creation of a mechanism for monitoring public procurement;
- prevention of bribery and corruption in the state sector.

Support for Ukraine in the implementation of corporate governance reform is also provided by the World Bank, which periodically responds to events that occur in the corporate governance sector of state-owned enterprises and provides technical assistance.

For example, in September 2021, the Vice President of the World Bank for Europe and Central Asia, Anna Bjerde, stated that the **implementation of corporate governance in Ukraine is lagging behind and in some issues there has been a rollback**. She also noted that the right to manage state-owned enterprises and supervise their activities remains scattered among 96 ministries and departments, which complicates the further implementation of the reform. As a result, SOEs continue to operate under conditions of excessive political influence, uncompetitive practices in the selection of key management positions, non transparent pay systems for senior staff, and

ineffective control and accountability mechanisms. According to her, the improvement of corporate governance in Ukraine requires the adoption of a new law on corporate governance at state-owned enterprises and its implementation in practice.

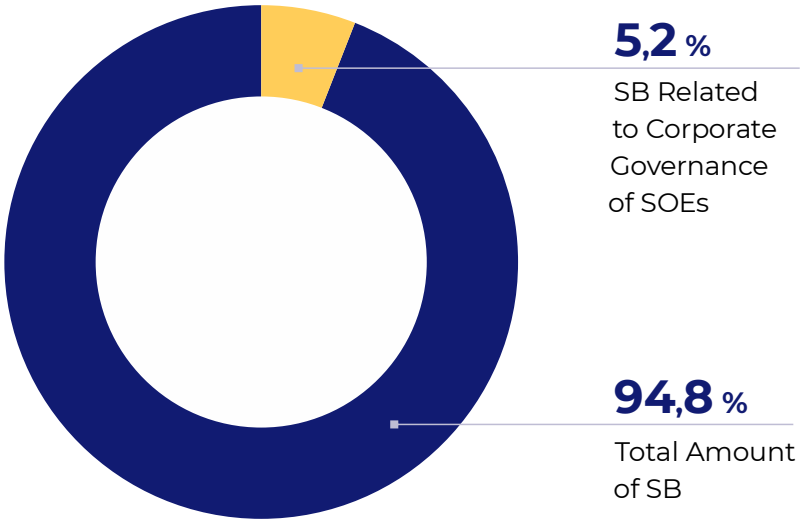
In August 2022, the World Bank called on the Ukrainian authorities to follow OECD corporate governance procedures when appointing the CEO of OGTSU. The representatives of the World Bank noted that the OECD principles of fair corporate governance suggest that the appointment and selection of the CEO is the sole responsibility of the OGTSU Supervisory Board once it is established.

Therefore, the EBRD and the World Bank are important partners in the context of the implementation of the corporate governance reform of SOEs, because for them the OECD serve as a guideline.

Conclusions

In general, it should be noted that the share of structural benchmarks related to the corporate governance of state-owned companies is only 5% (4 structural benchmarks) of the total number (73 structural benchmarks) within the framework of programs with the IMF for 2015–2022.

The Share of Structural Benchmarks Related to the Corporate Governance (2015-2022)



Three out of the last four programs contained structural benchmarks related to the corporate governance of SOEs. All of the structural benchmarks have been implemented, except for one, which was delayed during the war.

General List of all Structural Benchmarks Related to the Corporate Governance of the SOCs and the Status of their Implementation (2015–2022)

Structural Benchmark	Memorandum	Responsible Executive	Timing	Implementation Status
While consulting with IMF and World Bank experts, the Government: ▪ will adopt a strategy for reforming the state-owned enterprises sector in accordance with par. 36 of the Memorandum, providing for the measures necessary to	Memorandum dated February 27, 2015	Unknown	End of May 2015	**Implemented** * the status of implementation is determined in accordance with the information specified in the Memorandum dated July 21, 2015

strengthen budgetary supervision, develop a comprehensive policy on ownership, and improve corporate governance; ▪ will identify the priority enterprises that should be subjected to restructuring; ▪ will analyze options for improving the governance of other state assets.				
Strengthen corporate governance at state-owned enterprises, in particular, adopt a new corporate charter for NJSC Naftogaz in accordance with OECD corporate principles, recommendations on corporate governance and other applicable legislation, including the law on Joint Stock Companies.	Memorandum dated June 2, 2020	Ministry of Economy	End of September 2020	**Implemented late** (October 2020) * resolution of the Cabinet of Ministers on amendments to the Charter of NJSC "Naftogaz"
Appoint a Supervisory Board at Energoatom with a majority of independent members elected through a transparent and reliable procedure.	Memorandum dated October 8, 2021	Ministry of Economy	End of May 2022	**Implementation status is unknown** * On March 10, 2022, the Ukrainian authorities cancelled the Stand-By Agreement due to the war with russia.

Appoint the Supervisory Board of Naftogaz on the basis of transparent and competitive selection procedures and bring it into full working order.	Memorandum dated December 8, 2022	Unknown	End of Januray 2023	**Implemented** * On January 24, 2023, the Cabinet of Ministers appointed the supervisory board of NJSC Naftogaz.

Two of the four structural benchmarks related to the appointment of Supervisory Boards with independent members at the SOC. It should be noted that, in general, within the framework of cooperation with the IMF, considerable attention is paid to the issue of creating independent Supervisory Boards and improving their formation. However, based on the analysis of the fulfillment of the obligations stipulated in the Memorandums with the IMF, it can be seen that, starting from 2015, the authorities constantly had problems with the formation of Supervisory Boards and their appointment. For example, only in January 2023 members of the Supervisory Board of Naftogaz were appointed.

Among the commitments within the framework of programs with the IMF, there are those that have not been fulfilled as of 2023. For example, draft law No. 6428 on the improvement of corporate governance, which was defined in the Memorandum dated December 5, 2018 and the adoption of which was expected by the Government, was not adopted as of March 2023. As part of the stand-by 2020 program, the Government of Ukraine promised to adopt a draft law on corporate governance of state-owned enterprises to expand the power of Supervisory Boards in order to appoint managers and approve financial plans. Similarly to the previous case, the mentioned draft law not adopted as of March 2023. In addition, the KSE, having analyzed the bill, noted that despite the presence of positive aspects, it needs significant improvement. The main drawback of this draft law is that the Government actually refuses to fulfill the assumed obligation to expand the powers of the Supervisory Boards of the most important companies, which is declared in the explanatory note to the draft law in paragraph 29b of the Memorandum with the IMF dated June 2, 2021.

The issue of creating a single national holding company, whose task will be to manage strategic commercial SOEs, needs to be clarified. The Ukrainian authorities noted that this option was being considered back in 2017.

In addition, within the framework of the largest ever cooperation with the Fund - the EFF 2015 program - the Ukrainian side did not fulfill its commitments several times and transferred their implementation from one Memorandum to another. For example,

it was assumed that the Cabinet of Ministers would make a decision regulating the creation of Supervisory Boards, first by the end of September 2016, and then the deadline was moved to the end of March 2017. Also, within the framework of the last pre-war program, it was assumed that by the end of December 2021, the law on corporatization of the company Energoatom would be put into effect. However, the law was adopted only in February 2023.

Providing recommendations on improving the governance of the SOC, both the IMF, the European Commission, and representatives of the EBRD and the World Bank refer to the OECD Guidelines on Corporate Governance at State-Owned Enterprises. In particular, IMF representatives positively assess the government's desire to change the corporate governance system of the SOC in accordance with the OECD Guidelines. In this regard, attention should be paid to the OECD's May 2021 Review of the Structure of Corporate Governance of the State-Owned Enterprise Sector in Ukraine, which contains recommendations designed to improve the institutional and legislative environment in Ukraine related to corporate governance.

It is also important to note that in the context of strengthening corporate governance, in most cases, we are talking about the largest SOC that are key to industries. However, there are about 3.5 thousand state-owned enterprises in Ukraine. And more than 60% of state-owned enterprises are less profitable than private ones[1]. Therefore, the activities of these enterprises also need to be improved.

In materials related to Ukraine, representatives of the IMF, the EC, and the World Bank have repeatedly emphasized the shortcomings of Ukrainian legislation in the corporate governance sector of the SOC, as well as the need to solve institutional problems. The 2021 OECD Review notes that corporate governance reform is still in its early stages. The reform efforts of previous governments were sometimes fragmented, often incomplete, and in some cases even counterproductive. Many legal requirements and established policies are not implemented or violated.

To summarize, we have identified the main directions of movement of the sector of corporate governance of the SOC, which have prevailed during the last 7 years and which, to a greater extent, have not been implemented. These areas can become the basis for forecasting development priorities in the future, in particular, the basis for potential programs with the IMF.

[1] www.epravda.com.ua/publications/2022/11/15/693846

Key Movement Directions in the Sector of Corporate Governance of the State-Owned Companies (2015–2022)

- Creation of Supervisory Boards and ensuring their proper functioning at key state-owned companies.
- Improvement of the legislation in the field of corporate governance of SOCs and its alignment with the OECD Guidelines.
- Conducting audits of state-owned companies by independent experts and companies with publication of the results.
- Implementation of effective transparency and accountability mechanisms.
- Ensuring the activities of the state-owned companies independently of the Government.

The Recovery Plan (hereinafter referred to as the Plan) was presented within the framework of the International Conference on the Recovery of Ukraine held in Lugano. Among the priority initiatives of the Plan, it is also envisaged to implement certain steps in the sector of corporate governance.

Initiatives in the corporate governance sector under the Lugano Recovery Plan

1.	Implementation of new legislation in the field of corporate governance (expanding the powers of Supervisory Boards, including the appointment of the Head of the Board, approval of the financial plan).
2.	Completion of corporatization of state-owned enterprises (for example, Energoatom).
3.	Analysis of the possibility of centralizing the management of state assets, launching the National Wealth Fund.

In general, in our opinion, the fundamental task of the authorities in the future will be to preserve the previous achievements in the sector and to bring the system of corporate governance of state-owned companies into compliance with the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

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