The Republic of Moldova

SUPPORT TO STATE OWNED ENTERPRISES (SOE) PRELIMINARY DIAGNOSTICS AND REFORM ASSESSMENT:

PHASE 1

March 2017

Delivered by the World Bank in collaboration with the UK’s Good Governance Fund
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### MAIN ABBREVIATIONS AND ACRONYMS

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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>A&amp;A ROSC</td>
<td>World Bank Report on the Observance of Standards and Codes, Accounting and Auditing</td>
</tr>
<tr>
<td>CoA</td>
<td>Court of Accounts</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>GoM</td>
<td>Government of Moldova</td>
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<tr>
<td>IAASB</td>
<td>International Auditing and Assurance Standards Board</td>
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<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
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<tr>
<td>IFAC</td>
<td>International Federation of Accountants</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<td>ISA</td>
<td>International Standards on Auditing</td>
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<tr>
<td>JSC</td>
<td>Joint-Stock Company</td>
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<tr>
<td>KPIs</td>
<td>Key Performance Indicators</td>
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<tr>
<td>MAFI</td>
<td>Ministry of Agriculture and Food Industry</td>
</tr>
<tr>
<td>MDL</td>
<td>Moldovan Leu</td>
</tr>
<tr>
<td>MITC</td>
<td>Ministry of Information Technology and Communications</td>
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<tr>
<td>MOE</td>
<td>Ministry of Economy</td>
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<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
</tr>
<tr>
<td>MTRI</td>
<td>Ministry of Transports and Road Infrastructure</td>
</tr>
<tr>
<td>NASs</td>
<td>National Accounting Standards</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-Commercial Organization</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<tr>
<td>PEFA</td>
<td>Public Expenditure and Financial Accountability program</td>
</tr>
<tr>
<td>PIE</td>
<td>Public Interest Entity</td>
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<tr>
<td>PPA</td>
<td>Public Property Agency</td>
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<tr>
<td>PPP</td>
<td>Private Public Partnership</td>
</tr>
<tr>
<td>PSO</td>
<td>Public Service Obligations</td>
</tr>
<tr>
<td>SAI</td>
<td>Supreme Audit Institution</td>
</tr>
<tr>
<td>SE</td>
<td>State Enterprise</td>
</tr>
<tr>
<td>SIGMA</td>
<td>Support for Improvement in Governance and Management (OECD/EU joint initiative)</td>
</tr>
<tr>
<td>SOE</td>
<td>State Owned Enterprise</td>
</tr>
<tr>
<td>WB</td>
<td>World Bank</td>
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**APPROXIMATE CURRENCY EQUIVALENTS & EXCHANGE RATE:** Exchange rate in effect at August 01, 2016

**UNIT OF CURRENCY:** 1 USD = 19.7830 MDL (Moldovan leu)

**GOVERNMENT FISCAL YEAR:** January 1 – December 31
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\(^1\) The World Bank Centre for Financial Reporting Reform
This report is the result of research and analysis undertaken as technical assistance to the Ministry of Finance of the Republic of Moldova, delivered by the World Bank Governance team in collaboration with the UK’s Good Governance Fund. It focuses on the issues identified by OECD Guidelines on Corporate Governance¹ as important in ensuring that state owned enterprises (SOEs) operate in an efficient, transparent and accountable way.

Corporate governance principles and best practices have become global². Effective corporate governance of a SOE implies the proper allocation of power and responsibilities among owners, board of directors, and management. The key aspects of good corporate governance principles, further discussed and analyzed in the report, are:

(i) **Rationale for state ownership**: The state needs to exercise the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to recurrent review.

(ii) **Ownership policy**: The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

(iii) **SOEs in the marketplace**: Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

(iv) **Equitable treatment of shareholders & other investors**: Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders’ equitable treatment and equal access to corporate information.

(v) **Stakeholder relations and responsible business**: SOEs’ must recognize their responsibilities towards stakeholders and be open about their relations with stakeholders. Any expectations the state has in respect of responsible business conduct by SOEs should be made clear.

(vi) **Disclosure and transparency**: SOEs should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

(vii) **Responsibilities of the boards of SOEs**: The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic

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² Global institutions, including the Organization for Economic Cooperation and Development (OECD), the World Bank (WB), the International Finance Corporation (IFC) and many other regional groups form a global network that strongly endorses corporate governance principles and confirm their link to reduced business risk and improved performance.
guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

In addition, applying financial and fiscal discipline to SOEs can reduce government liabilities and simultaneously strengthen incentives for improved SOE governance and performance. For genuine financial and fiscal discipline, the Government must neither provide a financial advantage nor impose a financial disadvantage on SOEs relative to the private sector.

The report documents the findings of Phase I technical assistance, and serves as a foundation for the development and prioritization of potential reforms. Recognizing the challenges and legacy of reforms in this area, the report outlines current practices and highlights key areas for future focus by policy makers which may help to improve public ownership. It draws on publicly available data, data provided by counterparts and collected from country authorities. The report presents recommendations for reform; it does not attempt a comprehensive diagnostic comparing standards and practices in Moldova with relevant international benchmarks. Implementing many of the good practices will be a challenge for Moldova in the short-term. Phase 2 of this technical assistance will support implementation and capacity building in selected areas.
EXECUTIVE SUMMARY

Purpose of the report – identify issues and opportunities for enhancing SOEs Governance in Moldova

1. This report has been prepared to support the Government of Moldova’s efforts to identify and begin to address issues and opportunities in relation to their state owned enterprises (SOEs). The report documents the findings of Phase I technical assistance, delivered by the World Bank Governance team in collaboration with the UK’s Good Governance Fund, and serves as a foundation for the development and prioritization of potential reforms. Recognizing the challenges and legacy of reforms in this area, the report outlines current practices and highlights key areas for future focus by policy makers which may help improve public ownership. The report focuses on key areas of corporate governance that are vital to ensure that SOEs operate efficiently, transparently, and in an accountable manner. It draws on publicly available data, as well as material provided by counterparts and collected from country authorities. The report makes a number of recommendations for reform. Phase 2 of this technical assistance will support implementation and capacity building in selected areas.

Corporate governance – essential for SOE performance and accountability in Moldova

2. Strengthened corporate governance allows greater public trust that SOEs are effectively run in the best interests of society as a whole. Good governance is achieved through adequate board practices, effective internal control systems, transparency and disclosure of key financial and non-financial information, and well defined stakeholder relations. Formal and transparent stakeholder relations are critical for building an effective and financially sustainable SOE. The consequences of weaknesses in governance are that SOEs may become poor performers, generate losses, engage in uncompetitive practices, pollute the environment and enable corrupt practices. A strong governance program can help SOEs demonstrate to all stakeholders (including investors, customers, suppliers, regulators, creditors, organized labor, the media, the financial community, the general public and political leaders) that they work efficiently and are effective to serve the different interests and objectives for which they were created. Good governance also contributes to performance and the value of companies. The rights of stakeholders to be informed and to

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4 This report analyzes SOEs that are owned by central government, and include the legal forms of state enterprises (SEs), and Joint Stock Companies (JSCs) in which the state owns a majority of shares, unless otherwise stated. Entities that are owned by local governments are not included in the scope of this report. PPA and MOF differ on which JSCs are monitored; PPA monitors JSCs with over 25% of shares in state ownership, while the MOF monitors only JSCs with over 50% state ownership. Hence, depending on the source, this report may use data for different numbers of SOEs.
have their interests protected are currently compromised in Moldova especially for SOEs that are operating as monopolies, such as energy.

SOEs in Moldova – significant and important for the national economy

3. SOEs in Moldova play a major role in the national economy, as significant owners, operators and employers in key sectors. SOE assets account for more than 32% of GDP\(^5\) and approximately 10% of the corporate sector’s assets\(^6\). SOEs employ 13% of the working population\(^7\). The top ten SOEs control over 74% of total SOE assets and are engaged in nationally important activities and infrastructure, such as gas import and distribution, electricity networks, telecommunications, railways, transport, including national airline and roads infrastructure. In addition, many SOEs offer important public services such as the registration or issuing of documents and records.

Key issues of SOEs in Moldova – deteriorating fiscal position and poor service delivery

Deteriorating financial position and performance

4. SOEs are making losses and their long-term debt is rising, thus adding the costs to Moldova’s economy, damaging its sustainability and exposing the Government to fiscal risk. Financial performance as a whole has worsened in recent years as a result of an unreformed public sector and weak SOE governance. Although net assets remained relatively constant in 2015 compared to 2014, SOEs caused losses to the Moldovan economy of 1.2 billion lei (≈60.6 million USD). The potential for value generation is yet to be determined or employed. State Enterprises (SEs) seem to generate larger losses than joint stock companies (JSCs). While SOEs are not heavily indebted, all currently have positive net assets, profitability trends may negatively impact their financial position and create additional fiscal risks. Financial discipline of SOEs is weak in Moldova; the state is only starting to develop a system for assessing fiscal risks to the national public budget. Although SOEs do not receive preferential loans or direct budget subsidies or guarantees, some dividend policies and practices may be considered hidden subsidies or preferential treatment. Selected financial position and performance indicators are presented in Tables 1 and 2 below. The data however is not entirely reliable as it is drawn from sources often using unaudited financial statements; and the quality and reliability of financial reporting is generally weak (as described below in more detail).

\(^5\) The ratio assets to GDP is calculated on the basis of MOF reports and GDP data for 2015.
\(^7\) State owned enterprises and their role in national economy, IDIS Viitorul, July 2016
Table 1: Dynamics of key SOEs indicators

<table>
<thead>
<tr>
<th>Items</th>
<th>2015</th>
<th>2014</th>
<th>Deviation (+/-) [mln lei]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>40,016.4</td>
<td>39,306.8</td>
<td>709.6</td>
</tr>
<tr>
<td>Long term liabilities</td>
<td>7,027.5</td>
<td>5,694.5</td>
<td>1,333.0</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>8,034.7</td>
<td>8,615.4</td>
<td>-580.7</td>
</tr>
<tr>
<td>Net assets</td>
<td>24,954.1</td>
<td>24,996.8</td>
<td>-42.6</td>
</tr>
<tr>
<td>Sales revenue</td>
<td>21,321.9</td>
<td>16,855.0</td>
<td>4,466.8</td>
</tr>
<tr>
<td>Net profit/loss</td>
<td>-1,197.9</td>
<td>-276.9</td>
<td>-921.0</td>
</tr>
</tbody>
</table>

Table 2: SOEs financial performance for 2015

<table>
<thead>
<tr>
<th>SOE</th>
<th>Total number</th>
<th>Registered profit</th>
<th>Registered losses</th>
<th>Financial result = zero</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>mln lei</td>
<td>No.</td>
</tr>
<tr>
<td>SE</td>
<td>189</td>
<td>110</td>
<td>58.2</td>
<td>173.1</td>
</tr>
<tr>
<td>JSC</td>
<td>41</td>
<td>22</td>
<td>53.7</td>
<td>177.2</td>
</tr>
</tbody>
</table>

5. **State aid to SOEs in Moldova remains to be significant and is largely in the form of indirect financial support.** State aid legislation, in line with EU rules on state aid, seeks to ensure a fair competitive environment. The Law on State Aid\(^{10}\) regulates the procedures for authorizing, monitoring, and reporting state aid beneficiaries in all sectors of the national economy except for agriculture. Under the Law, the Competition Council is in charge of preventing and fighting the most harmful anticompetitive practices (such as cartels), and should pursue sustained competition advocacy activities in the design of pro-competitive regulations and collaboration with sectoral regulators. Such activities promote a competitive culture among businesses and civil society. They ensure that state aid is subject to review to minimize firm-specific aid, with its distortive effects, and promote better public spending. As reported by the Competition Council\(^{11}\), the value of the reported state aid was reduced from 4.9 billion MDL (~313 million EUR; estimated 5.52% of GDP) in 2012 to 4.4 billion MDL (~238 million EUR; estimated 3.96% of GDP) in 2014 (determined by applying the European Union methodology for tracking measures of state intervention). Indirect public financing is the prevailing form of state aid in Moldova. Exemptions, rebates, deferrals or rescheduling the

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8 Source: 2015 MOF report  
9 Ibid  
11 Source: [http://www.competition.md/public/files/StateAidReportsummary79c7e.pdf](http://www.competition.md/public/files/StateAidReportsummary79c7e.pdf)
poor performance in service delivery

6. **SOEs in Moldova deliver important public services: low citizen satisfaction with the quality of and access to these services is an important indicator that SOEs performance in service delivery needs to be improved.** Monitoring quality of service delivery is one of the key responsibilities of the ownership function. SOEs have key roles in essential services and industries including utilities, healthcare, transport, and energy, as well as supporting delivery of some Government administrative service functions. Public opinion surveys reveal customers’ concerns about the speed, access, quality, and especially unjustified cost, of services for citizens. Moldova’s citizens were consistently less satisfied than respondents in other countries, for example, with the quality of the public transportation system between 2005 and 2013, where SOEs are significantly present12 (Figure 1). A 2013 Government survey13 of the 14 most frequently used administrative services, some of which are provided by SOEs, revealed that 58% of customers considered that the charges were unjustified or insufficiently justified. Users’ experience was below their expectations for most of the service delivery characteristics listed above.

![Figure 1: Citizens satisfaction with public transportation, 2006-2013](image)

SOE governance in Moldova – some strengths but significant weaknesses

7. **Legal forms of SOEs are not unified**

**Moldova has two forms of SOE, State Enterprise (SE) and Joint Stock Company (JSC), which differ in requirements and governance practices.** There are inconsistencies in

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12 SOEs have a natural monopoly in public transportation, except taxi services.

13 Moldova Public Opinion Survey: Quantitative research on public perceptions of the quality of public service delivery (Management, Administration and Public Policy Institute, Chisinau, 2013)

14 Source: Gallup World Poll International
existing state monitoring of SOEs. Line ministries are responsible for SOEs strategic management; while the Public Property Agency (PPA) is responsible for some ownership functions, including analysis of financial statements and assessment of performance. The Ministry of Finance’s financial monitoring department monitors all SEs plus JSC SOEs with over 50% state held shares. The PPA include JSCs with over 25% state held shares in their annual reports and financial analyses. Governance of SEs is exercised by a board of directors and an executive body (administrator). Board members are appointed by the founding institution and the executive body is appointed by the founding institution based on the Board’s proposal. This means that the state ownership role is executed through the founding institution (line ministry). As set out in the JSC Law, governing bodies of JSC SOEs are the general meeting of shareholders, board of directors, executive body and censors’ committee. For the purposes of this report, SOEs include both legal forms: SEs and JSC SOEs. The international trend is to corporatize SOEs and move towards legislation that applies equally to SOEs and private sector entities.

Ownership rationale is not defined

8. A clear ownership rationale document would establish the objectives of SOEs ownership in Moldova. Although the basic objectives of state ownership are outlined, the legislation in force does not provide specific objectives of ownership, the functions of and governance principles and requirements toward specific SOEs. This hinders a systematic approach to governance of these entities, including decisions on continuing or ceasing ownership or creating new SOEs. OECD guidelines outline the good, and relatively recent, international practice of a clear rationale for state ownership. This rationale might include delivery of public goods and services where the state may be more efficient or reliable; operation of natural monopolies where markets are not efficient; and support for broad economic and strategic goals of the country, including maintaining strategic national interest companies or companies of systemic importance.

Ownership policy needs consolidation

9. The practice in Moldova of combining SOE policy-making and ownership in one entity (usually a ministry, sometimes even with the same staff involved) creates potential conflicts of interest. Government service delivery and social or regulatory policy-making are largely incompatible with ownership, which is driven by costs recovery, accountability and value creation. Ministries are mandated to promote sector policies but at the same time are delegating members to SOE corporate boards, often the same civil servants responsible for policies in that sector. Influence over those charged with governance of SOEs is often exercised through informal channels, undermining the systems and processes that have been put in place. Independent regulatory agencies partially help to address these shortcomings, for example by regulating prices in telecommunications or energy, but it is not sufficient. More positively, the Competition Council is mandated with observance of
competition legislation; preventing anticompetitive practices, removing competition infringements, promoting and improving the competition culture.

10. There is fragmentation of the state ownership function and a lack of clarity in the numbers and forms of SOEs; centralized ownership by a single public institution would reduce duplication, improve co-ordination, and address discrepancies and inherent conflicts of interests. A fragmented ownership function is associated with issues of scattered resources, inconsistencies, and may limit the possibilities for the state to promote consistent guidance and policies in areas such as assets management, dividend policies, performance measurement, and professionalization of boards. SOE ownership in Moldova is not centralized nor well-coordinated. The PPA and Ministry of Finance (MOF) duplicate some of financial monitoring functions; MOF performs financial monitoring based on the financial statements received from the Service of Financial Statements of the National Bureau of Statistics and other information received from the Fiscal Service and the Financial Inspectorate, while the PPA may require additional reports from SOEs. An inventory of SOEs is needed as there are significant discrepancies in the number of SOEs registered with the Registry of Public Property and the State Registry of Companies.

SOE boards - weak nomination and operation practices and little performance monitoring

11. Robust procedures would improve the selection and nomination of board members and executives of SOEs, including the appointment of independent board members for economically significant SOEs, and make decision-making for specific nominations more transparent. The majority of SOE board members in Moldova are involved in policy-making in the same sectors in which SOEs operate. They also include mandatory ex-officio representatives of the Ministry of Economy and the Ministry of Finance. This creates a perception that public servants have divided loyalties, serving the public by making policies while serving selected subjects of policy making through SOE board membership. It also raises questions about the amount of time and range of skills they can offer to SOEs. Neither the SE nor the JSC laws require open and competitive processes of identifying and appointing board members based on merit and professional capability. The appointment system would be strengthened by establishing a pool of qualified professionals that could be appointed to boards or executive structures (including as independent members for economically significant SOEs) who could professionally play this role on behalf of the state and transparently serve the public interest.

12. Effective audit committees would strengthen the quality of financial reporting and corporate governance. The legal framework does not provide for the establishment of audit committees for SOEs nor for other entities. As a consequence, there is a lack of proper monitoring of the annual audit of financial statements, effectiveness of the internal controls

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15 There is no such requirement for private sector entities either.
and risk management systems regarding the financial reporting as well as of independence of the auditors.

13. **SOE performance could be improved by introducing more accountability and establishing processes for evaluating senior management and the board, or its members, against pre-defined targets.** Weak financial reporting and auditing arrangements also mean any assessment of performance based on financial indicators is not reliable: indeed, the risk of manipulation of indicators is significant. There are no mechanisms to assess the performance of board members and/or administrators of SEs nor to make them liable for poor performance of duties, even if the legislation in force states that they are liable in accordance with labor, civil, administrative and criminal law. There is also no direct link between the long-term interest of the SOE and the remuneration of the administrator (chief executive) and members SOE boards. This lack of accountability contributes to the poor performance of SOEs. Performance should be judged against pre-defined targets, determined according to objectives set out in the ownership policy (i.e. economic performance, public policy or service delivery objectives, or both). It should be measured on the basis of indicators drawn from the audited financial statements and management reports of each SOE.

**Financial accountability (including assessing performance), controls and transparency**

14. **Even though the law requires SOEs to make their financial statements publicly available, this requirement is rarely observed in practice.** All entities are required to present their financial statements to owners (associates, participants, shareholders) and to the Financial Statements Information Service (Public Registry). The Public Registry, responsible for collecting and publishing financial statements of all entities, is overburdened with many responsibilities and too little capacity and resources. Transparency is also hampered by a lack of enforcement of the requirement for SOEs subject to statutory audit to publish financial statements on corporate websites; with only limited numbers complying.

15. **Economically significant SOEs are not classified as public interest entities, and therefore are subject to the National Accounting Standards (NAS) rather than the more demanding International Financial Reporting Standards (IFRS).** While NAS derive from IFRS there are significant gaps and some areas are not covered at all (such as goodwill, assets held for sales, employee benefits, accounting treatment of derivative financial instruments, consolidation requirements). Financial statements prepared by economically significant SOEs may not present a true and fair view. In addition, financial statements prepared in accordance with NAS also have significant issues of compliance and limited disclosures. All of this impacts the transparency of SOEs and creates additional risks of inappropriate economic decisions.
16. **The quality of financial information prepared by SOEs is not reliable for economic decisions.** The quality of audits in Moldova is of weak quality. Oversight and quality assurance of the audit profession are still at an early stage. Unaudited information is often used in aggregate reports for SOE monitoring and decision making. There are cases when the audit is performed after annual financial statements are submitted and annual reports prepared by PPA and MOF include non-audited financial information. Information on compliance with requirements on performing annual audit is limited.

17. **There are issues with SOE compliance with legal requirements and market expectations on transparency and disclosure.** Figure 2 below illustrates the transparency of 20 significant SOEs in Moldova. It shows that only one out of 20 significant SOEs are fully compliant with legislation and market expectation.

![Figure 2: Moldova’s Top 20 SOEs Transparency Illustration](image)

18. **PPA and MOF monitor a set of financial key performance indicators (KPI) that SOEs should achieve.** While this represents significant progress, it is not clear whether or not the indicators are binding for SOEs. The financial performance indicators are in line with good international practices, however, these KPIs may need to be reviewed and revisited as part of a performance monitoring cycle, which analyzes results and introduces necessary adjustments over time as experience and capacity increase. Additional indicators, industry specific and/ or non-financial KPIs, need to be introduced to monitor the main dimensions of each SOE’s performance.

19. **Unreliable data quality affects SOEs financial monitoring as it does not provide an adequate basis for assessing their performance.** Monitoring by PPA and MOF is often based on historical costs and unaudited data. This data is of limited value. As a consequence, presentation of assets in the financial statements of SOEs may not be true and fair and could negatively influence economic decisions.
20. The state in its capacity of owner publishes only limited aggregated information on SOEs as a sector. Although some information about the operation of SOEs is publicly available, there is no widely available and comprehensive annual report on public property administration.

21. Significant risk factors for resource leakages exist, these could be addressed by improving procurement controls, clarifying the responsibilities of boards and management, and addressing conflicts of interest. Many SOEs in Moldova function as parastatals providing government services and supporting government functions. Controls in SOE procurement need to be subject to regular scrutiny by boards, management, internal audit function and external audit. Moldovan authorities are considering transposition of EU Directive 2014/17/EC which imposes public procurement rules in the utilities sectors, including water, energy, transport and postal services, where competition is limited. It is important to note that special rights are to be granted on the basis of a transparent procedure based on objective criteria.

Competition and relationships with stakeholders

22. Insufficient protection for minority shareholders in Moldova JSC SOE’s raises issues of consistent application of good practices and market expectations. Few major SOEs in Moldova have minority interests, but there are examples of relatively significant SOEs with private investments. Minority interests currently have very limited representation in boards of JSC SOEs, and often decisions are made without taking their interests into account. They also lack the access to information given to state authorities.

23. Weaknesses in governance are also reflected in weak competitive conditions and competition policies, which contribute to a high degree of operational business risk for firms in Moldova. Currently Moldova is aligning its legislation to EU laws and policies in the field of competition to ensure a fair business environment. Recent economic reforms under the EU Association Agreement aim to improve the country’s competitiveness. However, the dominance of large SOEs and state-owned monopolies in the economy suggests that these companies are likely to receive preferential or favorable treatment (especially through exemptions, rebates, deferrals or rescheduling the payment of taxes) making it difficult for potential competitors to operate in some sectors. There are reported cases of SOEs subject to competition enjoying preferential treatment. Improved governance and transparency would help develop a more level playing field.

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16 Moldova scores relatively high on the indicator for protecting minority investors, but it covers only listed publicly traded companies and not SOEs. Source: www.doingbusiness.org

17 For example, the only SOE listed on the regulated market is not in exclusive state ownership.
Recommendations

24. Drawing on the report’s findings, three reform measures are of primary importance and merit high level Government support:

(i) adopting an explicit SOE ownership rationale and ownership policy;
(ii) strengthening and consolidating the ownership function and board practices;
(iii) improving incentives for better performance.

These policy-based proposals seek to help the Government of Moldova strengthen its ownership role of SOEs and thereby support overall economic growth and development in the country. The three mutually reinforcing measures are closely linked and aim to increase accountability across the whole ownership structure of SOEs, from their ultimate owners, the citizens, to their employees. The report outlines the main areas for consideration, all of which contribute to one or more of the three reform measures either over a short period of time or in the longer term. However, while improvements in SOE governance are important they will not in themselves guarantee financial sustainability and improved performance of SOEs. Some of the best practices from OECD countries may not be feasible for Moldova in the short term.

25. Within the three areas of proposed reform there are a number of recommendations, some requiring immediate attention as well as longer-term planning. Reforms in SOE governance are challenging and it is often difficult to find suitable and workable solutions. The following first action steps in the areas of financial accountability; controls and transparency; and board practices are recommended to help improve SOE corporate governance and create an effective basis for implementation and enforcement of further major reforms:

- Facilitate learning for PPA, MOF, SOE boards and management, and other relevant key stakeholders, to raise awareness, explain good international practices in SOE governance, and build commitment for reforms.
- Create a proper rationale of state ownership, stating clearly why enterprises are owned and how this benefits society as a whole.
- Create a comprehensive SOE database and analyze whether the existing legal form is suitable for the purpose of each SOE (particularly important for non-economic activities). Designate large SOEs and large JSCs, where the state holds at least 50% of shares, as Public Interest Entities and require them to prepare and publish audited IFRS-based financial statements.

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18 Based on the criteria defined by the art. 3 of the Accounting Directive (2013/34/EC), which will be transposed into new Accounting Law, i.e. (i) balance sheet total ≥ EUR 20 000 000; (ii) net turnover ≥ EUR 40 000 000 and average number of employees ≥ 250.
• Establish systems to monitor and enforce publication of audited financial statements and managements reports on corporate websites by SOEs.

• Ensure ownership policies are publicly available and accessible on websites, including the aggregate situation and performance of SOEs and measures taken to ensure the SOE sector is well governed.

26. In longer term, Government efforts could concentrate on the following areas of reform (for more details see Chapter 11):

The state’s role as an owner

• Move towards a centralized ownership function with a specific public institution responsible for overall coordination, separate from policy making by Government authorities.

• Establish a program of gradual transition to professional board membership. Initially this might include training and on-boarding programs, and the creation of a roster of state representatives for boards and independent directors.

• Develop clear guidelines for line ministries/agencies on how information is passed from the owner to SOE board members; clarify and define responsibilities of ownership function, boards, and management.

State-owned enterprises in the marketplace

• Establish a system to identify and cost public policy objectives that are assigned to SOEs as part of their mandate.

Equitable treatment of shareholders and other investors

• Develop and require consistent application and enforcement of a Corporate Governance Code for economically significant SOEs; introduction of a “comply or explain” principle will gradually influence the behavior of SOEs governance structures.

• Establish a policy on access to information, respecting the rights of all stakeholders in SOEs to access sufficient relevant and reliable information on a timely and regular basis.

Transparency, disclosure and controls

• Benchmark aggregate reporting on SOEs to good international comparators and identify missing quantitative and qualitative information; ensure that statutory audits are undertaken and audited financial information is used for such reporting.
Performance monitoring and management

- Design a proper SOEs compliance dashboard, with required financial reporting and audit requirements and KPIs; develop and publish individual SOE’s performance results and evaluations in public domains for better accountability of SOE boards and management.
- Develop medium to long-term business plans for each (or at least the largest) SOEs (medium-term budgeting can be considered a good start for business planning), including financial and non-financial KPIs for each SOE.
- Develop a SOE performance monitoring system, including performance agreements with each SOE and covering key financial and non-financial performance indicators.

Financial discipline

- Create an appropriate set of incentives for improving controls in the area of procurement by clarifying the responsibilities of boards and management, and addressing conflicts of interest.

The responsibilities of SOE boards

- Move towards the professionalization of board membership.
- Amend the current legislation to require independent members for economically significant SOEs boards.
- Strengthen the role of SOE boards, handing them respective responsibilities and ensuring their accountability as advised by good corporate governance practices.

27. The Government has recently initiated a new draft Law on SOEs that will address some weaknesses in SOE Governance. The draft law includes proposals to address some issues of performance management for senior managers and appointment of board members. The team did not review the draft law in detail (although such a review may be undertaken as part of phase II of the technical assistance, delivered by the World Bank Governance team in collaboration with the UK’s Good Governance Fund). The findings and recommendations of this report may be helpful for policy makers in finalizing the draft law.

28. Implementation of these recommendations should form part of a broader strategy for SOEs linked to economic and sector strategies in Moldova. Given the significance of SOEs and a range of important socio-economic and political-economy related factors, improving SOEs governance in Moldova is a significant challenge. The second phase of the project can help implement selected reforms of highest priority.
CHAPTER 1: CONTEXT AND OVERVIEW OF SOEs IN MOLDOVA

Context and Rationale

1. **Most SOEs in Moldova are former Soviet structures transformed into new legal forms, designed to be compatible with a market economy and allow for privatization.** Privatization has been only partially achieved. As of July 2016, at least 141519 entities were registered as State Enterprises (SEs), meaning these entities administer assets on behalf of the state. Given the relatively small size of the Moldovan economy, it has been difficult to find a buyer for some SOEs. Privatization efforts have been unsuccessful or take a considerable time to mature. Other actions to rationalize the governance of these enterprises have included the merger of some and the liquidation and winding up of others. Privatization and other actions remain an ongoing process.

2. **The management of public assets may not always have been guided by the best interests of the citizens of the country.** Efficiency appears instead to have been narrowly defined as the return on assets. There seems to be little recognition that ownership of SOEs can advance general societal interests, as well as lead to better outcomes for individual companies, for example: (i) improving the availability, accessibility and openness of essential infrastructure that is difficult to replicate (such as telecoms); (ii) enabling universal access to modern water and sanitation services while minimizing the adverse environmental effect; or (iii) improving environmental conditions through maximization of recycling of waste and provision of competitive sourcing of recycled raw materials. The performance of SOEs is often beyond financial returns and is typically a complex set of indicators that take into account service delivery and quality.

3. **State policy in the field of public property administration is promoted by the Ministry of Economy.** The institution responsible for the direct implementation of policy is the Public Property Agency (PPA), which operates under the Ministry of Economy. The Law on Administration and Denationalization of Public Property prescribes the functions and responsibilities of the PPA and of central public authorities in respect of administration of public property, There are currently 26 central public authorities, including the PPA, involved in the governance of SOEs (see annex 2 for detailed information).

4. **Given the economic importance of SOEs, in 2012 the Government of Moldova initiated corporate governance reform but proposals were not implemented and did not**
generate major reforms\(^20\). The 2012 Public Policy Proposal on Improving Corporate Governance Rules for State-Owned Enterprises contained several policy options together with an impact assessment. It set out why having boards with independent directors is important for qualitative corporate governance; provided a good foundation for a results-based reward system for board members; and stressed the importance of ensuring executives have sufficient independence from political interference to achieve the goals agreed with the board. The draft policy explains the rationale of SOEs, that they provide specific important societal services which might not be appropriate for, or of interest to, the private sector. The analysis underlying the policy proposal relied on a rough financial analysis based on key ratios available from PPA. It draws the conclusion that while the aggregate assets of SOEs slightly increased in 2009-2010, their financial performance deteriorated substantially as a result of weak management and corporate governance. The average return on assets was about 0.8%. The existence of this policy proposal on its website indicates awareness in the Ministry of Economy of the problem of poor corporate governance of SOEs (at least in 2012 when it was developed). It is not clear what, if any, follow there was on this policy initiative.

5. This report complements other studies and activities conducted by other institutions or development partners. OECD/SIGMA\(^21\) carried out a study on governance of SOEs focusing on central level, containing references to good international practices (including OECD Guidelines for Governance of State Owned Companies) and comparing these to the situation in Moldova. The need for such an assessment was identified in the 2013 World Bank Report on the Observance of Standards and Codes, Accounting and Auditing (A&A ROSC)\(^22\). The A&A ROSC indicated that the Government should conduct a specific analysis of SOEs governance arrangements to serve as a basis for the establishment of appropriate mechanisms for accountability and oversight of SOEs. Such an analysis should also include an assessment of the training and technical needs of public agencies for better monitoring and oversight of SOEs. The European Bank for Reconstruction and Development (EBRD) is also working with SOEs, focusing on making SOEs more attractive for investors. The EBRD recently signed a Memorandum of Understanding (MoU) with the Government of Moldova (GoM) under the Investment Climate Governance Initiative and initiated a pilot project with the Moldova Railways company SOE “Calea Ferată din Moldova”. The pilot project will assist in the following areas: reporting to shareholders; state ownership functions; independence of SOEs in setting their strategic direction; and application of principles outlined in OECD guidelines for corporate governance in SOEs. The project developed an action plan to be implemented in the next 36 months. The World Bank and the EBRD have agreed to coordinate implementation of their findings and activities.

\(^{20}\) http://www.mec.gov.md/ro/content/public-property-administration

\(^{21}\) It was initiated by the EU Delegation in Chisinau and executed in co-operation with key ministries, such as the Ministry of Economy and Ministry of Finance.

6. This study relies on the most recent available data provided by the Government of Moldova. The information was obtained through research and missions in Moldova conducted in close cooperation with Government authorities. Information has been collected from different sources, including local authorities and publicly available data. In some areas, comprehensive updated data was not yet available, which may limit the analysis.

7. The study is not a comprehensive diagnostic comparing standards and practices in Moldova with relevant international benchmarks. It instead outlines current practices and indicates areas for further consideration by policy makers which may help improve the public ownership. It recognizes that it is a challenge for Moldova to implement many of the good practices in the short-term. The areas of research addressed in this report include: (i) the rationale for state ownership; (ii) the state’s role as an owner; (iii) SOEs in the marketplace; (iv) equitable treatment of shareholders and other investors; (v) stakeholder relations and responsible business; (vi) disclosure and transparency, including audit arrangements; (vii) performance monitoring and management; (viii) financial and fiscal discipline; and (ix) the responsibilities of the boards of state-owned enterprises.

General overview of SOEs in Moldova

Number of SOEs

8. There are discrepancies in the total number of SOEs included in the Registry of Public Patrimony and Registry of Companies; public data consistency raises certain doubts. According to data in the Report on Public Property Administration and Privatization23, as of January 1, 2016, the state held shares in 362 SOEs, including 251 state enterprises and 111 joint stock companies (see annex 2 for additional details). The Registry of Companies, available through the Government open data portal, as of July 19, 201624, states there are 141525 registered state enterprises, of which 450 are liquidated. The difference of 714 state enterprises (1415 “initially registered” - 450 “liquidated” - 251 registered in the Registry of Public Patrimony) raises questions regarding the data integrity and traceability of half of initially registered state enterprises, although in some cases the same company appears in the registry several times which indicates reorganization. This issue is somewhat highlighted by the 2015 PPA report (although it says about 397 SEs are not registered in the Registry of Public Patrimony) which suggests the main reason is fragmentation of the public property administration by sectors/branches.

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23 Unpublished but made available to the World Bank team.
24 no new SE were registered in 2016
SOEs importance and financial performance

9. **SOEs in Moldova play a major role in the national economy, as significant owners, operators and employers in key sectors.** SOE assets account for more than 32% of GDP\(^{26}\) and approximately 10% of the corporate sector’s assets\(^{27}\). SOEs employ 13% of the working population\(^{28}\). The top ten SOEs control over 74% of total SOE assets and are engaged in nationally important activities and infrastructure, such as gas import and distribution, electricity networks, telecommunications, railways, transport, including national airline and roads infrastructure. In addition, many SOEs offer important public services such as the registration or issuing of documents and records. These administrative services, typically undertaken by state agencies or parastatals in other countries, are a result of an unreformed public sector seeking to put some public services beyond budgetary systems and controls.

10. **SOEs are making losses and their long-term debt is rising.** Financial performance as a whole has worsened in recent years as a result of an unreformed public sector and poor SOE governance. Although net assets remained relatively constant in 2015 compared to 2014, SOEs caused losses to the Moldovan economy of 1.2 billion lei (~60.6 million USD). Value generation potential is yet to be determined and employed by the state. State Enterprises (SEs) seem to generate larger losses than joint stock companies (JSCs). Although SOEs are not heavily indebted, all of them have positive net assets, the profitability trends may negatively impact their financial position and create additional fiscal risks. Long-term debt also increased significantly in 2015 compared to 2014. Selected financial position and performance indicators are presented in Tables 3 and 4 below. It should be noted, however, that the data is not entirely reliable as it is drawn from sources often prepared on the basis of unaudited financial statements; and the quality and reliability of financial reporting is generally weak (as described below in more detail).

**Table 3: Dynamics of key SOEs indicators\(^{29}\)**

<table>
<thead>
<tr>
<th>Items</th>
<th>2015</th>
<th>2014</th>
<th>Deviation (+/-) [mln lei]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>40,016.4</td>
<td>39,306.8</td>
<td>709.6</td>
</tr>
<tr>
<td>Long term liabilities</td>
<td>7,027.5</td>
<td>5,694.5</td>
<td>1,333.0</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>8,034.7</td>
<td>8,615.4</td>
<td>-580.7</td>
</tr>
<tr>
<td>Net assets</td>
<td>24,954.1</td>
<td>24,996.8</td>
<td>-42.6</td>
</tr>
<tr>
<td>Sales revenue</td>
<td>21,321.9</td>
<td>16,855.0</td>
<td>4,466.8</td>
</tr>
</tbody>
</table>

\(^{26}\) The ratio assets to GDP is calculated on the basis of MOF reports and GDP data for 2015.


\(^{28}\) State owned enterprises and their role in national economy, IDIS Viitorul, July 2016

\(^{29}\) Source: 2015 MOF report
### Table 4: SOEs financial performance for 2015

<table>
<thead>
<tr>
<th>Items</th>
<th>2015</th>
<th>2014</th>
<th>Deviation (+/-) [mln lei]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit/loss</td>
<td>-1,197.9</td>
<td>-276.9</td>
<td>-921.0</td>
</tr>
</tbody>
</table>

### International experience suggests that strengthening corporate governance can contribute to improved SOE performance.

Countries’ experience of SOE reforms have made clear that challenges faced by SOEs are often caused less by exogenous problems and more by fundamental governance challenges. SOEs are often driven by a myriad of interests between ownership (by the government on behalf of the citizens) and control (by the directors and managers that run the company). This includes complex or contradictory mandates, the absence of clearly identifiable owners, risks of politicized boards and management, lack of SOE autonomy in day-to-day operational decision making, weak financial reporting and disclosure practices, and insufficient performance monitoring and accountability systems. In turn, promoting clear ownership rules and responsibilities, establishing strong SOE oversight entities, developing independent and professional boards, implementing robust performance monitoring mechanisms, and introducing disclosure of sound quality audited financial reports and management reports, including adequate monitoring procedures can positively impact performance. Weak existing SOE governance systems and processes are often further undermined in Moldova by those charged with governance of SOEs being influenced through informal channels.

### Service delivery

SOEs in Moldova deliver important public services: low levels of citizen satisfaction with the quality of and access to these services indicates that SOEs performance in service delivery needs to be improved. Monitoring quality of service delivery is one of the key responsibilities of the ownership function. SOEs have key roles in essential services and industries including utilities, healthcare, transport and energy as well as supporting delivery functions.
of some government administrative service functions. Public opinion surveys reveal customers’ concerns about time, access, quality, and especially unjustified cost, of services for citizens. Moldova’s citizens were consistently less satisfied between 2005 and 2013, for example, with the quality of the public transportation system, where SOEs are significantly present32, than respondents in other countries (Figure 3). According to the 2013 Government survey of the 14 most frequently used administrative services, some of which are provided by SOEs, 58% of customers considered that the charges were unjustified or insufficiently justified. Users’ experiences were below their expectations for the majority of service delivery characteristics listed above33. International experience suggests that improved governance of SOEs can contribute to improvements in quality of service delivery and ensure SOEs are more effective and accountable.

Figure 3: Citizens satisfaction with public transportation, 2006-201334

13. International surveys also reveal increased business concerns about sectors in which SOEs play an important role. Electricity, transportation, and business licenses and permits are identified by Moldovan firms as among the 10 top obstacles in business operations, with corruption in these areas worsening (Box 1), according to the latest World Bank-EBRD Business Enterprise and Environment Survey (BEEPS)35. The Cost of Doing Business Survey for 2014 (CODB) also observed major bottlenecks in respect of construction permits, unfair competition, and unofficial payments (corruption)36.

32 SOEs have a natural monopoly in public transportation, except taxi services.
33 Moldova Public Opinion Survey: Quantitative research on public perceptions of the quality of public service delivery (Management, Administration and Public Policy Institute, Chisinau, 2013)
34 Source: Gallup World Poll International
Box 1: Corruption in service delivery in Moldova, BEEPS\textsuperscript{37}

The results of BEEPS V, published in 2015, indicate that since BEEPS IV (2008-2009) the relative severity of corruption for Moldovan firms has significantly increased, moving from eighth place in BEEPS IV to first place in BEEPS V. Moldovan firms were much more likely to report that an informal payment was expected or requested than an average firm in eastern Europe and the Caucasus (EEC) region. The share of firms reporting that an informal payment was expected or requested in relation to applications for various items has increased significantly since BEEPS IV: for an electrical connection from 1.6\% to 23\% (Chart 2); for a construction-related permit from 22.8\% to 42.4\%; for an import license from 5.9\% to 8.6\%; and for an operating license from 6.9\% to 22\%.

Informal payments to be connected to electricity, Moldova, BEEPS V

Employment

14. Employment by SOEs has increased from around 76,000 in 2010 to 79,000 in 2014\textsuperscript{38}. Dynamics in sectors, however, vary: the increase is primarily explained by a growing number of employees in transport and communications where the largest share of employment is concentrated, while the numbers in other sectors remained stable or declined over the period of 2010-2014 (Figure 4). According to the 2015 PPA report (for entities that are monitored by PPA), in 2015 SOEs employed 51,958 people, 35,919 in SEs and 16,039 in JSC SOEs.

\textsuperscript{37} BEEPS Round IV was completed in 2008-2009; round V BEEPS survey was implemented in 2012-2015, with field work completed in July 2014.

\textsuperscript{38} http://statbank.statistica.md/pxweb/Dialog/Saveshow.asp
15. According to the limited available data SOE staffing levels vary significantly, some have a sizable workforce but low salaries, while others pay more competitive salaries. On average, the monthly remuneration of staff in SEs for 2015 amounted 4,790 MDL (around US$ 242) and in JSC SOEs – 6,053 MDL. The highest monthly salaries included those paid by SE "Air Moldova", 17,947 MDL (543 employees); SE "MoldATSA", 12,900 MDL (185 employees), JSC “Moldova Gaz”, 12,743 MDL (311 employees); JSC Energomor”, 12,110 MDL (9 employees), JSC Metalferos", 10,850 MDL (200 employees). The lowest salaries included those paid by SE "Staţiunea Tehnologica pentru Irigare Bender", 1,099 MDL (68 employees), SE "Stația Nordica de Proiectări și Prospectiuni Chimice", 1,038 MDL (5 employees), JSC "Uzina de mașini de salubritate din Făleşti", 1,530 MDL (25 employees).

Figure 4: Employment in SOEs 2000 – 2014, in thousands

Legal framework applicable to SOEs

16. The laws and government decisions governing SOEs were developed more than a decade ago and, although amended, they are not aligned with good aspirational benchmarks set by recently updated OECD Guidelines. The guidelines recommend ways to ensure that SOEs operate efficiently, transparently and in an accountable manner. Many SOEs, for example, have a public interest character but are not defined as Public Interest Entities (PIEs) in accounting and auditing legislation and therefore are not subject to the same financial reporting and transparency requirements as PIEs. OECD guidelines suggest

39 Source: 2015 PPA report
40 Source: Republic of Moldova National Statistics Bureau
that significant SOEs be subject to the same transparency and disclosure requirements as listed companies. Additional details are provided in chapter 641.

17. **Moldova maintains a parallel legal regime with separate laws on SOEs and JSCs.** The OECD recommends use of a standardized legal form under which SOEs operate, with operational practices in line with commonly accepted corporate norms. The tendency internationally is not to have separate laws and legal status for SOEs, they should instead be subject to legislation applicable to any other business entity.

18. **SOEs and JSC are regulated by different laws.** Law 146 of September 16, 199442, applies to SOEs regulating the establishment, administration, and eventual winding up of enterprises executing governmental tasks and with only one owner, the State. The governance of JSCs is regulated by Law 1134 of April 2, 199743, which provides a standard framework for all companies. The general purpose enterprise legal framework on entrepreneurship, accounting, auditing, taxation, customs, and labor relations is also applicable for SOEs.

19. **Other important laws and regulations applicable to SOEs include:**

   a) **Law no 121-XVI of July 04, 200744, on Administration and Denationalization of Public Property.** This law establishes the goals and the principles of administration of public property. It specifies an overarching goal, calling for harmonization of the volume and structure of public property in correspondence with the functions of the state. Other goals include attracting investment, ensuring efficient management, and developing competition in the public sector economy. The principles underpinning the administration of public property are efficiency, legality and transparency.

   b) **Law no 91 of April 05, 200745, on Land Plots in Public Property and Demarcation.** This law establishes public domain land plots and private domain state owned land plots.

   c) **Regulation on identification and disposal of unused enterprise assets approved by Government Decree no 480 of March 28, 200846.** This provides guidance on the criteria for identifying unused assets, requires their evaluation by a licensed evaluator and states the disposal rules.

   d) **Regulation on Representation of State Interests in the Commercial Societies approved by Government Decree no 1053 of November 11, 201047.** This

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41 For the purpose of this report, SOEs include both legal forms: SEs and JSC SOEs.
establishes the role of state representatives (including board members) in commercial entities where the state owns at least 10% of the shares (if it is less the authorities decide whether they want to delegate anyone). It provides the requirements for appointments and obligations in relation to the delegating authority: the selection of directors and members of executive bodies and modification of equity. It also outlines the main types of activity: amendments to an entity’s statutory documents, reorganization or liquidation of entity, conclusion of transactions surpassing 25% of assets, issuance of new shares, conclusion of management contracts with administrators, reevaluation of fixed assets, issuance of bonds or other debt instruments (loans), acquisition of stakes in other firms, and other issues bearing on the legitimate rights of the state as established by the delegating authority.

e) Government Decree no 568 of May 06, 2008, on Organization of the Records of Public Property and its Circulation; Exercising of Function of Persons Charged with Representing the Interest of the State. This regulation mandates that SOEs report to PPA on use of public property every year by April 25th, according to a template contained in the annex.

f) Regulation on Transferring Goods in Public Property; approved by Government Decree no 901 of December 31, 2015.

g) Regulation on Writing-Off Used Up Assets Attributable to Fixed Assets; approved by Government Decree no 500 of May 12, 1998.

20. There is no general requirement for SOEs to follow a code of corporate governance, except SOEs that are PIEs (currently only one enterprise). The Code of Corporate Governance issued by the National Commission on Financial Markets entered into force in March 2016, and public interest entities must comply with its provisions by September 4, 2016. All JSCs are encouraged to comply with the code provisions. As of July 1, 2016, only one SOE falls under the definition of a PIE, Franzeluta SA, which is listed on a regulated market.

Objective

21. This report has been prepared to support the Government of Moldova’s efforts to identify and begin to address issues and opportunities in relation to their state owned
enterprises (SOEs). The report documents the findings of Phase I technical assistance, delivered by the World Bank Governance team in collaboration with the UK’s Good Governance Fund, and will serve as a foundation for the development and prioritization of potential reforms. Recognizing the challenges and legacy of reforms in this area, the report outlines current practices and highlights key areas for policy makers’ future focus which may help improve public ownership. The report focuses on key areas of corporate governance, vital to ensure that SOEs operate efficiently, transparently and in an accountable manner. It draws on publicly available data, data provided by counterparts, and collected from country authorities. The report presents recommendations for reform. It does not attempt a comprehensive diagnostic comparing standards and practices in Moldova with relevant international benchmarks and recognizes that it is a challenge for Moldova to implement many of the good practices in short-term. Phase 2 of this technical assistance will support implementation and capacity building in selected areas.

Methodology

22. The analysis of the corporate governance arrangements and practices of central government SOEs in Moldova is based on the OECD Guidelines and the World Bank Toolkit on Corporate Governance of SOEs, focusing on key issues relevant to the country context. The analysis of the corporate governance framework and practices in Moldova in relation to international good practice and provides reform options for consideration. The study undertakes an assessment of the existing institutional arrangements while taking into account de facto practices drawn from discussions with key stakeholders. An extract from OECD Guidelines on Corporate Governance of State-Owned Enterprises summarizing key areas is provided in the Annex 1.

Key Audience

23. Government stakeholders are the primary audience for this report. The major stakeholders include Ministry of Finance, Ministry of Economy and Agency for Public Property under the Ministry of Economy of the Republic of Moldova. Subject to prior agreement with the Government, the report or parts thereof could subsequently be considered for publication for the benefit of a larger audience including SOEs management, boards of directors and other interested practitioners in Moldova and beyond.

52 This report analyzes SOEs that are owned by central government, and include the legal forms of state enterprises (SEs) and Joint Stock Companies (JSCs) with state owning majority of shares, unless otherwise stated. Entities that are owned by local governments are not included in the scope of this report. PPA and MOF differ on which JSCs are monitored; PPA monitors JSCs with over 25% of shares in state ownership, while the MOF monitors only JSCs with over 50% state ownership. Hence, depending on the source, this report may use data for different numbers of SOEs.


54 [https://openknowledge.worldbank.org/handle/10986/20390](https://openknowledge.worldbank.org/handle/10986/20390)
CHAPTER 2: RATIONALE AND CHARACTERISTICS OF STATE OWNERSHIP IN MOLDOVA

OECD principles and recent trends in defining rationale for state ownership

24. OECD Guidelines recommend that “the state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review”. SOEs are usually differentiated from various other public agencies, quasi-governmental organizations, or other parastatals\textsuperscript{55} organizations in different countries that carry out public policy functions at arms’ length from government line departments and earn a significant share of their own revenues.

25. OECD guidelines advocate for a clear rationale for the state’s ownership of economic activities, with regular reviews to ensure the rationale remains relevant and appropriate. This is a relatively new area and only a few countries (including Norway, Chile and Hungary) have developed a strong and open rationale. Such a rationale should be included in the ownership policy and cover areas such as the ultimate purpose and rationale of state ownership, the role of the state in governance of SOEs, political accountability and periodic revision of the ownership policy, and rationale for owning individual SOEs.

26. Each jurisdiction sets its own scope and goals for their SOEs and quasi-governmental sector entities, depending on governmental priorities, economic needs and fiscal powers. There is no universal, globally recognized model or set of objectives for SOEs and quasigovernmental sector entities. However, some common elements exist which represent good practice. In many OECD countries entities in public sector are classified as SOEs or other types of institutions depending on whether they pursue economic activities or fulfill specific policy objectives. This is typically based on various philosophies regarding the need for state ownership. Parastatals are typically established to carry out well-defined public policy objectives. Public authorities impose specific requirements on these types of entities as the providers of the service in order to ensure that certain public interest objectives are met, for instance, in the matter of utilities, healthcare, transport and energy. These obligations are set as objectives at the time of establishment of an entity and can be applied country wide, or at regional or municipal level.

\textsuperscript{55} A company, agency, or intergovernmental organization, that possesses political clout and is separate from the government, but whose activities serve the state, either directly or indirectly. Parastatals generally enjoy operational autonomy and operate with their own or separate budget from the general government.
27. The OECD recommends that the ultimate purpose of state ownership of SOEs should be to maximize value for society, through an efficient allocation of the resources. Box 2 provides examples of good practices with considered and articulated objectives in a sample of countries.

**Box 2: State ownership objectives - examples**

**Australia:** The government has a unified approach to the establishment of new business and non-business enterprises [in the state owned sector]. Under this approach a new public entity should only be set up in cases where it can be demonstrated that this is the most effective and appropriate means of carrying out the desired function (service delivery, stewardship of public assets, integrity, regulatory, quasi-judicial, and/or advisory). The State Owned Enterprises Act (1992) states that “The principal objective of each state owned company is to perform its functions for the public benefit by (a) operating its business and pursuing its undertaking as efficiently as possible consistent with prudent commercial practice; and (b) maximizing its contribution to the economy and well-being of the state.” In relation to the commercially driven companies the recent guidelines from the Australian Government state that “A principal objective for each Government Business Enterprise is that it adds to its shareholder value” (Australian Department of Finance, 2015).

**New Zealand:** The State Owned Enterprises Act 1986 specifies that “the principal objective of every state enterprise shall be to operate as a successful business and, to this end, to be (a) as profitable and efficient as comparable businesses that are not owned by the Crown; (b) a good employer; and (c) an organization that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavoring to accommodate or encourage these when able to do so…”

**Slovenia:** The Ordinance on State Assets Management Strategy was developed by the Government and approved by the National Assembly/Parliament in 2015. The main goal of the State Assets Management Strategy is “to pursue a stable, balanced and sustainable economic development, thus providing for the stable long-term well-being of citizens of the Republic of Slovenia”, while pursuing the objectives of individual sectoral strategies. The objectives of individual companies differ according to the classification of these companies as SOEs with strategic assets, those with important assets, or those with portfolio assets.

**Sweden:** The State Ownership Policy, approved by the Government in 2015, pronounces that “The Government’s overall objective is creating value for the owners” and, where applicable, to ensure that specially commissioned public policy assignments are well performed. The Government believes in principle that the state should not own companies that are active in competitive commercial markets unless the company has a specific public service assignment that would be difficult to fulfill in any other way (OECD, 2015b).

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56 Source: Data prepared based on applicable legislation in each jurisdiction.
28. **Governments choose to retain control over certain sectors and industries, often referred to as strategic sectors.** The rationale behind maintaining state participation in such industries vary from one country to another, but may be grouped into the following categories: (i) keeping control over natural monopolies; (ii) establishing specific regulations; (iii) dealing with political sensitivities or institutional constraints; (iv) maintaining infrastructure, such as railways and telecommunications; (v) producing strategic goods and services (mail, weapons); (vi) extracting natural resources; (vii) providing access to energy; (viii) keeping grasp over other essential and social areas, i.e. broadcasting, merit goods (healthcare), demerit goods (alcohol) etc.

29. **Examples reported by the OECD and by the World Bank suggest that it is becoming good practice to explicitly state the rationale for state ownership, some OECD member-countries use legislation for this.** In Germany, for example, Section 65 “Holdings in private-law enterprises” of the Federal Budget Code 1969 explicitly states the ownership rationale. OECD countries governments have increasingly addressed the rationale for state ownership policy to improve SOE governance and performance, to strengthen the state’s ownership function and improve efficiency of resource allocation. The World Bank, through reviewing practices from several countries around the world, particularly advises on strengthening SOE corporate governance, including through clarification of ownership objectives by the state. Box 3 summarizes OECD and the World Bank study findings.

**Box 3: Rationale for state ownership – examples**

**France:** The Guidelines for the State as Shareholder assign to the State Holdings Agency list the following four objectives for ownership of economic entities: (1) ensure a sufficient level of control (…) in sectors particularly sensitive for sovereignty; (2) ensure the existence of resilient operators to meet the country’s fundamental needs; (3) support the development and strengthening of enterprises particularly in sectors playing a crucial role for national and European economic growth; (4) participate in the rescue of enterprises whose failure could have systemic consequences, in accordance with the European rules.

**Hungary:** The Privatization Act (Act XXXIX of 1995) states that assets may remain in long term state ownership in: (1) national public utility service providers; (2) companies of strategic significance in the national economy; (3) companies carrying out defense or other special duties or services; and (4) cases when company shares are needed to guarantee state ownership or voting rights.

In **Mexico** the strategic areas for state ownership are defined in Art. 28 of the Constitution. These are postal delivery, telegraphs, and radio telegraphy; petroleum and

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57 Source: Data prepared based on applicable legislation in each jurisdiction.

58 That should not constitute monopolies.
other hydrocarbons; basic petrochemicals; radioactive minerals and the generation of nuclear energy; electric power, and activities expressly provided by the laws enacted by the Congress of the Union. The state must secure the interests of the nation in satellite communications, and railroads are a priority for national development.

**Norway:** The Government’s objective is to maintain a diverse and value-creating ownership. In line with the pronouncements of the White Paper presented by the Government to the Parliament [Meld. St. 27 (2013-2014)], A Diverse and Value Creating Ownership, SOEs in Norway are classified into four groups with different objectives for state ownership: (1) companies with commercial objectives; (2) companies with commercial objectives and national anchoring of their head office functions (i.e. develop Norwegian markets in Norway); (3) companies with commercial and other specifically defined objectives; (4) companies with sectorial policy objectives (State Ownership Report 2014).

In **Slovenia** the 2015 Law on State Assets Management Strategy requires the state to maintain or obtain at least a 50% shareholding + 1 share in companies classified as strategic. It defines the following strategic assets:

- **Enterprises carrying out key infrastructural duties:**
  - network infrastructure of key electronic communications;
  - transport infrastructure (roads, railways);
  - natural monopolies (ports, etc.).

- **Companies in economic activities which are important for the stable and safe supply of resources and energy and public grid operators:**
  - energy industry;
  - distribution of electricity and distribution and storage of other energy products (gas, oil);
  - water supply and other environmental services; national operator of the port activity (Port of Koper).

- **Companies rendering important public obligations (services of general economic interest):**
  - public passenger transport;
  - maintenance and management of public infrastructure (roads, railways, distribution networks).
  - companies increasing the competitiveness of the entire forest-wood value chain.
Rationale for state ownership in Moldova

30. A document defining the objectives of state ownership does not exist in Moldova. Some enterprises appear to be held wholly or partially by the state for commercial reasons, others for social reasons, some simply as a way of avoiding budgetary restrictions, and some for a combination of these reasons. Over-riding all of these reasons, however, is an implied objective that all enterprises should be managed commercially because the PPA has specified a set of financial returns and other financial ratios that state owned companies ought to achieve. This is supported by the Ministry of Finance (MOF) making recommendations to improve the operating performance of state enterprises. The legislation on SOEs defines how a company should exist (how it is created etc.) but not why it exists. The Law on State Enterprises, for example, focuses on function stating that the decision to establish the SE is approved by the Government at the proposal of the central public administration line authority or other administrative authority, and the function of the founder is exercised on behalf of the Government by the authority specified in the Government Decision, but there is no legal requirement to justify the entity’s purpose.

31. Although the basic objectives of state ownership are outlined, the legislation does not provide for objectives and functions of ownership, or for governance principles and requirements toward specific SOEs. The Law on Administration and Denationalization of Public Property describes the public property administration general objectives: to balance the proportion of state and private ownership; enhance competition; ensure effective management of SOEs; and attract investments in SOEs. The law sets the roles of the Government, PPA, ministries and other central public administration authorities’ in owning and managing the state property. It does not require objectives or functions of the ownership, nor governance principles and requirements toward specific SOEs. According to the above mentioned law and the Regulation of PPA59, PPA exercises, on behalf of the state, the ownership functions of state public property and the rights and responsibilities arising from the shareholding. PPA exercises the shareholder functions in commercial companies fully or partially owned by the state. However, based on the Government Decision 51960 on delegation of the administration functions of public property to the central public administration authorities, the exercising of shareholding rights on behalf of the state in different sectors should be transferred to sectoral central public administration authorities.

32. One unusual facet of SOEs in Moldova is that they play an important role in supporting the delivery of Government services typically undertaken by line ministries or parastatals. These functions include company registration and issuance of passports, personal IDs and driver licenses as well as cadastral services. Some SOEs provide other goods and services that are also delivered by private sector firms.

60 http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=353742
33. **Rationales for ownership of individual SOEs are not disclosed.** Central public administration authorities are legally entitled to review and define entities suitable or not for privatization and give their judgments to the PPA; there is no evidence of such analyses available. The law allows authorities to use economic, social and legal reviews to assess SOEs and inform the PPA, who keep a list of SOEs not liable for privatization, of the reasons to retain ownership or privatize specific SOEs. Based on the 2011-2015 privatization rounds and statements of public officials, the Government’s rationale for privatizing or holding ownership of SOEs was dictated by reasons of inefficient management, losses generated, insufficiency of funds to recapitalize them, or state budget constraints. Certain natural monopolies, utilities, and infrastructure companies are owned by the state while others were privatized or conceded into private management. For instance, SE “Calea Ferată a Moldovei” (national railway company), JSC “Moldtelecom” (national telecom incumbent), JSC “Termoelectrica” (electricity & heat producer as well as heat distributor in Chișinău), SE “Moldelectrica” (high voltage electricity transporter), JSC “RED-Nord” (electricity distribution for northern Moldova) are all state owned. Electricity distribution in Central and southern Moldova was sold to JSC Gas Natural Fenosa (Spanish owner) in 1999.

34. **New SOEs continue to be created despite the existing large portfolio of enterprises, some seemingly to move activities outside the public budget system and control.** Many new SOEs seem to be created not because of a clearly defined rationale, but to enable management of the resources associated with the activity outside the direct budgetary control process. This is the case even in instances where activities would be better described as those undertaken by public agencies or parastatals (and would be organized this way in most countries). The company structure has thus become a device to avoid budget rules (or set-up activities off the balance sheet of the Government), with such enterprises delivering non-market activities which ought to fall within the responsibilities of the founding ministry and for which the relevant minister should be directly accountable. An additional risk is that SOEs may create subsidiaries without proper sanctioning by relevant government bodies. This has created significant issues of uncontrolled expansion of number of SOEs in some countries. The problem may be worse in the absence of proper consolidated financial reporting requirements, essentially allowing entities to create unreported off-the-balance sheet activities.

35. **Moldova could aspire to recent international trends and the OECD Guidelines by setting-up a proper rationale of state ownership, supplemented by a detailed review of whether the legal form of SOE is appropriate for certain types of activities.** In so doing the state would develop an overall ownership policy, stating clearly why it owns enterprises and how it maximizes the benefit for society as a whole by doing so. Currently the Law on Administration and Denationalization of Public Property has only an annex detailing what the state would not privatize (i.e. strategic enterprises of national importance). This is in essence a safeguard, the state also needs to be clear about the positive outcomes it pursues through state ownership in enterprises.
36. Introducing a clear rationale document establishing state ownership policy, defining the objectives, principles and modalities for managing and reforming SOEs in Moldova, would improve accountability to both the legislature and the electorate. The ownership rationale policy could explicitly address the trade-offs in respect of the governance of SOEs: whether they should pursue economic activities for returns, or whether they should also serve as instruments for the pursuit of industrial or other policies; whether SOEs should aim at generating short-term profits, or at maximizing long-term growth and quality of service delivery; whether profits should be re-invested or distributed as dividends; etc. The ownership rationale policy should then be periodically revised (yearly, for instance). This policy should be made public (subject to specific omissions to protect the confidentiality of sensitive business information if any is included). The ownership rationale policy would be an important act of the Government, for which it will be politically accountable to both the legislature and the electorate; the Government will thus have a clear incentive to ensure that the objectives set in the ownership policy are achieved.

37. A clear ownership rationale document would establish the objectives of SOE ownership in Moldova. Although the basic objectives of state ownership are outlined, the legislation in force does not provide for objectives of the ownership, functions of and governance principles and requirements toward specific SOEs. This hinders a systematic approach to governance of these entities, decisions on continuing or ceasing ownership, as well as decisions on creating new SOEs. OECD guidelines outline the good, and relatively recent, international practice for a clear rationale for state ownership. This might include delivery of public goods and services where the state may be more efficient or reliable; operation of natural monopolies where markets are not efficient; and support for broad economic and strategic goals of the country, including maintaining strategic national interest companies or companies of systemic importance.
CHAPTER 3: THE STATE’S ROLE AS AN OWNER

Good practices in consolidating state ownership

38. In recent years, improving the corporate governance of SOEs has become a major policy objective in countries around the world. Managing multiple and potentially conflicting objectives is one of the central challenges in the governance of SOEs. The OECD SOE Corporate Governance Guidelines (2015) recommend that the state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

39. The OECD guidelines for SOEs governance set aspirational targets for the state’s role as an owner that recommend establishing appropriate institutional arrangements conducive to responsible ownership practices. These include standardizing legal forms of SOEs and their operational autonomy, independence of boards, centralization of ownership functions (or at least proper coordination arrangements) and their accountability to other relevant public bodies, and acting as an informed and active owner. The SOEs governance system can be illustrated as follows in Figure 5. Each level is accountable to the one above, in different ways, and each is exposed to rewards or sanctions (political or contractual ones) depending on the performance of the lower level, over which it exercises control or supervision. Consequently, each level has a strong incentive to conduct rigorous oversight over the lower level. The top circle includes the political actors – electorate, parliament, government – which are linked to each other through political accountability. In particular, the government is accountable to both parliament and the electorate on the basis of the ownership policy and the overall performance of SOEs. The middle circle would include the policy-making actors that influence the performance of SOEs: the government, which determines the overall ownership policy; the boards of directors of SOEs, which translate such policy into guidance for their managers; and the supervising entity, which monitors the interface between such guidance and the ownership policy, and the performance of the SOE. The lower circle includes various stakeholders: boards, managers and customers. Each is accountable to each other through the common rules of corporate and contract law. The crucial link is the supervising entity (which may be also called ownership entity), which joins the political circle to the SOE circle. Its function, in essence, is to channel the political accountability of the government (to which it reports) down to the SOE. If the supervising entity is a rigorous supervisor, and a fair and predictable provider of both sanctions and rewards, then the boards of SOEs have a strong incentive to supervise their managers equally rigorously, and managers have an equally strong incentive to perform appropriately, to the benefit of the government and, ultimately, of the citizens. The OECD guidelines recommend centralization of such an entity, or at least providing for a coordinating body. In
other words, if the ownership/supervising entity is subject to rewards and sanctions depending on the performance of SOEs, their boards of directors will know that they will be rewarded or sanctioned by the supervising entity depending on how the managers perform. These managers will therefore take their duties more seriously, as the managers of private companies generally do.

**Figure 5: SOE Accountability lines**

40. Governance of SOEs has a particular issue of separation of control and ownership—the owners being the citizens of a country—but they also face additional challenges inherent to public ownership that can severely undermine efficiency. Unlike a widely held corporation in the private sector, an SOE generally cannot have its board changed via a takeover or proxy contest, and most cannot go bankrupt. The absence of potential takeovers and proxy contests reduces the incentive of board members and managers to maximize the value of the company, and the lack of bankruptcy can introduce a soft budget constraint, which reduces pressure to contain costs. Hence, two of the most
important checks on underperformance are absent. Although an SOE has very diffused ownership, it is generally subject to oversight by a higher body or bodies. This can be one or more ministries, an ownership entity specifically created to oversee SOEs, the Parliament, or frequently some sort of combination (ideally a well-coordinated combination). In the worst examples these various authorities may use SOEs to achieve short-term political goals at the cost of both efficiency and longer-term policy objectives; in the best they provide effective guidance and governance.

41. This complex principle-agency chain, through various levels of government, presents difficulties that are absent in the more straightforward relationship between a company's board and managers and its shareholders. SOEs also have the related problem of common agency. Given that each relevant part of the government has somewhat different objectives, each could attempt to influence the SOE accordingly. Even if the various objectives are perfectly legitimate, the overall impact of this competition for influence reduces accountability and weakens the incentives for managers and board members.

42. State ownership, regardless of the form, requires protecting the state’s interest as an owner of valuable assets while ensuring that SOEs carry out their economic or policy objectives. Achieving these twin goals demands competence and accountability that can be undermined by an ownership form that is opaque, complex, or contains inherent conflicts of interest. Clearly, the role of directors is crucial: in the absence of adequate external pressures, effective management of an SOE relies almost exclusively on the behavior of its board of directors and on compliance with its own fiduciary duties.

Institutions and their main responsibilities

43. There are two types of state owned enterprises in Moldova, namely state enterprises (SE) and joint stock companies (JSC). The majority are SEs, which are wholly owned and governed by the state. A smaller group of enterprises are JSCs and the state may own various proportions of shares from partial ownership to full ownership.

44. Governance arrangements for SOEs in Moldova are not standardized or consistent. SEs and JSCs have different legal frameworks. In the case of SEs, strategic management responsibilities lie with the responsible line ministries, a board of directors and administrator. According to the Law on State Enterprises board members are appointed by the founding institution; the administrator (chief executive) is appointed by the founding institution based on the board’s proposal. There do not appear to be subordinate regulations which provide further guidance and as a consequence ministers and heads of agencies have significant discretionary powers. In the case of JSCs, the governance arrangements comprise a general meeting of shareholders (the state appoints a “state
representative” to act on its behalf as owner), board of directors, executive body and censors’ committee. SOEs are not obliged to establish audit committees; however, the Code of Corporate Governance, which is mandatory for JSCs that are PIEs, recommends establishing various committees such as remuneration committee, risk management committee, etc.

45. In addition to ownership through state representatives in JSCs, or being the founder institution in SEs, the PPA and the Ministry of Finance exercise certain monitoring functions on behalf of the state. Since 2007, the PPA has existed as the central public administration line authority, operating within the Ministry of Economy. In line with the PPA Regulation approved by Government Decision, the PPA is responsible for the execution of state policy on management and privatization of state property and exercise of ownership rights, including analysis of financial statements and assessment of SOE performance. The PPA monitors JSCs where the state holds over 25 percent of shares by producing PPA’s annual reports and financial analyses. Majority owned JSCs and SEs are also monitored by the Ministry of Finance’s financial analysis and monitoring division.

46. There is fragmentation of the state ownership function and a lack of clarity in the numbers and forms of SOEs. A fragmented ownership function is associated with issues of scattered resources and inconsistencies, and may limit the possibilities for the state to promote consistent guidance and policies in areas such as assets management, dividend policies, performance measurement, and professionalization of boards. Of the 251 SEs and 111 JSCs included in the Registry of Public Patrimony for 2015, PPA performed financial monitoring of 200 SEs and 58 JSCs where the state holds more than 25% (the total number of JSCs with more than 25% shares is 86). SOEs in liquidation, under insolvency process, registered abroad, or which failed to submit their financial statements to the Registry of Financial Statements are not included in the financial analysis. The MOF 2015 report, however, states that financial monitoring is performed for 189 SEs and 41 majority owned JSCs (71 JSCs have more than 50% state ownership). PPA includes in its report for the same period 200 SEs based on the additional information received directly from these SOEs. The state ownership in JSCs, as of January 01, 2016 is shown in table 5 below.

Table 5: State ownership in the JSCs, as of January 01, 2016

| JSC SOEs |  
|------------------|------------------|
| Total JSCs in which the State holds a share, of which |  
| 111 |
| 100% | 25 |
| 75% - 99.9% | 31 |

63 45 SEs and 28 JSCs where the state holds more than 25%.
64 Source: 2015 Report on financial monitoring, performed by MOF
<table>
<thead>
<tr>
<th>Percentage</th>
<th>JSC SOEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>50% - 74.9%</td>
<td>16</td>
</tr>
<tr>
<td>25% - 49.9%</td>
<td>14</td>
</tr>
<tr>
<td>10% - 24.9%</td>
<td>6</td>
</tr>
<tr>
<td>Below 10%</td>
<td>19</td>
</tr>
</tbody>
</table>

47. **Centralized ownership by a single public institution would reduce duplication, improve co-ordination, and address discrepancies and inherent conflicts of interests.** SOE ownership in Moldova is not centralized nor well-coordinated. PPA and MOF partially duplicate financial monitoring functions; according to the authorities, currently this is an efficient way of additional scrutiny over financial information. Also, the scope of SOEs ownership is very broad and reflects both very limited structural reforms and an unreformed public administration, where the state is focused on control and command rather than policy formulation. As a consequence, every line ministry and many subordinated agencies exercise the so called founder function in at least one SOE.

48. **Policy making and ownership functions are not separated.** During the recent history of Moldova there was a failed attempt to concentrate the ownership function in the PPA, then in the early years of this century ownership reverted to line ministries. This makes the line ministries responsible for both sector policy formulation and policy execution through the entrusted SOEs. Unusually, SOEs are often also created not for economic activities but to undertake public services which would normally be performed by state agencies or parastatals, e.g.:

- enterprise registration;
- issuance of personal IDs, passport and drivers’ licenses;
- maintenance of various public registries and databases;
- IT management of tax, customs, MOF’s IT systems;
- various inspections particularly in food safety and conformity assessment;
- management of water and irrigation and sewerage;
- forestry management;
- geological works, soil conservation and rehabilitation;
- theaters;
- management of radio spectrum;
- cadastral services.
49. Moldova’s Supreme Audit Institution, the Court of Accounts (CoA), has highlighted the problem of board conflicts of interest and raised the issue in public hearings. It is common practice for one institution (often a ministry) to have both the policy-making and ownership role. Ministries must somehow reconcile policy making functions, promoting the sector, and ensuring its effective operation, with the ownership functions and delegation of officials to SOE corporate boards, which are working primarily towards profit maximization.

50. Until recently the CoA had no authority to audit entities in which the state owns less than 50% of shares. As a result, the CoA had no authority to audit some relatively large companies like the Glass Container Company or MoldovaGAZ, even though, for example, the latter has a monopoly supplying gas to the majority of Moldovan households. Law no. 261 of December 05, 2008, on Court of Accounts was amended in March 2016, so that the CoA now has the authority to audit SEs and JSCs if the state owns 30% shares or more. Typically supreme audit institutions would not perform financial audits of corporate SOEs, but such a right should exist to perform specialized audits as needed and when risks become important for public finances.

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66 Previously CoA had authority to audit SOEs with full state participation and SOEs where state share exceeds 50%.
OECD principles and good international practice

51. Good international practice and OECD guidelines recommend that, in order to avoid market distortions, the legal and regulatory framework for SOEs should ensure a level playing field in markets where SOE and private sector companies compete. When SOEs undertake both public policy and economic activities these should be accounted for separately, and public policy activities should be funded by the state. Moldova could aspire to such a framework, fully compatible with the OECD Principles of Corporate Governance.

52. A number of areas need to be addressed regarding the issue of similar conditions for private sector companies and SOEs. These include: (i) separation of regulatory and ownership function; (ii) redress through legal and arbitration processes should be similar for all stakeholders; (iii) if SOEs have both economic and public policy activities these must be accounted for separately, disclosed, and costs of public policies implementation should be adequately compensated; (iv) laws related to economic activities or taxation should be similar for SOEs and private companies; (v) SOEs should have the same access to finance as private companies without any preferential treatment; and (v) when SOEs are involved in public procurement, either as purchaser or bidder, the procedures have to be competitive and non-discriminatory.

53. The legal framework for SOEs in Moldova is compatible with the OECD Principles of Corporate Governance in some aspects, including sharing the position that SOEs should not receive preferential treatment. However, as shown in this Chapter, there are a number of actual practices that hamper achievement of this objective, including the absence of separate government authorities responsible for SOEs ownership function which creates clear conflicts of interest, the lack of separate accounting for public services obligations, and low financial and fiscal discipline.

Conduct of SOEs in the marketplace

54. Under the current SOE legal framework, there is no clear overall separation between the state’s ownership function and other functions that can have an effect on SOEs in Moldova. Under the Law on Administration and Denationalization of Public Property, the ownership function is dispersed by delegation of state ownership rights to the line ministries that are responsible for sectoral policy and other authorities. Ministries have
sectoral policy functions and were also empowered, by Government Decision\textsuperscript{67} in 2014, with the ownership function of SOEs. As noted in Chapter 2, good international practice calls for distinct differentiation of ownership and policy-making and/or regulatory functions which is lacking in Moldova. In many cases, ministries that are responsible for sectoral policy and/or regulation also exercise ownership in SOEs that operate in the relevant markets. As examples, as of January 01, 2016, the Ministry of Agriculture and Food Industry owns over 40 JSCs (annex 2); and the Ministry of Transport and Road Infrastructure exercises state ownership in aviation and railways through SE Compania Aeriana "Air Moldova" and SE "Calea Ferata din Moldova". Some degree of functional separation occurs in markets where there is an independent sectoral regulator (recent analysis of Moldova’s regulators by De Vrieze and Ieseanu (2011) reveals a lack of consistency and coherence in the application of the instruments of independence and accountability among the ten examined agencies), but most regulation bearing on SOEs is still the responsibility of the line ministries and their subordinate institutions.

55. Moldova has endorsed legal reforms to develop a sound policy framework on competition, continuously aligning its legislation with EU laws and policies to ensure a fair business environment. The new Law on Competition\textsuperscript{68} was adopted in 2012. The Constitution of the Republic of Moldova\textsuperscript{69} declares market, free economic initiative and fair competition as the main elements of the economy\textsuperscript{70}. The Constitution also declares a socially-oriented market economy based on the coexistence of freely competing private and public sectors\textsuperscript{71}. In addition, the State has to ensure “the freedom of commerce and entrepreneurial activity, protection of loyal competition, creation of a framework that would be favorable to the development of all factors of production”\textsuperscript{72}. The Government Decision on the Regulation of Monopolies\textsuperscript{73} lists the state and natural monopolies, as well as the government bodies empowered to regulate them. Another recent pronouncement is the Law on State Aid\textsuperscript{74} which regulates the procedures for authorizing, monitoring, and reporting of state aid beneficiaries in all sectors of the national economy, except for agriculture.

56. Despite this framework, there are weak competitive conditions and low effectiveness of competition policies, contributing to a high degree of operational business risk for firms in Moldova, which reflect weaknesses in governance. The recent economic reforms of the Government under the EU Association Agreement are aimed to improve the competitiveness of the country. The competition perception indicators of the

\textsuperscript{67} http://lex.justice.md/viewdoc.php?action=view&view=doc&id=353742&lang=1
\textsuperscript{68} http://lex.justice.md/viewdoc.php?action=view&view=doc&id=344792&lang=1
\textsuperscript{69} http://www.presedinte.md/eng/constitution
\textsuperscript{70} Article 9. Fundamental Principles Regarding Property, para. (3)
\textsuperscript{71} Article 126, Economy, para. (1)
\textsuperscript{72} Ibid. para. (2), b)
\textsuperscript{73} http://lex.justice.md/viewdoc.php?action=view&view=doc&id=296512&lang=2
\textsuperscript{74} http://lex.justice.md/viewdoc.php?action=view&view=doc&id=344389&lang=2
World Economic Forum’s Global Competitiveness Report (2015-16) indicate highly distorted competition in Moldova as an area for continuous improvement. The country ranks 103 out of 144 countries on the intensity of local competition, 124 on the extent of market dominance, and 135 on the effectiveness of antimonopoly policy (a high rank indicates poor performance). Investors in Moldova perceive that they face one of the highest business risks related to a weak competitive environment among other neighboring countries, mainly related to: (i) vested interests and discrimination against foreign firms that may hinder innovation and preclude more efficient firms from gaining market share; and (ii) price controls and the control of other market variables that limit the benefits that firms could obtain by competing effectively (Figures 6 and 7).

**Figure 6: Business Risks Related to Weak Competition Policies (By Component)**

57. SOE boards include representatives of the ownership entity and other state officials, which goes against the spirit of the OECD Guidelines recommendation of separation between ownership and regulatory functions. The boards of companies such as SE Compania Aeriana “Air Moldova”76, SE “Moldelectrica”77 and JSC “Moldtelecom”78 are, for example, typically chaired by line deputy-ministers and composed of civil servants (see Chapter 10 for an overview of the board structure and composition in Moldova). Good international practice suggests that any civil servants employed by an ownership entity and involved in sectoral policy functions do not serve on the boards of SOEs operating in the relevant market and Moldova could consider adopting these practices in the longer term.

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77 [http://www.moldelectrica.md/ru/about/admin_council](http://www.moldelectrica.md/ru/about/admin_council)
78 [http://www.moldtelecom.md/ru/content/%D1%81%D0%BE%D0%B2%D0%B5%D1%82-%D0%BF%D1%80%D0%B0%D0%B2%D0%BB%D0%B5%D0%BD%D0%B8%D1%8F](http://www.moldtelecom.md/ru/content/%D1%81%D0%BE%D0%B2%D0%B5%D1%82-%D0%BF%D1%80%D0%B0%D0%B2%D0%BB%D0%B5%D0%BD%D0%B8%D1%8F)
58. SOE stakeholders in Moldova have, in principle, access to the same legal and arbitration processes as those available to the stakeholders of private companies. Commercial, labor or other disputes involving SOEs are to be resolved through the court system and without special arbitration procedures. SOE stakeholders must be treated fairly and equitably by the judicial system as required by current legislation, such as the Law on Entrepreneurship and Enterprises\(^\text{80}\), the Law on State Enterprise, and the Law on Joint-Stock Companies. However, as SEs and some JSC SOEs do not legally own the state assets under their management, and as public sector property cannot be alienated or be a subject to execution sale\(^\text{81}\), the ability to place collateral or for lenders to access collateral in the case of non-payment could be limited in practice.

59. It is not easy to maintain a level playing field with the private sector in Moldova given the absence of formal policies and procedures to monitor, or compute the true cost of, public service obligations (PSOs) or to assess SOE activities with an explicit budget transfer. There is no evidence that SOEs separately account for and disclose revenues and costs attributed to commercial and public policy objectives. Good international practice and principles of competitive neutrality suggest that SOEs should be adequately compensated by the government for the fulfillment of public service obligations, with measures taken to avoid both over compensation and under compensation. Further, all compensations should be disclosed regardless of their nature. In the absence of clear quantification of the cost of

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\(^{79}\) Ibid

\(^{80}\) http://lex.justice.md/viewdoc.php?action=view&view=doc&id=311735&lang=1

\(^{81}\) The Law on Administration and Denationalization of Public Property, Article 10. The legal status of public property, para. (3.b)
SOEs non-commercial objectives it is hard to assess whether the failure to perform efficiently is due to mismanagement or to the heavy burden imposed by the state.

60. **State aid in Moldova is largely in the form of indirect financial support.** State aid legislation, in line with EU rules on state aid, seeks to ensure a fair competitive environment. The Law on State Aid\(^{82}\) regulates the procedures for authorizing, monitoring, and reporting of state aid beneficiaries in all sectors of the national economy except for agriculture. Under the Law, the Competition Council is in charge of preventing and fighting the most harmful anticompetitive practices (such as cartels), pursuing sustained competition advocacy activities in the design of pro-competitive regulations, and collaboration with sectoral regulators. Such activities promote a competitive culture among businesses and civil society, ensure that state aid is subject to review to minimize firm-specific aid and its distortive effects, and promote better public spending. As reported by the Competition Council\(^ {83} \), the value of the reported state aid was reduced from 4.9 billion MDL (~313 million EUR; estimated 5.52% of GDP) in 2012 to 4.4 billion MDL (~238 million EUR; estimated 3.96% of GDP) in 2014 (determined by applying the European Union methodology for tracking measures of state intervention). Indirect public financing is the prevailing form of state aid in Moldova. Exemptions, rebates, deferrals or rescheduling the payment of taxes account for 78.93% of state aid; while direct public financing in the form of subventions and subsidies is only 16.15%; and other forms 4.92%. World Bank experience in other countries demonstrates that reducing preferential access to direct and indirect public financing increases the commercial orientation of SOEs and helps to level the playing field with private competitors. Box 4 presents an example of public policy objectives imposed by the state as a controlling shareholder on the largest bakery in Moldova.

**Box 4: Public policy objectives at JSC "Franzeluta"\(^ {84} \)**

JSC "Franzeluta" is the largest bakery in Moldova. The company is listed on the regulated market in Moldova and 52.51% of the shares are owned by the state. Overall the company has 1438 shareholders. In addition to commercial products, the bakery must produce cheap “social bread”. In 2015 the approximate cost of one loaf of “social bread” was 5.70 MDL while at the same time the sales price set by the government was 1.50 MLD.

In 2014 during the annual shareholders meeting of JSC "Franzeluta" the shareholders

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\(^{82}\) [lex.justice.md/viewdoc.php?action=view&view=doc&id=344389&lang=1](http://lex.justice.md/viewdoc.php?action=view&view=doc&id=344389&lang=1)

\(^{83}\) Source: [www.competition.md/public/files/StateAidReportsummary79c7e.pdf](http://www.competition.md/public/files/StateAidReportsummary79c7e.pdf)

\(^{84}\) Source: Review of Moldova media:


[www.logos.press.md/node/39358/](http://www.logos.press.md/node/39358/)

[www.infomarket.md/ru/industry/chistaya_pribyil_ao_Franzeluta_kishinev_v_2015_g_sostavila_225_mln_leev_uvelichivshis_v_16_raza_po_sравнению_s_2014_godom_138_mln_leev](http://www.infomarket.md/ru/industry/chistaya_pribyil_ao_Franzeluta_kishinev_v_2015_g_sostavila_225_mln_leev_uvelichivshis_v_16_raza_po_sравнению_s_2014_godom_138_mln_leev)
discussed a need to reorient production only to profitable bakery and other products. Once again, the minority shareholders expressed their major concern on production of cheap “social bread” that contribute to the negative results of operations and requested adequate compensation from the government in addition to the symbolic supply of wheat from state reserves. More detailed publicly available information on the requested compensations and whether any compensation took place is not available.

Private bakers in Moldova also estimate that the production cost of “social bread” is three times higher than the sales price. Private bakers claim that the dominance and pricing policy of the state-controlled JSC "Franzeluta" ruins not only the bakery market, but JSC "Franzeluta" as well.

61. **SOEs in Moldova are not formally exempt from the application of general laws, tax code and regulations.** Wholly or majority owned SOEs and enterprises with non- PIE status in particular may in practice, however, benefit from some advantages arising from the state ownership status. In the case of Moldova, the generally weaker corporate governance-related arrangements that are placed on such SOEs could be a source of competitive advantage. As an example, non-PIE status enterprises are exempt from mandatory adoption of the Code of Corporate Governance. On the other hand, their legal framework may also be a source of competitive disadvantage: as an example, as discussed in Chapter 10, wholly or majority owned SOEs, have limited flexibility in board composition and appointment of top management, while private sector companies traditionally have better performing boards and top-management.

62. **SOEs are not included in the scope of the new Law on Public Procurement** which requires that public procurement procedures should respect minimum standards of non-discrimination and transparency. As is the case with state aid, Moldova is aligning legislation to EU laws and policies that impose standardized rules aimed at safeguarding a level playing field in public procurement. The new Law is effective from May 1, 2016, so actual adherence to the principle of competitive neutrality needs to be tested over time. In theory, SOEs that act as prospective suppliers for public procurement can benefit from exemptions to the Law which could arguably jeopardize fair competition and transparent procedures. For example, as outlined in Article 4.1.a, the Law does not apply to public procurement in the areas of energy, water resources, transport and post services that are regulated by normative acts. This could potentially lead to competitive distortions by protection of natural state-owned monopolies if these sectors of the economy are liberalized. If the public procurement contract in question is below a certain value threshold, then it does not have to go through the standard procurement process (Article 2.1-4).

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85 http://lex.justice.md/viewdoc.php?action=view&view=doc&id=363619&lang=1
86 http://lex.justice.md/viewdoc.php?action=view&view=doc&id=360122&lang=1
provision is not in itself a cause for concern, but one implication is that small SOEs, e.g. in the socio-cultural sectors, are not required to announce tenders. Historically, the procurement practices of SOEs in Moldova have been subject to criticism for violation and irregularities based on the results of audit by CoA and other authorized bodies. The previous (2007) Law on Public Procurement did not oblige SOEs, including those providing utility services, to pass through the public procurement system. More details on procurement when SOEs are purchasing goods and services are described in Chapter 7.
CHAPTER 5: EQUITABLE TREATMENT OF SHAREHOLDERS AND OTHER INVESTORS

OECD principles and good corporate governance practices

63. This chapter only applies to SOEs that are incorporated as joint stock companies and not wholly owned by the state. SOEs that are registered as state enterprises by law may not include non-state investors.

64. OECD guidelines call for equitable treatment of all shareholders or other non-state investors. This should include but is not limited to: (i) treating shareholders equally and with full transparency; (ii) corporate governance codes should be adopted for listed and where applicable non-listed SOEs; (iii) adequate treatment of non-state shareholders if SOEs pursue public policy objectives or in cases of joint-ventures.

65. The assessments of corporate governance carried out by the World Bank in many countries suggest that the state, as well as minority shareholders, benefit from recognition of the rights of all shareholders and promotion of equitable treatment. The reputation of the state as an owner is an important factor considered by private local and international investors in business valuation. Moreover, by functioning as a check on costly or unreasonable demands from the ownership entity or another part of the government, equitable treatment of shareholders also can improve SOE performance. Policy-makers and SOEs in Moldova could use the G20/OECD Principles of Corporate Governance as a benchmark in this area.

Shareholder rights and progression matrix

66. The progression matrix presents the key steps in ensuring shareholder rights based on IFC-World Bank previous international studies in that area and analysis of SOEs legal framework in Moldova (Table 6). The case of Moldova should be interpreted with caution, since it presents only a high-level de jure review of the framework, while de facto adherence to and compliance with the framework by the state itself is low. This summarized progression matrix presents the four levels and key steps in ensuring shareholder rights.

Table 6: IFC–World Bank Progression Matrix for Shareholder Rights at State-Owned Enterprises and SOEs legal framework in Moldova

<table>
<thead>
<tr>
<th>Description</th>
<th>Moldova: De jure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Level 1: Acceptable corporate governance practices</strong></td>
<td></td>
</tr>
<tr>
<td>The company’s legal framework treats all shareholders of the same class equally with respect to voting rights, subscription rights, and transfer rights.</td>
<td>✔ Art. 14-15, 24-29</td>
</tr>
<tr>
<td>Shareholders participate in the shareholders’ meeting and receive dividends.</td>
<td>✔ Art. 25.1.a and d</td>
</tr>
<tr>
<td>Changing the articles requires supermajority approval.</td>
<td>✔ Art. 50.3.a, 61.2</td>
</tr>
<tr>
<td><strong>Level 2: Extra steps to ensure good corporate governance</strong></td>
<td></td>
</tr>
<tr>
<td>Shareholders are provided with accurate and timely information on the number of shares of all classes held by the state and other major shareholders.</td>
<td>✔ Art. 56.2.a</td>
</tr>
<tr>
<td>The SOE encourages minority shareholders to participate in the shareholders’ meeting.</td>
<td>✔ Art. 55</td>
</tr>
<tr>
<td>Minority shareholders may nominate board members.</td>
<td>✔ Art. 26.1, 52.1, 52.5</td>
</tr>
<tr>
<td><strong>Level 3: Major contribution to improving corporate governance nationally</strong></td>
<td></td>
</tr>
<tr>
<td>Rights of shareholders are protected during new-share issues and changes of control, including privatizations and renationalization.</td>
<td>✔ Art. 20.6, 21.1, 31.90 Art. 1.4, 25.15, 27, 44, 79, 84</td>
</tr>
<tr>
<td>Shareholders are provided details on special rights the state has in the SOE (golden shares) and control through government-linked entities.</td>
<td>✔ Art. 56.2.a</td>
</tr>
<tr>
<td>Rules on related-party transactions address transactions with the government and other SOEs and require recusal by interested shareholders.</td>
<td>✔ Art. 86.1, 50.3.f</td>
</tr>
<tr>
<td>Effective board representation of minority shareholders is provided</td>
<td>✔</td>
</tr>
</tbody>
</table>

89 Source: Adapted from the Corporate Governance of State-Owned Enterprises: A Toolkit, World Bank, 2014 and applicable legislation of Moldova
90 http://lex.justice.md/viewdoc.php?action=view&view=doc&id=344790&lang=1
### Description

<table>
<thead>
<tr>
<th></th>
<th>Moldova: De jure</th>
</tr>
</thead>
<tbody>
<tr>
<td>by cumulative voting or similar mechanisms.</td>
<td>Art. 66.2&lt;sup&gt;91&lt;/sup&gt;</td>
</tr>
<tr>
<td>Minority shareholders can ask questions at the shareholders’ meeting and influence its agenda.</td>
<td>✔️ Art. 25.1.a, 52.1</td>
</tr>
<tr>
<td>All securities’ holders are treated equally with respect to information disclosure (fair disclosure).</td>
<td>✔️ Art. 25.1.b-c.</td>
</tr>
</tbody>
</table>

#### Level 4: Leadership

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The state has no special rights in the company (golden shares) beyond its ownership.</td>
<td>✔️</td>
</tr>
<tr>
<td>Supermajority approval is required for large, extraordinary transactions.</td>
<td>✔️ Art. 50.3.f</td>
</tr>
<tr>
<td>The SOE’s history of equitable treatment of shareholders evidences consistent conformity with international market expectations.</td>
<td>❌</td>
</tr>
</tbody>
</table>

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67. **SOEs legal framework in Moldova has key elements of shareholder rights starting from its most basic level to the highest degree of good practice.** Its most basic level starts from equal treatment of all shareholders of the same class with respect to voting rights, subscription rights, and transfer rights. While at the highest level, it includes such key elements as required supermajority approval of large, extraordinary transactions.

68. **Concerning the general legal framework for shareholder rights, fully corporatized SOEs are subject to the relevant provisions of the Law on Joint Stock Companies.** In Articles 14 and 15 the Law defines common and preferred stock, their classes, and also states that common stock can be only of one class, while preferred stock may have different classes. The Law guarantees certain rights to all shareholders including the right to: elect and be elected to the governing body; participate and vote in shareholder meetings; and receive a share of profits as dividends (Articles 24-29). Changing the articles of the JSC is an exclusive competence of the shareholder meeting that requires a two-thirds supermajority vote for passage (Articles 50.3.a. and 61.2). The state has no special rights in joint stock companies (golden shares) beyond its ownership. In addition, Article 50.3.f. is also intended to protect minority shareholders by requiring supermajority approval for large, extraordinary transactions.

69. **Moldova’s history of equitable treatment of SOE shareholders does not consistently conform with good international practice and market expectations.** Although *de jure* minority shareholders enjoy the same rights and are treated equally, *de facto* even the basic right of receiving a dividend payment may be violated. By way of example, in 2014

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<sup>91</sup> Only for JSC with more than 100 shareholders

during the annual shareholders meeting of S.A. "Franzeluta" the state, as the controlling shareholder, voted against retrospective payment of dividends for the financial years 2008 and 2009. The decision on the agenda item that was initiated by the minority investors was blocked by the state. Annual shareholder meetings in 2009 and 2010 took decisions to reinvest all the profits into the company. However, tax authorities considered this reinvestment as a violation and withheld an amount equal to the proportion the state would have received had the dividends been paid at the announced 30% payout rate. In addition, the tax authorities withheld a fine for “late payment of dividends”. The state withheld 9 million MDL while the minority shareholders received no dividends for the 2008 and 2009 financial years.

**Information rights and transparency**

70. Shareholders have equal access to certain information by the Law on Joint Stock Companies. Article 56.2.a. gives all shareholders the explicit right to receive an information pack containing shareholder meeting materials, and including the list of all shareholders, in advance of meetings (not later than 30 days prior to ordinary shareholders meeting and 15 days for extraordinary meetings). However, in contrast to good practices of transparency and access to information, the Law does not have provisions on the rights of shareholders to address written requests to the company and receive answers.

71. Simultaneous disclosure of information to all shareholders is not fully provided for by the Law on Joint Stock Companies, controlling shareholders can have privileged access to information not available to minority shareholders. Line ministries and other state authorities engaged in SOE monitoring can, in practice, legally access company information that is not simultaneously available to minority investors. This gap in corporate governance also affects minority shareholders as it arguably increases the scope for the state’s involvement in the day-to-day management of SOEs and increases the risk of privileged use of corporate information by the state.

72. The state as a controlling shareholder arguably has privileged access to corporate information unavailable to other shareholders owing to its board representation. Minority shareholders may nominate board members if individually or jointly they have at least 5 per cent of voting shares (Article 26.1, 52.1 and 52.5). However, a review of boards’ composition of a sample of joint-stock companies not wholly owned by the state suggests that the minority shareholders of these SOEs have little say in the nomination of board members, and all board members either represent only the state shareholder or share the board with the controlling shareholder in the case of partially owned SOEs. As an example, the five

93 listed on regulated market and 52.507% owned by the state
94 http://www.logos.press.md/node/39358
95 Such as PPA and MOF that both perform financial monitoring.
board members of S.A. "Metalferos" are civil employees representing the state that has a 78.28% stake in the company, while the non-state shareholders– although together they hold 21.72% of company shares – have no board representation. Given that the board is composed of state shareholding representatives, the state as a controlling shareholder arguably has access to information discussed by the board that is not available to the minority shareholders. Under the Law on JSC the board is expected to act in the interest of shareholders only (Article 65.1). Good practice dictates that board members should act in the interest of the company and all of its shareholders. State employees on the board may therefore theoretically have incentives that could conflict with the interests of minority shareholders. This practice does not maintain the confidence of minority investors and does not sustain the value of the company and its access to capital.

73. Insufficient protection for minority shareholders in Moldova JSC SOE’s raises issues of consistent application of good practices and market expectations. Few major SOEs in Moldova have minority interests, but there are examples of relatively significant SOEs with private investments. Moldova scores relatively high on the indicator for protecting minority investors, but it covers only listed publicly traded companies and not SOEs. Minority interests currently have very limited representation in boards of JSC SOEs, and often decisions are taken without taking their interests into account. They also lack the access to information given to state authorities. A more comprehensive policy of protecting such interests will reassure existing investors and encourage more. It is important both for the state, as a minority shareholder in 40 companies, as well as private investors that can include employees.

74. To protect its own interests, the government of Moldova should pursue broad-based corporate governance and investor protection reforms. Gaps in protection of shareholders in Moldova increase the potential for abusive treatment of private shareholders and further reduce investor confidence. The reforms should include legal and regulatory reform, including strengthening governance discipline and the creation of new institutions that support good corporate governance. Beyond broader corporate governance improvements, SOEs in Moldova should work to protect the basic rights of shareholders and to encourage appropriate participation by other shareholders in the governance of the company.

96 For example, the only SOE listed on the regulated market is not in exclusive state ownership.
97 www.doingbusiness.org
CHAPTER 6: STAKEHOLDER RELATIONS AND RESPONSIBLE BUSINESS

OECD principles and good corporate governance practice

75. Good corporate governance is achieved by strong board practices and commitment, effective internal control systems, transparent disclosures and well-defined shareholder relations. Designing proper corporate governance frameworks may be challenging, and their implementation can become difficult and complex.

76. Formal and transparent stakeholders’ relations are crucial for building an effective and financially sustainable enterprise. Clear frameworks for the distribution of rights and obligations among main stakeholders, including shareholders, directors and managers, articulate the rules and procedures for the decision making process, setting enterprise goals, directing development and ensuring milestones are achieved.

77. Clarity in stakeholders’ relations has even greater importance at SOEs, as these entities often deliver vital services to the public and carry social importance to the economy. Good corporate governance practices, including the OECD Guidelines on Corporate Governance of SOEs, indicate that clear policies on formal and transparent decision making and communication among shareholders should be established.

78. SOEs can benefit from building strong connections with larger groups of stakeholders to improve their service delivery, increase social responsibility, and receive timely feedback from citizens. SOEs can play much bigger role in communities by leveraging their external influence and by co-creating value with other stakeholders in society to be a catalyst or driver for good, inclusive growth linked to its purpose, mission and strategic objectives. For instance, SOEs can take an active role in developing better corporate governance practices, demonstrating stronger financial discipline, and lead the market by example. (Figure 8).

79. The Government of Moldova recognizes the existing weaknesses in corporate governance of SOEs and poor enforcement in the area of stakeholders’ relations. The GoM accepts that weak corporate governance policies and poor enforcement of the existing frameworks lead to SOE underperformance and sub-optimal use of public resources. To address these issues, the GoM is looking to reform SOEs strategy, ownership policy, and corporate governance arrangements, with an expectation of improving the transparency and accountability of SOEs.

80. In private companies, owners typically play the key role in setting proper corporate governance policies. Shareholders aim to attract the most qualified and experienced people
to the board of directors, set company’s goals, monitor performance, and provide capital to fund expansion.

**Figure 8: Relationships between Key Stakeholders in State Owned Enterprises**

81. **OECD Guidelines on Corporate Governance of SOEs** acknowledge the government’s role as a dominant shareholder in SOEs and the risk of controlling certain corporate decisions, possibly to the detriment of other stakeholders. While such cases may not be entirely avoided, the Guidelines indicate that it is crucial to establish a clear policy in this regard. SOEs should fully respect the rights of stakeholders, as established by law, regulations and mutual agreements. SOEs should ensure that stakeholders have access to relevant, sufficient and reliable information on a timely and regular basis to be able to exercise their rights.

82. **The Government may pursue certain social objectives through the SOEs it owns.** However, if such decisions are not carefully evaluated, they may negatively impact both the enterprise’s performance and the quality and effectiveness of the social objective. If the government imposes certain social objectives on an SOE they must be explicitly formulated and quantified in the strategic plan of an enterprise, indicating funding sources to cover such costs (i.e. the enterprise capital or state budget). Such transparency would allow the

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state to observe the actual performance of a SOE from its business efficiency, as well as monitor the achievement of social objectives.

83. **The institutional level conflict of interests may be addressed by clarifying the roles, and setting the boundaries of decision making, for each of the groups of stakeholders, as well as by enforcing these rules in practice.** In line with good international practices and the OECD recommendations, intervention by the entity which owns the SOE should be limited to approving SOE strategic plans and annual reports, and appointing, on a competitive basis, members of the board; this is often not the case in Moldova. Any diversions from the established rules should be avoided. In case this is not possible, such interventions should be publicly disclosed and made available to all interested stakeholders.

**Stakeholder relationships in Moldova**

84. **Conflicts of personal interest are somewhat addressed in Moldova by the Law on Conflict of Interest** and the Law on JSCs. These laws define conflict of interest and provide a level of accountability for violating the legislation. It is difficult, however, to define the pursuit of personal interests to the detriment of the company, harder still to quantify its effects. Absence of basic control mechanisms (for example personal declarations renewed on a periodic basis), public investigations, and the outcomes of such cases, lead to a perception that SOEs are managed by ineffective managers exercising their own interests to the detriment of company interests and state assets. The absence of clear control mechanisms and segregation of responsibilities further increases the autonomy of SOE managers. The current legal framework, while addressing conflicts of interest in specific transactions and restrictions, does not impose conflict of interest restrictions on SOE board members with regulatory functions in respect of the supervised entity. Those board members should not take part in regulatory decisions concerning the SOE nor have any specific obligations or restrictions that would prevent them from acting in the enterprise’s interest (no inherent or perceived conflict of interest). No Code of Ethics appears to exist for members of the ownership entity and other state officials serving as SOE board members, which would indicate how the information should pass from board members to state (including conflict of interest) and how it should be handled.

85. **Employees’ participation in SE boards in Moldova is mandatory, in JSC SOEs boards it is encouraged but not required.** According to the OECD Guidelines, where employee representation on the board is mandated mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence. Examples of mechanisms for employee participation include employee representatives on boards and governance processes such

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99 http://lex.justice.md/md/%20327989/
as trade union representation and works councils that consider employee viewpoints in certain key decisions (see box 5).

### Box 5: Employee Representation on SOE Boards in OECD Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Employee Representation</th>
</tr>
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<tbody>
<tr>
<td>OECD</td>
<td>Common practice in concerned countries, such as Austria, Czech Republic, Denmark, Finland, Germany, and Norway. Legal statute required in France, Greece, Israel, Slovenia, Spain, Sweden, and Switzerland. SOE laws stipulate inclusion in others. Employee representation in Chile is based on SOEs' own statutes. Employee representation found in China and Egypt.</td>
</tr>
</tbody>
</table>

In OECD and many non-OECD countries, employees are represented on SOE boards to bring in their knowledge and to ensure that their concerns as key stakeholders are taken into account. Employee representatives bring employment and social issues to the table and can be a primary source of information that is independent from senior management. In some countries, lack of employee involvement in board decisions has resulted in tension when decisions were brought to the workplace.

In many cases, the presence of employee representatives on SOE boards derives from usual corporate practice in the countries concerned, such as in Austria, the Czech Republic, Denmark, Finland, Germany, and Norway. In other cases, employee representation is required by legal statute, as in France, Greece, Israel, Slovenia, Spain, Sweden, and Switzerland. In other cases, SOE laws stipulate their inclusion. In still others, such as Chile, employee representation on a few statutory corporations’ boards is based on the SOEs’ own statutes. In non-OECD countries, employee representation on boards is found in China and Egypt, for example.

While employee representation is common in these countries, practices differ somewhat. For example, in both Israel and Slovenia, employee directors are subject to the same duties and responsibilities as any other board member. However, Israel has stronger mechanisms for ensuring the nomination of the most suitable individuals: employees elect a pool of candidates from which the owner picks two. In Slovenia, one-third of the supervisory board is appointed directly by SOE work councils.

In general, most countries report that employee representation on boards contributes to improved company performance. Special care, however, needs to be exercised to ensure that employee representatives are sufficiently well qualified to play an equal role with other directors and to prevent their “capture” by stakeholder interests.

Employee representatives should be selected through transparent and democratic processes involving all company employees. Qualities such as competence and independence should be sought.

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100 Source: OECD 2013.
Managing the workforce

86. In terms of managing the workforce, SOEs around the world apply a wide variety of labor regulations. Some countries fully apply the civil service regime, and some use general private sector labor law for handling employment relations at SOEs. Hybrid regimes may combine certain aspects of both. The global tendency is that with privatization and corporatization of SOEs, labor legislation typically becomes aligned with the general labor law regime. Often, the change is staged through the periods to facilitate and smooth the transition, as demonstrated by the example of New Zealand (box 6).

Box 6: New Zealand Rail: From Civil Servants to Private Employees

The status of workers in the New Zealand rail sector has changed several times in the recent past. In 1982, New Zealand Rail was converted from a departmental enterprise in which workers had civil service status to a statutory corporation (New Zealand Rail Corporation, or NZRC) in which workers were public servants. In 1990, the entity converted from a statutory corporation to a public limited-liability company; staff continued to be public servants. Finally, in 1993, shares of New Zealand Rail Ltd. were sold to private interests. The employees’ status then changed from public sector employee to private sector employee. There were also changes in the labor contracts. Until 1986, employees of NZRC served under the central civil service conditions of employment. In 1987, NZRC came under the legislation applicable to SOEs, which made NZRC independently responsible for bargaining over its own labor relations contract.

Several key changes followed:

- Simplification of the collective labor–government agreement and removal of artificial distinctions among job categories.
- Removal of the state service seniority and appeals system for the appointments and promotions process.
- Removal of senior management from the collective bargaining agreements to individual contracts with incentive-based performance measures.
- Simplification of the allowance structure and an increase in the base pay to absorb some of the allowances as well as the introduction of incentive-based compensation to most of the white-collar employees.

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Nevertheless, the contract still retained many aspects of the state sector model in respect to work hours, overtime payments, and penalty payments. Following privatization in 1993, however, a privately owned company was able to make further changes to the labor contract: (1) more flexible work hours, including overtime after 80 hours each fortnight instead of after eight hours per day, were instituted; (2) fewer penalties on work outside the conventional eight-hour day, Monday to Friday, were imposed; (3) a change from one collective contract to five contracts was accomplished; and (4) no weekend or night work penalty payments for new employees were permitted.

A lump-sum payment was also made to those workers who lost out from the changes to the overtime, penalty, and allowance payments.

87. **SOEs face a number of labor restrictions that reduce their operational autonomy and disadvantage them vis-à-vis the private sector.** In many, if not most, countries SOEs’ limited flexibility to hire employees or to pay market salaries restricts their ability to attract and retain talent, especially for board membership and senior management positions. In addition, SOE employees are often protected from dismissal to a greater degree than their private sector counterparts. This often leads to overstaffing and reduced labor productivity.

88. **In Moldova, the general labor legislation applies to SOEs employees.** Technically, SOEs are able to manage their workforce and ensure that productivity levels are retained at optimal levels with sufficient staff. But in practice, SOEs rarely take any action due to ethical considerations and the negative publicity of massive layoffs. State enterprises apply the Labor Regulation No. 743 for Entities with Financial Autonomy[^102], dated June 11, 2002, which sets certain limits and requirements for salary and other incentives levels of employees and administrators.

89. **SOEs and their boards should have mandated authority to determine and decide optimum employee numbers and productivity levels.** In order to maximize results and attract qualified personnel, accurate comparisons between SOEs and private sector companies need to be conducted to determine the competitiveness of SOE compensation packages, including taking account of benefits and nonwage rewards, such as greater job security and more generous retirement benefits.

Fair treatment in bankruptcy or insolvency

90. **SOEs across many jurisdictions often enjoy preferential treatment in bankruptcy proceedings.** Some countries include no bankruptcy provisions in their SOE laws, or may exempt SOEs from general insolvency rules, giving them an advantage over private companies. Increasingly, particularly in the OECD, SOEs are being made subject to general insolvency laws. At the same time, SOEs may not be subject to the application of insolvency and bankruptcy procedures but have specific systems in place for protection from creditors of SOE assets used to further public service. The international standard on insolvency, embodied in the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes\(^{103}\), recommends that state-owned enterprises be subject to general insolvency law. It also recommends that exceptions to this general rule are clearly stated in legislation.

91. **Moldovan legislation provides for the general application of Insolvency Law\(^{104}\) no. 149 of June 29, 2016, to all entities, including SOEs.** The newly produced draft of the Law on State Enterprise and Municipal Enterprise introduces additional protection of SOE assets that are public domain goods by stressing that these may not be subject to foreclosure, not even in case of insolvency (Article 3(4)). This practice is principally in line with good international practices, as long as the new Law has criteria and clear guidance with particular reference to other insolvency legislation. According to Law No. 121 on Administration and Denationalization of Public Property the public patrimony received from the state (as a contribution to equity or in economical administration) cannot be encumbered or be subject to insolvency proceedings (this would apply, for example, to the railway infrastructure). Public property is managed by public authorities, state enterprises and only in special cases provided by the law, by commercial entities. Government Decision 761\(^{105}\) regarding the remediation, reorganization or liquidation of SOEs (SE and other legal forms where the state owns more than 50%) provides specific measures for insolvencies of SOEs, such as granting state aid or changing the activity of the enterprise.

Transparency in SOE strategies, objectives and performance reporting

92. **All SOEs are expected to provide an accurate picture of the enterprise’s strategy and operations, but this information is rather limited in its nature and substance in Moldova.** Financial statements and management reports are difficult to obtain, the composition of boards is not properly disclosed, and SOE strategy is not made public. The

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\(^{104}\) [Moldovan Law](http://lex.justice.md/md/344788/)

\(^{105}\) [Government Decision](http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=296762)
commitment to transparency and appropriate disclosure will send the signal that the GoM is serious about working for, and with, its stakeholders to achieve desired societal outcomes, and will be held accountable for the part it plays in the process (see chapter 6 for additional information).

93. **SOE annual reporting currently includes only very limited descriptions of various commercial and non-commercial objectives and details of the financial assistance provided by the state, if applicable.** Reporting should include cost estimates for any non-commercial socially responsible activities undertaken. This better enables various stakeholders, including the GoM, to weigh the trade-offs between fulfilling different objectives.

94. **Annual reporting of SOEs should also contain indicators over its recent performance.** It is recommended that all SOEs produce accurate financial statements, which are available to the public. Large SOEs’ financial reporting should comply with International Financial Reporting Standards (IFRS). Performance indicators related to SOE objectives could also be reported, linked to the SOE scorecard or major indicators of SOE performance. Limited information on SOEs’ performance is disclosed in the notes and annexes to the annual financial statements, however usually such information is not available to the public.

**Responsible business**

95. **SOEs are often among the largest business entities in a country, their operations impact many stakeholders: private business, governments, non-profit organizations and citizens.** OECD Guidelines recommend that SOEs embrace their engagement with all groups of stakeholders, observing high standards of responsible business conduct, including with regards to the environment, employees, public health and safety, and human rights. The current legislation in Moldova does not require enforcement and/or disclosure of such policies. However, the new draft of the Accounting Law aims to transpose the requirements of the EU Accounting Directive (2013/34/EU) with respect to non-financial reporting for all relevant entities, including SOEs.

96. **The state’s expectations regarding the responsible business conduct of SOEs should be disclosed in a clear and transparent manner.** One of the ways to approach this concept is to develop several non-financial key performance indicators for SOEs to follow (also addressed in Chapter 7) and report back to the public on achieving such indicators. For example, in Norway the “Government’s Ownership Policy” mentions specific requirements for SOEs in terms of stakeholder relations: “The state expects companies in which the state has an ownership interest to maintain an open dialogue with their surroundings about their finances, social responsibility and environmental matters, and that the companies take steps to provide information about how they deal with these matters in practice and the
results they achieve. Both the companies’ annual reports and their websites are appropriate channels in this context”.

97. **OECD has strengthened their recommendation on SOEs involvement in the financing of political activities.** The 2015 edition of OECD Guidelines contains an explicit recommendation to eliminate political donations by SOEs, or use of SOEs to achieve partisan political goals, given the inherent conflicts of interest involved. Currently, the Electoral Code prohibits\(^\text{106}\) funding or providing material support in any form to political parties, electoral campaigns, and electoral competitors by SOEs.

\(^{106}\) [Link](http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=312765)
CHAPTER 7: TRANSPARENCY, DISCLOSURE AND CONTROLS

OECD principles and good international practice

98. The OECD Guidelines recommend that SOEs should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies. In OECD countries external audit firms in most cases carry out the statutory annual audits of the SOEs’ financial statements. In some cases, the statutory audit is conducted by the country’s Supreme Audit Institution. Governments may also implement external control procedures, in addition to the statutory audit. Supreme Audit Institutions normally also have the authority to carry out performance audits in addition to the audit of the financial statements of economy, efficiency and effectiveness with which an institution, program or activity financed or owned by the state uses its resources in carrying out its responsibilities.

99. The legal framework for SOEs transparency and disclosure in Moldova could be revised to reflect high-quality international standards adopted by many countries. Each country may choose to apply their own tailor-made standards on transparency, disclosure, and controls to reflect local needs. However, this can involve significant costs in their initial design, updates in response to changes in the business environment, and in educating those responsible for implementing and using them. Adopting international standards avoids having to “reinvent the wheel” and reduces or avoids many of those costs entirely. It also prevents lack of local capacity from leading to lower-quality national standards. The main International Standards on Transparency, Disclosure, and Controls which could be applied to ensure proper governance of SOEs are summarized in the box 7 below.

Box 7: Main International Standards on Transparency, Disclosure, and Controls

<table>
<thead>
<tr>
<th>Topic</th>
<th>International Standard</th>
<th>Standard setter</th>
<th>Current status in Moldova</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial reporting</td>
<td>International Financial Reporting Standards; IFRS for SMEs</td>
<td>International Accounting Standards Board</td>
<td>IFRS are mandatory only for PIEs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>IFRS for SMEs are not adopted in Moldova</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Topic</th>
<th>International Standard</th>
<th>Standard setter</th>
<th>Current status in Moldova</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit</td>
<td>International Standards for the Professional Practice of Internal Auditing</td>
<td>Institute of Internal Auditors</td>
<td>National Standards on Internal Audit, approved by the MOF</td>
</tr>
<tr>
<td>Internal control and risk management</td>
<td>COSO Internal Control–Integrated Framework</td>
<td>Committee of Sponsoring Organizations of the Treadway Commission</td>
<td>Not applicable in Moldova</td>
</tr>
<tr>
<td>External audit</td>
<td>International Standards on Auditing</td>
<td>International Auditing and Assurance Standards Board</td>
<td>ISAs are mandatory for all audits</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>Principles of Corporate Governance</td>
<td>OECD</td>
<td>Partially transposed via Code of Corporate Governance mandatory for PIEs</td>
</tr>
<tr>
<td></td>
<td>SOE Corporate Governance Guidelines</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Integrated reporting</td>
<td>Sustainability Reporting Guidelines</td>
<td>Global Reporting Initiative</td>
<td>Not applicable in Moldova</td>
</tr>
</tbody>
</table>

100. **It is good practice for external auditors to be recommended by an independent audit committee of the board** or an equivalent body, and to be appointed either by that committee/body or by shareholders directly (annual meeting of shareholders). This ensures that management is not significantly involved in decision making for the appointment or dismissal of auditors.

**Financial reporting requirements**

101. **Financial reporting and accounting requirements for all entities in Moldova, including SOEs, are primarily regulated by the Accounting Law**. The law specifies how

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109 http://ccrm.md/pageview.php?l=ro&idc=33&t=/Audit/Metodologie-de-audit&
entities should maintain their accounting books and records, financial reporting standards applicable for preparation of financial statements, as well as related governance and transparency arrangements.

102. SOEs are not classified as public interest entities, and therefore are subject to the National Accounting Standards (NAS) rather than the more demanding International Financial Reporting Standards (IFRS). IFRS are mandatory for PIEs, defined as “an entity with a significant importance to the public due to its area (type) of activity such as financial institution, investment fund, insurance company, non-state pension fund, commercial companies listed on the stock exchange in the Republic of Moldova”. The level of disclosures required under NAS is less demanding than under IFRS and in fact the financial information prepared under NAS is prone to be incomplete, if not inaccurate in some cases. While NAS derive from IFRS there are significant gaps and some areas are not covered at all (such as goodwill, assets held for sales, employee benefits, accounting treatment of derivative financial instruments, and consolidation requirements). Financial statements prepared by economically significant SOEs using NAS may not present a true and fair view. All of this impacts the level of transparency of SOEs and creates additional risks of inappropriate economic decisions. OECD guidelines and good practices recommend that significant SOEs should be subject to financial reporting requirements similar to those for listed companies. According to information published by the Stock Exchange of Moldova, as of July 01, 2016, the bakery JSC Franzeluta SA (52% shares owned by state) is listed on the Moldova Stock Exchange’s regulated market. It is therefore classified as a PIE and required to prepare IFRS-based financial statements but appears to continue to prepare financial statements based on NAS (only limited information from the full set of financial statements is available on their website). Some non-PIE SOEs prepare IFRS based financial statements at the request of investors and/or creditors. It seems that in practice day-to-day accounting is widely based on NAS, and that IFRS-based financial statements for SOEs are often prepared by auditors (which in itself represents a threat to their independence) using a conversion process. Such financial statements are not published, not submitted to PPA or to MOF, and audited financial statements based on IFRS are not made available to the general public.

103. Financial statements prepared in accordance with NAS have significant issues of compliance and very limited disclosures. A sample of 6 sets of financial statements as received from PPA was reviewed. All financial statements were presented in accordance with NAS-prescribed formats for the balance sheet, profit and loss statement, and cash flow statement. However, they did not properly disclose accounting policies nor provide other explanatory notes in compliance with NAS “Presentation of Financial Statements” and other

111 http://www.moldse.md/
113 This is similar to conclusions of the 2013 ROSC: http://www.worldbank.org/ifa/Moldova_ROSC_AA_en.pdf; http://www.worldbank.org/ifa/Moldova_ROSC_AA_Romania.pdf
applicable standards. The absence of such disclosures and explanatory notes may create difficulties in the process of understanding financial results and the position of an SOE. In addition, the team’s understanding is that all financial statements submitted to PPA and MOF via the State Service of Financial Statements are prepared based on NAS and are accepted as submitted by SOEs (no formal procedures are in place by PPA and/or MOF to check which standards are required for a particular SOE according to the requirements of Accounting Law, i.e. NAS or IFRS). Also, neither PPA nor the MOF scrutinize financial statements, for instance no formal process to follow-up on auditor’s qualification is in place even if the MOF requests audit reports from SOEs.

104. The requirements for consolidated financial statements of corporate entities, including SOEs, are not clearly defined in current legislation and they are not made available to the general public. Article 37 of the Accounting Law requires that consolidated financial statements should be prepared in accordance with accounting standards. NAS in force do not contain a requirement for consolidation, and in fact non-PIEs including JSCs with state capital could avoid preparing consolidated financial statements even if they have subsidiaries and/or exercise control over other entities. On the other hand, Article 4(5) of the Accounting Law says that if the provisions of NAS do not foresee some provisions, the entity is encouraged to apply IFRS requirements for a particular circumstance. Such an approach is ambiguous, parent-entities, which are not required by law to apply IFRS, may simply ignore preparation of consolidated financial statements. For example, the gas transmission and distribution JSC SA “Moldovagaz” (state share is 35.33%) owns several subsidiaries114, but no consolidated financial statements were available on their website nor were they able to be obtained or their existence determined.

105. The Accounting Law requires all entities to prepare a management report, including a chapter on corporate governance for PIEs; but there are no clear legal requirements for publication and, even when prepared, such reports are not available to the public. JSC SOEs listed on regulated market are required by Law no.171 on Capital Market115 to publish the management report on their website. The management report (and the consolidated management report where applicable) are important elements of corporate governance and financial reporting. A fair review of the development of the business and of its position should be provided, in a manner consistent with the size and complexity of the business. Conclusions on compliance with legal requirements could be made only on an entity by entity basis, as management reports are not publicly available.

114 http://www.moldovagaz.md/menus/ro/subordinate-companies
Auditing requirements

106. Annual audit is required for major SOEs but information on compliance is limited; sometimes audit is performed after submission of annual financial statements, and annual reports prepared by PPA and MOF include non-audited financial information. The requirements are set by several laws. The annual audit of financial statements is mandatory for: (i) all PIEs according to the Law on Auditing Activity; (ii) JSCs with state ownership greater than 50 per cent, according to the Law on JSCs; and (iii) SEs which exceed two of three thresholds in two consecutive years according to the Law on SEs. According to the information provided by the MOF, 107 SOEs (41 JSCs and 66 SE) were required to perform annual audit for the year ended December 31, 2015. Information on how many and which entities complied with legal requirements by March 31 and/or April 30 (deadlines for submission of financial by non-PIEs and PIEs respectively) was not available. Despite the legal requirements, not all SOEs subject to statutory audit submitted an audit report to the MOF, reasons included: (i) audit firms had not been selected/contracted because of lack of financing; (ii) the audit was not finalized by the date of mandatory submission of the financial statements (one of them referred to the delay in issuing the Regulation on the selection audit firms and terms of reference for the audit of annual financial statements of SEs and JSCs in which the state holds more than 50% of shares); (iii) SOEs not knowing that they are obliged to submit a copy of audit report to MOF; (iv) ambiguous legal requirements with regard to submission of the audited financial statements allowing entities, including SOEs, to interpret them to their benefit (for example, Article 38 of the Accounting Law requires that individual and consolidated financial statements be submitted within 90/180 days following the reporting year but says nothing about the deadline for audit report submission; in addition, no deadline for submission of the audit report is mentioned in Article 8(f) of the Law on SEs and Article 69(6) of the Law on JSCs).

107. SOEs statutory audit may be performed only by audit firms selected by the board of the state enterprise, or the JSC’s Council, following criteria prescribed by the legislation in force. Price is often the dominant final selection factor. The Law of JSCs and Law of SEs set two main criteria for an audit firm to be allowed to perform an SOE audit: (i) the firm has at least two certified auditors, and at least one of them should have a minimum 5 years of experience; and (ii) the audit firm and auditors have not been sanctioned for the previous reporting period, as confirmed by the Auditing Oversight Council. The process of selecting the SOEs audit firm and the content of terms of reference are regulated by Government Decision no. 875 of December 22, 2015. Selection of the audit firm should be performed by the Board of the SE, or the JSC’s Council, in a transparent manner taking into account the

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116 capital exceeding MDL 500000; total revenue exceeding MDL 10m; and more than 100 employees.
117 as of June 29, 2016, only 9 SOEs (5 SEs and 4 JSCs) submitted a copy of the audit report to MOF.
118 The largest SOE, Moldova-Gaz, where the state holds 35,33% is not subject to statutory audit (according to the legislation in force only majority owned JSC SOEs are required to conduct annual audit).
following information from the submitted offer: (i) the period for conducting the audit; (ii) the submission deadline of the management letter to those charged with governance and management; (iii) the submission deadline of the auditor’s report; (iv) the minimum number of auditors who will carry out the audit of annual financial statements; and (v) affiliation (absence of) relationships with the audited entity, founder, and/or personnel with decision making powers, and the entity's founder, excluding the state. However, there is no clear guidance to what extent the selection process should be based on qualitative criteria and it seems clear that in practice the lower price is a decisive factor in selection of an audit firm.

108. There are some additions to regular audit reporting legal requirements in case of SOEs; these requirements are outside the scope of an audit of financial statements, such as confirmation by auditors of performance indicator calculations. All audits are performed based on International Standards on Auditing (ISA) and Code of Ethics as issued by the IFAC’s International Auditing and Assurance Standards Board (IAASB) and adopted by MOF. In addition to the auditor report and communication with those charged with governance and management required by the ISA, Regulation no. 875 requires firms auditing SOEs to confirm the fairness of the listed indicators calculated by the audited entity for current and previous periods, e.g. book value of each group of receivables; the amount of bad debts; the amount of capitalized borrowing costs; dividends per share, etc. This requirement is outside the scope of an audit of financial statements. SOEs could instead be required to include the financial analysis and calculated indicators in a separate chapter of the Management report, and the auditors required to express an opinion regarding information prepared by the entity.

109. SOEs financial performance and respective key performance indicators must be based on sound audited financial information. Information contained in the MOF and PPA annual reports may be inaccurate as many of the financial statements of major SOEs are included before annual audit. The quality of any indicator depends on its accuracy and reliability. As most key performance indicators derive from the financial statements of SOEs, these must be prepared in accordance with recognized financial reporting standards and be audited to ensure the quality and accuracy of the information. It is critical for state ownership entities to ensure that the audit system for SOEs is robust and grants sufficient credibility to SOEs’ financial statements. This might require a clarification of the respective roles and focus of internal, state, and external audits.

110. The quality of audits in Moldova is often weak, and therefore the quality of financial information prepared by SOEs is not reliable for economic decisions. As mentioned in the A&A ROSC, oversight and quality assurance of the audit profession are in the initial development phase. Effort is needed to modernize and improve audit oversight, which in turn may positively influence audit quality and thus the quality and reliability of SOEs financial information. The MOF is drafting a new audit law, in line with the Moldova-EU association agreement legal obligation to transpose EU requirements. The aim is that
Audit committees

111. Effective audit committees would strengthen the quality of financial reporting and of corporate governance. The legal framework does not provide for the establishment of audit committees for SOEs nor for other entities. As a consequence, there is a lack of proper monitoring of the annual audit of financial statements, the effectiveness of internal controls, and risk management systems, regarding financial reporting as well as the independence of the auditors. A JSC Censors’ Committee is charged with exercising control over the financial and economic activities of the entity including checking and confirming the year-end financial statements. The functions of the Censors’ Committee are not, however, the same as of an Audit Committee. As noted by the 2013 A&AROSC report, the role of a JSCs Censors’ Committee is somewhat unclear: they are not an internal audit function as they are appointed by and report to shareholders; they are not an external audit function as they report separately from external audit and appear to exercise a control function; and they are not an Audit Committee in that they do not appear to have a formal relationship with the external auditors. The key functions of the audit committee are: (a) to inform the board about the outcome of the audit and explain how the audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process; (b) to monitor the financial reporting process and submit recommendations or proposals to ensure its integrity; (c) to monitor the effectiveness of the internal quality control and risk management systems regarding financial reporting, without breaching its independence; (d) to monitor the audit of the annual and consolidated financial statements; (e) to review and monitor the independence of the auditors; and (f) to be responsible for the procedure for the selection of auditors. Good practice also calls for audit committee members to be independent. To ensure consistency with the requirements of the EU’s Statutory Audit Directive, the Ministry of Finance intends to require the mandatory establishment of an Audit Committee by PIEs. According to the first draft of the Law on Auditing prepared by MOF, PIEs will be legally bound to create an independent audit committee which will consist of a minimum of 3 members, independent from the audited entity and appointed by the General Meeting of shareholders or by the founder. It is expected that the audit committee will have significant importance in selecting, appointing, and communicating with the statutory auditor. The new provisions, if approved by Parliament, will however be applicable only to JSC SOEs which are classified as PIEs.
Presentation of assets in the financial statements of SOEs may not be true and fair and could negatively influence economic decisions. In fact, financial monitoring performed by both PPA and MOF is based on historical costs and could be of limited value. Property, plant, and equipment account for around 54.78% of SOEs total assets (see table 7 below for additional details). These are mainly measured using the cost model and even if NAS require application of depreciation tests at the end of each reporting period there is no evidence on the reliability of fair values calculation. In addition, the accounting treatment of assets impairment according to NAS “Impairment of assets” differs from the provisions of IAS 36 “Impairment of assets” with reference to calculation of the fair value and recoverable amounts. As mentioned above, accounting policies are not properly disclosed in the notes to the financial statements and therefore it is difficult to assess the models applied for the subsequent measurement of property, plant, and equipment used by SOEs. The team’s understanding is that many of them prefer a cost model (NAS allows entities to apply a re-evaluation model, but there is no guidance on its application and entities have limited capacity to apply it in practice). PPA and/or MOF do not scrutinize accounting policies applied by various SOEs for measurement of property, plant, and equipment. No guidance and/or recommendations are available from the state, in its capacity as owner, on what model is better for SOEs to apply where such assets represent a significant share of total assets. The auditors of Moldovan transmission system operator SE Moldelectrica (one of the biggest SOE; see annex 3), for example, issued a disclaimer of opinion on the financial statements for the year ended December 31, 2015, citing lack of evidence on proper measurement of fixed assets.

Table 7: SOEs’ non-financial assets as of January 1, 2016120

<table>
<thead>
<tr>
<th>Items</th>
<th>245 SEs</th>
<th>% in total assets</th>
<th>58 JSCs</th>
<th>% in total assets</th>
<th>Total 303 SOEs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>mln lei</td>
<td>% in total assets</td>
<td>mln lei</td>
<td>% in total assets</td>
<td>mln lei</td>
</tr>
<tr>
<td>Total assets, of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed assets</td>
<td>11,889</td>
<td>51.91</td>
<td>11,084</td>
<td>36.90</td>
<td>22,973</td>
</tr>
<tr>
<td>Lands</td>
<td>678</td>
<td>2.96</td>
<td>329</td>
<td>1.10</td>
<td>1,008</td>
</tr>
<tr>
<td>Tangible assets in progress</td>
<td>3,741</td>
<td>16.34</td>
<td>748</td>
<td>2.49</td>
<td>4,490</td>
</tr>
<tr>
<td>Total non-financial assets</td>
<td>16,309</td>
<td>71.21</td>
<td>12,162</td>
<td>40.49</td>
<td>28,471</td>
</tr>
</tbody>
</table>

120 Source: 2015 PPA annual report
113. CoA Annual Reports on Administration and Use of Public Financial Resources and Assets have repeatedly referred to serious violations related to SOEs improper bookkeeping of assets, and non-performance or faulty performance of patrimony inventory. This generates a range of risks, including non-insurance of asset integrity and assets/patrimony of SOEs being taken over by third parties. The report on public patrimony management by the air traffic services entity SE "Moldatsa" in 2010-2011, for instance, says that previously identified problems in the area of state patrimony management and recording remain current and are determined by insufficient managerial accountability; thus, there is a further high risk of not ensuring the integrity and reporting of patrimonial assets. The CoA annual reports also offer evidence of poor accounting records at SOEs or failure to register land and buildings with State Cadastre. For example, the reports refer to the non-compliance in accounting of assets at the SOE under the Ministry of Information Technology and Communication - 59 buildings, 4,062 sq. m and another 321 land plots (or a total of 110.1 hectares) do not appear to be fully reflected on books and a further 35 buildings, 2,280 sq. m, 311 land plots 88.8 hectares are not registered within State Cadastre. The CoA report on the Government’s report on state budget execution for 2015 states that as of December 31, 2014, the total land area used by SEs is 9,030.8 hectares, of which only 1,879.9 hectares (20.8%) are evaluated and included in the financial statements. 7,150.9 hectares are not accounted for and thus the value of the state capital is underestimated.

Controls in procurement

114. SOEs procurement controls are weak in Moldova and are a significant risk factor for resource leakages. Controls in procurement in SOEs need to be subject to regular scrutiny by boards, management, internal audit function and external audit. SOEs in Moldova are not subject to the Law on Public Procurement. In some countries SOEs are required to follow public procurement laws while in others they are required to at least apply competitive neutrality principles. Moldovan SOEs usually rely on internally approved procurement procedures. The World Bank Toolkit on Corporate Governance of SOEs states that SOEs in many countries are bound by public procurement laws to guard against corruption and misuse of public funds. Such rules can be cumbersome and pose a constraint on the ability of SOEs to operate and invest in a timely manner to meet the competition. Complex, time consuming procedures that are not commercially oriented can have a significant negative impact, especially when SOEs are purchasing commodities from world

124 http://lex.justice.md/md/360122/
125 https://openknowledge.worldbank.org/handle/10986/20390
markets where speed and flexibility are paramount. Some countries, such as Turkey, exempt SOEs from the procurement law for purchases below a certain threshold; other countries, such as the United Kingdom, have specifically addressed competitive neutrality in procurement contracts through a set of principles of competition put together after consultation with stakeholders. Recent efforts have been made to analyze the problems resulting from private and public incumbency advantages in procurement and to identify the characteristics that a competitively neutral procurement policy should have in Moldova.

115. **Most SOEs in Moldova use sole source procurement for goods and services; this generates significant risks including potentially paying above market prices and increased scope for corruption, including bribery and related-party transactions.** One example mentioned by various stakeholders and the media is the acquisition of electricity through a convoluted chain of intermediaries, who increase tariffs while adding questionable value in terms of improved services. Where SOEs do not minimize their operating and capital costs because of procurement (or other) arrangements, it is inevitable that SOEs will have to raise prices, reduce profits and dividends, incur additional debts, or a combination of these outcomes, including low quality of public services. Data on the total value of SOEs procurement is currently unavailable.

116. **There is a need to improve controls in the area of procurement, clarifying the responsibilities of boards and management, and addressing conflicts of interest.** The procurement practices of SOEs have been criticized by NGOs, media and findings by CoA. The CoA 2014 annual report reported that the Ministry of Information Technology and Communication failed to ensure proper management control of SOEs under its administration with respect to procurement processes. SOEs made purchases without initiating procurement procedures totaling over 17.2 million MDL (~0.86 million USD), which limits transparency and increases the risk of distortion of the procurement process. The most common violations related to procurements, highlighted by the 2012 Public Policy Proposal, are still valid and summarized below:

- procurements at unjustified prices;
- performance of procurements through intermediaries;
- performance of large procurements without the consent of the board/founder;
- performance of procurements by violating internal regulations and procedures.

In fact, many SOEs in Moldova function as parastatals providing government services and supporting government functions. Currently authorities are considering transposing the EU
Directive 2014/17/EC which requires imposition of public procurement rules in the utilities sectors, including water, energy, transport and postal services, where competition is limited. In general, controls in SOEs procurement need to be subject to regular scrutiny by boards, management, internal audit function and external audit.

Public availability of financial statements and aggregated data on SOEs

117. Even though the law requires SOEs to make their financial statements publicly available, this requirement is rarely observed in practice. Despite the legal requirements, financial statements, including management reports and audits reports where applicable, are not available through the public registry of financial statements, and only few entities publish them on their websites. Publication and submission of financial statements are regulated by the Accounting Law. All entities are required to present their financial statements to owners (associates, participants, shareholders) and to the Financial Statements Information Service (Public Registry). Individual and consolidated financial statements should be filed within 90 days of the end of the reporting year. SOEs that are PIEs are currently required by the Accounting Law to submit individual and consolidated biannual financial statements for the first semester within 30 days of the semester end, and annual financial statements within 120 days following the reporting year. The obligation to publish financial statements as such is vested with the Public Registry. However, as mentioned by the 2013 A&A ROSC report, even if transparency requirements have improved in recent years, compliance is still very weak. The Public Registry, responsible for collecting and publishing financial statements of all entities, is overburdened with many responsibilities and too little capacity and resources, putting compliance with the Accounting Law at risk. Improving the functionality of the Public Register of Financial Statements is a focus of STAREP/CFRR\textsuperscript{129} support jointly with the Government of Moldova.

118. There are issues of SOE compliance with legal requirements and market expectations on transparency and disclosure. Figure 9 below (on the basis of data in annex 3) represents the transparency of 20 significant SOEs in Moldova. It illustrates that only one out of 20 significant SOEs are fully compliant with legislation and market expectations.

119. Transparency is also hampered by lack of enforcement of the requirement for entities subject to statutory audit, including SOEs, to publish financial statements on corporate websites. As mentioned above, JSCs in which the state holds more than 50% of shares and large state enterprises are subject to annual audit. The audited financial statements of major SOEs are typically not published on their websites and only limited

\textsuperscript{129} http://go.worldbank.org/TJIUDM0870
financial information is disclosed. Law no. 146 was recently amended\(^{130}\) (on March 17, 2016) to require all SEs subject to annual audit to publish audited financial statements, including management report, on their website by May 30 of the year following the reporting period. For the year ended December 31, 2015, the requirement entered into force in July 2016. Detailed information on the availability of audited financial statements of the 20 SOEs with the largest assets is shown in the Annex 9.

**Figure 9: Moldova’s Top 20 SOEs Transparency Illustration**

![Graph showing the Top 20 SOEs](image)

120. **The State in its capacity of an owner publishes only limited aggregated information on the SOE sector as a whole.** PPA prepares annual reports on administration and denationalization of public property but this report is not published or otherwise made available to the general public. The PPA annual report includes SEs and those JSCs where the state holds over 25% of shares\(^ {131}\), while the MOF report on financial monitoring (prepared on annual and quarterly basis) includes SEs and those JSCs where the state holds over 50% of shares. Both reports include an aggregated financial analysis of SOEs in Moldova providing the GoM with a better overview of SOE performance. This is important in several respects: (i) it provides an aggregated snapshot of SOEs performance; (ii) it informs the GoM on SOEs debt level indicating potential fiscal risks for the budget; and (iii) it offers detailed recommendations on improving SOEs performance, corporate governance, public access to information and other. It is important to note that it is not clear what information is used to compile this report, therefore, the quality of this aggregate financial report is dependent on the quality of SOE data submitted to PPA. As already mentioned in this report, it is critical that financial information and respective key performance indicators are audited to ensure quality and reliability. Despite the OECD recommendation for the use of web-based communications to facilitate access by the general public, the latest annual report published

\(^{130}\) [http://lex.justice.md/md/364093/]

\(^{131}\) for previous years PPA published the main financial indicators for the JSCs where the state holds over 30%
on the Ministry of Economy (MOE) website is dated 2011\textsuperscript{132}. The most recent data published by PPA refers to selected financial indicators of SOEs activity for the year ended December 31, 2015, separately for SEs\textsuperscript{133} and JSCs\textsuperscript{134} activity. OECD guidelines recommend publishing annually an aggregate report on SOEs.

121. Other key aspects of the OECD principles in the area of transparency, disclosure, and controls that do not appear to be covered, or are only partially covered, by the existing legal requirements. Actual practices are summarized below:

- there are no legal requirements to make a clear statement to the public of enterprise objectives and their fulfillment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity);
- disclosures on the governance, ownership, and voting structure of the enterprise, including the content of corporate governance code or policy and implementation processes, are not mandatory for non-PIE SOEs; furthermore, only PIE SOEs\textsuperscript{135} are required to implement and follow a code of corporate governance;
- there are no clear legal requirements that any material transactions with the state should be disclosed by SOEs;
- there are no legal requirements to disclose 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.

\textsuperscript{132} http://www.mec.gov.md/ro/documents-terms/app-rapoarte
\textsuperscript{133} http://date.gov.md/ckan/ro/dataset/5086-date-privind-rentabilitatea-veniturilor-din-vinzari-rentabilitatea-activelor-rentabilitatea-cap
\textsuperscript{134} http://date.gov.md/ckan/ro/dataset/5087-date-privind-rentabilitatea-profitului-net-rentabilitatea-activelor-rentabilitatea-financiara-a/resource/cb150730-443b-49dd-9478-8ab0c6b870bb
\textsuperscript{135} Currently, there is only one PIE SOE, Franzeluta SA which is listed on regulated market.
CHAPTER 8: PERFORMANCE MONITORING AND MANAGEMENT

OECeD principles and good international practice

122. Effective and timely performance monitoring is a key ownership function of a business owner. Strong performance monitoring practices establish clear objectives and financial targets for a company, and formalize owners’ expectations. The practice of establishing and monitoring financial and non-financial indicators has long been employed by private businesses in all sectors of the economy. Transparency of operations and accountability of directors and managers of SOEs are especially important as their ultimate owners are the citizens of a state. To achieve good corporate governance and financial sustainability of SOEs, it is necessary not only to publish clear objectives for SOEs and their managers, but also periodically to assess progress towards these performance objectives and hold respective managers accountable.

123. Historically, SOEs across most countries performed worse than their private sector peers. This trend was similar across different jurisdictions and sectors of the economy. The reasons for this trend vary from country to country, but are summarized in three main weaknesses of a state as the owner: (1) setting unclear or conflicting goals for SOEs; (2) appointing directors that lack commercial or industry expertise to SOE boards; and (3) lack of strong monitoring of SOE performance and adherence to the financial and non-financial objectives set by the owner. Addressing the trend of weak performance of SOEs, many governments have initiated reforms aimed at raising accountability. These measures are particularly aimed at clarification of SOEs’ financial and non-financial objectives, measuring performance against quantifiable targets and publishing this information for open access by all interested stakeholders. To increase incentives for SOEs to stay on track with the objectives, a number of governments began integrating the results of performance management into performance-based contracts for SOE executives.

124. OECD Guidelines have summarized the aspirational international practices in SOE performance monitoring and management, inspiring governments across the world to carry out SOE reforms. OECD Guidelines include the state’s prime responsibilities as an owner to:

- Set and monitor the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;
• Establish reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards. 

• The OECD Guidelines also support proper incentives for SOEs boards through a clear remuneration policy that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

125. Performance-monitoring systems typically refer to the institutions, processes, and documents that government uses to monitor the financial and non-financial performance of SOEs. A performance monitoring system typically involves three key elements: (i) setting mandates, strategies, and objectives for SOE; (ii) structuring performance agreements between SOE and government to monitor each SOE performance; and (iii) developing key performance indicators and targets.

126. The first step in setting up an SOE performance monitoring system is to formulate and document each SOE’s mandate and strategy. Clear definition of the mandate and objectives of each SOE is necessary to establish the basis for the company’s accountability, determining the scope of public services or other special obligations, and formulating more specific targets for company’s operations. Governments may also benefit from developing cross-cutting objectives for all SOEs in the country, as illustrated in Box 8.

**Box 8: Examples of cross-cutting ownership objectives in selected OECD member countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>“creating value for the owners”</td>
</tr>
<tr>
<td>France</td>
<td>“to contribute to a better valorization of state shares in SOE”</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>“to ensure that Government’s shareholdings deliver sustained, positive returns and return their cost of capital over time within the policy, regulatory and customer parameters set by Government, by acting as an effective and intelligent shareholder”</td>
</tr>
<tr>
<td>Finland</td>
<td>“to achieve an economic and societal overall result that is as good as possible ... The economic overall result is the sum of the development in value of the shares owned and their annual dividend yield”</td>
</tr>
<tr>
<td>Norway</td>
<td>“to attend to the common good. As an owner, the State also expects these companies to take corporate responsibility and to uphold our basic values in an exemplary manner”</td>
</tr>
</tbody>
</table>

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137 Source: OECD Corporate Governance Principles
127. Non-commercial objectives of SOEs, such as the delivery of certain public services or fulfilling social responsibilities, should be clearly documented in the SOE’s mandate, properly disclosing costs associated with such social commitments or public obligations, and indicating respective funding sources. It is important to ensure a high degree of transparency and ongoing separate reporting on non-commercial objectives. This separation of objectives will provide the state and the public with an understanding of the cost of meeting social objectives. It also allows the owner to assess SOE progress in meeting its commercial objectives in a clear way. Failure to set the strategies and objectives for each SOE in a clear manner may lead to ambiguities in subsequent monitoring of SOE performance.

128. It is good international practice to connect SOE performance with remuneration levels of the SOE board and executives. Management remuneration in many countries includes a fixed payment and a variable payment, in Australia, the UK, and the US the variable share may account for 60% or more of total remuneration. Remuneration of board members of listed companies is typically composed of three elements: base salary and two types of variable compensation (annual bonus and long-term incentive premiums). Variable payments are based on the performance of a company, preferably related to key performance indicators discussed above. In listed companies, a part of annual bonuses are increasingly paid as shares, and long-term incentive premiums are almost always in the form of shares. In Finland, guidelines on remuneration in SOEs establish that bonuses and other variable payments "should be based on measurable profitability, and good performance of executives should be for a long term", and that "the minimum length for determining long-term incentive payments is three years". Remuneration instructions in Sweden state that SOEs should avoid over-payments but be “wage-leading”. Some countries expressly provide that the amount of wages in SOEs cannot be higher than the market level, although it should be competitive.

Key considerations in establishing a sound performance monitoring system

129. Moldova does not yet have a comprehensive SOE strategy or policy to serve as a basis for establishing goals and objectives of individual state owned entities. The GoM may benefit from developing such a document addressing SOE ownership goals, government priorities and defined commercial and social roles of such entities.

130. The process of formulating SOE strategy may also crystalize the government’s vision and assist in identification of main groups of SOEs, such as: (i) commercial entities safeguarding national strategic interests that the government will keep in state ownership; (ii) commercial entities that do not represent strategic interest for the GoM, but which generate strong revenue stream for the state budget; (iii) other entities that do not
represent strategic interest, and which may be privatized or jointly managed with private investors through public private partnerships (PPP); and (iv) policy oriented companies implementing the state’s social objectives and delivering public services. Profit generation would typically have a secondary role for such entities.

131. The SOE performance monitoring system should include performance agreements negotiated between SOEs and the GoM owning entity (the PPA or respective decentralized institution responsible for ownership of a particular SOE). Performance agreements formalize and describe the expectations and specific objectives agreed to by the ownership entity, and the boards of each SOE. Performance agreements may include the following elements:

- SOE’s vision and strategy;
- SOE’s mandate and the scope of activities, defining core and noncore activities that an SOE board will be accountable for;
- Clear description and explicit financial estimate of SOE’s non-commercial objectives, providing the state and the public with an understanding of the cost to meet social objectives;
- Financial and nonfinancial performance indicators, as well as targets for those indicators, to measure an SOE performance against its strategy and objectives;
- Frequency and procedures for reporting, unless specified in other laws or regulations;
- Dividend policy, driven by an SOE’s capital structure, profitability, and estimate of future capital expenditure.

132. SOEs performance against the agreed objectives and targets as set out in the performance agreement should be regularly monitored. Monitoring of SOE performance against the agreed objectives and targets set out in the performance agreement is typically undertaken on an annual basis, but more frequent monitoring may be established for important or strategic SOEs. The monitoring process can be streamlined by requiring SOEs to provide standard-form financial and non-financial data. More sophisticated systems can facilitate data analysis by identifying trends, producing cross-sector or intertemporal analysis, and generating aggregate reports.

133. Performance monitoring is usually carried out by SOE ownership entities, though sometimes SOE boards play this role too. In Singapore, for example, performance evaluations of individual companies are conducted by their respective boards, whereas in Indonesia, the Ministry of State-Owned Enterprises develops an evaluation manual with clear quantitative indicators against which to conduct SOE performance evaluation. These evaluations are undertaken by assessors from SOE boards before being ultimately submitted to the Ministry of State-Owned Enterprises.
134. SOEs’ performance in Moldova is currently assessed based mainly on financial indicators, the traditional measures of company performance. These indicators are based on standard information presented in income and financial statements. Financial indicators commonly used to track financial performance of SOEs in countries around the world fall into several categories, e.g. profitability indicators, efficiency indicators, solvency indicators, budgetary appropriations indicators, etc.

135. Key performance indicators should be an integral part of performance agreements between SOEs and those responsible for ownership function. To be meaningful, performance indicators should be based on the entity’s strategy and objectives, industry sector, benchmarking, management performance, tracking, and auditing. It is highly advisable that performance indicators include both financial measures and non-financial ones. The current system of financial indicators does not include all dimensions of SOEs performance, and combined with issues of quality of financial information (see Chapter 6 for details) this may mislead users of performance indicators.

136. Non-financial performance indicators are equally important and can cover a broad range of topics, providing a broader perspective on a company’s performance. Examples of such indicators may include: customer satisfaction, service quality, market share, environmental compliance, research & development, employee safety etc. As for financial indicators, non-financial indicators must be tied to SOE strategy and objectives reflecting the nature of business, as well as government’s priorities.

137. It is important to strike a balance on the number and importance of performance indicators. The set of performance indicators should be tailored to capture main dimensions of SOE performance, and such indicators should be limited in number. Keeping to a manageable number of trackable indicators (around 15 is good practice) allows SOEs to focus on key areas and minimize administrative resources required for collection and processing data. Requiring too many performance indicators places a burden on both the SOE to produce them and on the SOE ownership entity, which may have limited capacity to analyze them. See Box 9 as an example of Swedish alcohol retail monopoly.

Box 9: Example of SOE social objectives and non-financial key performance indicators in Sweden

The Swedish Government’s owned alcohol retail chain (Systembolaget) principal assignment is, with exclusive rights, to conduct retail sales of alcoholic beverages to the public with the socio-political purpose of restricting access to alcohol. This case illustrates how state ownership holds SOEs to a higher social responsibility and ensures that SOE revenues are used for the benefit of society as a whole.

138 Source: Annual report on state owned companies 2014. www.regeringen.se
Systembolaget, under the Ministry of Health and Social Affairs, is committed to helping to reduce the impact of alcohol abuse while providing good service to its customers and conducting its operations in a financially efficient way. In order to live up to its social responsibility, targets have been set for the age-checks conducted in its stores.

Systembolaget is obliged to make advertisements focused on the side effects of drinking and to encouraging moderate drinking. It is not allowed to advertise its products to increase sales.

The Company’s strategic sustainability targets include: reduction of harmful effects of alcohol in society; and reduction in climate impact by 14,000 tones CO2e by 2020. Public policy and non-financial indicators include: the Company’s share in total alcohol consumption in Sweden; customer satisfaction index; age verification at the retail shops; and positive trend in alcohol index, measuring people’s attitude to alcohol.

138. SOE performance monitoring should be structured as an ongoing process, analyzing results and introducing necessary adjustments over time as experience and capacity increase (see Figure 9 below). This ongoing process would enable the state to actively monitor SOEs to ensure that they not only achieve their stated objectives in an efficient, effective and socially responsible way, but that they deliver on wider societal outcomes that create value for the public.

Figure 10: SOE Performance Monitoring Cycle
139. Moldova has introduced several legislative changes which, if implemented and enforced properly, can produce tangible results for SOE governance and their improved accountability. Since 2011, for example, SOEs have been required to prepare business plans. This important process currently involves mainly SOE boards and their line ministries. The PPA and MOF are not directly involved in the process or made aware of the content of the business plans; this is done, however, through the representative of these institutions in SOEs’ boards.

140. Preparation of a business plan is an important element of good management and governance. A business plan helps the board clarify an entity’s business objectives; identify potential problems; set out the performance expectations by period; and measure the actual progress of SOEs. It supports the effective management of an entity and is a source of key information for the owner, the GoM, which can assist in the process of drafting and negotiating performance agreements between the GoM and individual SOEs. It is important that either PPA or MOF are involved in the review of SOE business plans and have the opportunity to provide input or comments to these documents on an ongoing basis.

141. The Republic of Moldova is at an early stage of developing SOE performance monitoring framework. SOE ownership functions, supervision and monitoring of SOEs performance are dispersed across several agencies and line ministries. Despite some recent efforts to consolidate SOE ownership functions, cooperation between these agencies and respective line ministries remains rather low, precluding effective and pro-active management of SOEs performance.

142. Reform efforts in improving SOE corporate governance and enhancing their financial performance have not produced the expected results. As mentioned earlier in this report, the 2012 Public Policy Proposal on Corporate Governance Rules for State-Owned Enterprises was not implemented and there was no major follow-up to that policy initiative.

143. Performance agreements in Moldova could be implemented gradually, taking into account the critical contextual factors. International experience suggests that the effective implementation of performance agreements is a complex process that takes time and strong support from various stakeholders. Therefore, the roll-out of performance agreements with SOEs could potentially be carried out in a phased manner while simultaneously working towards increasing the oversight capacity of PPA.
PPA and MOF monitor a set of financial key performance indicators (KPI) that SOEs should achieve. While this represents significant progress, it is not clear whether or not the indicators are binding for SOEs. The financial performance indicators are in line with good international practices. However, these KPIs may need to be reviewed and revisited as part of a performance monitoring cycle, which analyzes results and introduces necessary adjustments over time as experience and capacity increase. Additional indicators, industry specific and/or non-financial KPIs, need to be introduced to monitor the main dimensions of each SOE performance. Financial performance indicators are presented in Table 8 below.

Table 8: Performance indicators of SOEs as of 01.01.2016

<table>
<thead>
<tr>
<th>Performance Indicator</th>
<th>Target</th>
<th>200 SEs 2014</th>
<th>200 SEs 2015</th>
<th>58 JSCs 2014</th>
<th>58 JSCs 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial profitability (the ratio of net profit (net loss) to shareholders’ equity)</td>
<td>&gt; 1/3</td>
<td>0.85</td>
<td>0.84</td>
<td>0.38</td>
<td>0.33</td>
</tr>
<tr>
<td>Return on assets (the ratio of profit (loss) before tax to the total assets)</td>
<td>&gt; 10 %</td>
<td>-1.41</td>
<td>-3.16</td>
<td>-5.54</td>
<td>-11.66</td>
</tr>
<tr>
<td>Commercial profitability (the ratio of the gross profit before tax to the cost of sales)</td>
<td>&gt; 20 %</td>
<td>-2.34</td>
<td>-4.98</td>
<td>-22.94</td>
<td>-40.92</td>
</tr>
<tr>
<td>Return on sales (the ratio of net profit (net loss) before tax to sales)</td>
<td>&gt; 20 %</td>
<td>14.02</td>
<td>14.41</td>
<td>14.75</td>
<td>19.43</td>
</tr>
<tr>
<td>Financial autonomy rate (the ratio of the shareholders’ equity to the sum of equity and long-term debts)</td>
<td>&gt; 0.5</td>
<td>0.69</td>
<td>0.65</td>
<td>0.34</td>
<td>0.23</td>
</tr>
<tr>
<td>Total debt ratio (the share of the total long-term and short-term debts to the total assets)</td>
<td>&gt; 2</td>
<td>3.2</td>
<td>2.83</td>
<td>1.61</td>
<td>1.30</td>
</tr>
</tbody>
</table>

Financial key performance indicators set by PPA must become mandatory for all SOEs, with proper incentives for SOE boards and management, and strict enforcement by the GOM. The GOM, as owner, must require all SOEs to perform at a certain level. The GOM should make performance agreements with each (or at least the largest) SOEs, confirming existing and introducing new binding financial and non-financial key performance indicators. These should be monitored and enforced by the state to hold SOE boards and management accountable for performance. It should be noted that auditors of SOEs subject to statutory

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139 Source: 2015 PPA report
audit are required by Regulation no. 875\textsuperscript{140} to confirm the fairness of the performance indicators listed in that regulation (e.g. return on sale; financial autonomy rate).

146. An important element of SOEs performance monitoring is benchmarking against industry standards and comparators, existing PPA and MOF annual reports lack such analysis. This area is still underdeveloped in many emerging market countries, but SOE ownership entities should strive to benchmark SOE performance against appropriate peers, domestic or foreign, with the aim of identifying gaps and areas for improvement.

\textsuperscript{140} http://lex.justice.md/viewdoc.php?action=view&view=doc&id=362489&lang=1
CHAPTER 9: FINANCIAL DISCIPLINE AND FISCAL RISK

Analyzing and managing fiscal risks—international practices

147. As defined by the IMF, fiscal risks represent possible deviations of fiscal outcomes from what was expected at the time of the budget or other forecast. Sources of risk include various shocks to macroeconomic variables (economic growth, commodity prices, interest rates, or exchange rates) as well as calls on several types of contingent liabilities (obligations triggered by an uncertain event: including both explicit liabilities—those defined by law or contract, e.g., debt guarantees—and implicit liabilities—moral or expected obligations for the government, based on public expectations or pressures, e.g., bailouts of banks or public sector entities).

148. SOEs are a potentially significant and common source of fiscal risks, with government bailouts of troubled SOEs costing 3 percent of GDP on average and 15 percent of GDP in the most extreme cases. Financial performance of SOEs can be monitored to inform assessments of fiscal risk and their management. A common set of financial indicators, similar to those used in the corporate sector, can be used to help inform assessments of fiscal risks. Governments can identify more problematic entities to focus their oversight on those that present the largest fiscal risk, and ensure monitoring activities are commensurate with the degree of fiscal risk they pose. The institutional framework for fiscal oversight of SOEs should also be supported by sound governance principles and proper accountability mechanisms. Box 10 offers an example of framework for oversight of SOEs.

Box 10: South Africa: Managing Fiscal Risks from State-Owned Enterprises

South Africa has a relatively well-developed oversight framework for monitoring SOE performance. The Public Financial Management Act (PFMA) and Treasury Regulations require that SOEs submit corporate plans annually, covering a period of three years. These should outline the strategic objectives, agreed with the government, key performance indicators for assessing the entities performance, a risk management plan, and a financial plan. The financial plan must include: projections of revenue, expenditure and borrowings, asset and liability management, capital expenditure programs and dividend policies.

The PFMA sets controls on borrowing and contingent liabilities of SOEs. The Minister of Finance must authorize the issuance of guarantees or indemnitees. Some SOEs must also

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obtain the Minister’s approval before borrowing and all SOEs may not borrow in foreign currency above a prescribed limit set by the Minister. Entities that are permitted to borrow must submit annual borrowing programs to the National Treasury as well as quarterly reports on actual borrowing.

A Fiscal Liability Committee has been established within the National Treasury to advise the Minister on these matters as well as short and medium-term risks related to SOEs. The committee receives reports on the financial performance of SOEs and their compliance with any conditions attached to fiscal support, which are assessed as part of its aggregate fiscal risk monitoring.

SOEs are required to submit audited annual financial statements in accordance with generally accepted accounting practices within five months of the end of the financial year to the shareholder minister and the National Treasury. SOEs are also required to submit quarterly reports to their shareholder Minister.

149. Where SOEs corporate governance and institutional oversight are weak SOEs can generate significant fiscal risks, including requiring subsidies from the budget, generating low rates of return with commensurate lower dividend, paying less in taxes and by incurring debts. Governments can reduce their exposure to fiscal risks from SOEs by: (i) reducing overall state participation in commercial activities; (ii) limiting exposure to contingent liabilities by ensuring there is a clearly defined set of criteria that govern the operation and conduct of SOEs; (iii) strengthening governance arrangements (for example through appointing independent boards based on transparent and merit-based nomination processes); (iv) placing legal limits on bail-outs; and (v) providing transparent mechanisms in the budget to compensate SOEs where they deliver non-commercial government goals.

Financial discipline and fiscal risks

150. Financial discipline of SOEs is weak in Moldova; the state is only starting to develop a system for assessing fiscal risks to the national public budget. Significant changes are required in monitoring of financial performance, making boards and executives accountable, increasing efficiency in procurement and improving dividend policies. Although SOEs do not receive preferential loans or direct budget subsidies or guarantees, some dividend policies and practices may be considered hidden subsidies or preferential treatment. MOF’s assessment of fiscal risk is basic, improvements are needed to identify, quantify and manage risks of SOEs. Strengthened capacity is necessary to take decisions on the basis of these assessments and for those in ownership positions to influence appropriate behavior of boards and management of SOEs.
Enforcement of financial and fiscal discipline in SOEs can reduce government liabilities and simultaneously strengthen incentives for improved SOE governance and performance. According to the 2014 CoA annual report, financial management and control practices in the country are at an early stage of development. Critical areas for improvement identified by the CoA include such areas as slow and unsystematic application of the Law on State Internal Financial Control, inefficient public financing and procurement, poor governance of SOEs, dysfunctional administrative boards and management appointed by authorized bodies, growth of public sector debt, unjustified, unauthorized or undisclosed tariffs set by certain SOEs, and infringement of financial reporting.

Weak procurement practices allow potential misuse of funds. While public institutions ensure transparency in the public procurement process to some extent, most SOEs do not. The authors of the recently published Report on Public Procurement Monitoring concluded that procurement by SOEs is not transparent. Even once the new Law on Public Procurement, transposing EU legislation, is adopted and in effect, and the regulations envisioned by this law decided, it will not bring the necessary changes in the public procurement process. This is a serious shortcoming.

The role of SOE owners and boards in the monitoring of financial and non-financial reporting continue to be limited. There is a need for more scrutiny and more demanding follow-up on audit reporting and improved communication with SOEs’ auditors (boards can perform these functions in the absence of an audit committee). As discussed in more detail in Chapter 9, SOE boards are currently made up of civil servants appointed by the institution head who governs the respective SOE. Appointments to management boards can appear to be more to offer financial privilege to a bureaucrat than to ensure effective corporate governance. A recently published analysis by a think-tank NGO found the clientelistic aspect of forming the management board, along with the lack of a professional group of state’s representatives in the SOEs boards, leads to a vicious system of poor management of the public property held via SOEs.

The Public Expenditure and Financial Accountability (PEFA) Assessment Update for Moldova (2012-2014) found improvements in the monitoring of public sector entities’

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145 http://lex.justice.md/viewdoc.php?action=view&view=doc&id=336794&lang=1
fiscal risk, but there remains scope for more. The financial monitoring report is prepared by the MOF, based on the financial statements of SOEs (as received from the National Bureau of Statistics). However, financial statements are not properly scrutinized, audits are of uneven quality and no significant follow-up on audit qualifications or management letter points are done. Therefore, the reliability of financial indicators included in annual reports is questionable (these aspects are discussed in detail in Chapter 6 of this report). The analysis prepared by the MOF is very detailed, but touches only briefly on areas of fiscal risk and may be further improved and streamlined for better decision making, including decisions related to fiscal risks and incorporating these risks in the budgetary process.

155. **Assessment of fiscal risk performed by the MOF is rather basic, more effort is needed to identify, quantify and manage SOEs risks.** Fiscal risk mitigation practices could be improved by: (i) identifying risks and quantifying them; and (ii) quantifying explicit exposures. The capacity to take decisions on the basis of these assessments also needs strengthening, as does the ability to influence the behavior of SOE boards and management by those in charge of ownership function. Some mitigation measures are already undertaken, for example registration of debt of SOEs by the MoF, or offering state guarantees only in exceptional cases and by decision of the parliament (public debt and guarantees are regulated by Law 419 of 2006 on public debt, guarantees and on-lending by the state). An analysis of SOEs net contributions to the state could also be performed, taking into account all taxes, dividends, subsidies or any other payments that exist between SOEs and the national budget. Major SOEs could additionally be further analyzed in detail so that proposed risk mitigation measures can influence and limit state exposure to risk from such enterprises.

**Dividend policies towards better fiscal discipline**

156. **There are several dividend models used globally to determine SOEs pay out levels and mechanisms.** In most economies, the state sets a dividend policy and implements it through negotiation with the SOE board. A fundamental principle is that dividends are paid only to the extent that this is not detrimental to the SOEs’ ability to meet its capital needs and financial obligations. SOE boards and management should have a clear sense of the expected dividend amount, retaining a degree of flexibility for crisis situations and market fluctuations. Receipt of dividends from SOEs may provide a significant revenue stream for the state budget. In the current economic environment many countries are reviewing and strengthening their dividend policy for SOEs, aiming to increase the budget revenues and to maximize the use of SOEs capital.

157. In Moldova dividend policies are set by law and are not necessarily based on such factors as the SOE’s capital structure, proposed capital investments, and profitability. Article 13(3) of the Law on SE and article 49(11) of the Law on JSCs require SOEs to distribute part of their annual profits as dividends to the state budget by June 30 each year. Non-compliance with these provisions is deemed fiscal breach and is subject of remedies according to Title V of the Tax Code. Government decision no. 110 dated February 23, 2011 provides that ministries and other public authorities should, inter alia: (i) require boards of JSCs with state share exceeding 5 percent to include on the agenda of the general meeting of shareholders until January 20 the issue of the distribution of net profit for the previous year; (ii) promote prudent distribution and payment of dividends, state representatives at the general meeting of shareholders and/or boards of SEs should encourage decisions on the distribution and payment of dividends of not less than 50 percent of profit; for SOEs included in the list of goods that cannot be privatized the recommended amount of dividends should be no less than 25 percent; (iii) state representatives will not promote decisions on dividends distribution/payment where a SOE is insolvent or payment of dividends will lead to its insolvency or where the SOE’s net assets are lower than its authorized capital or will become smaller after payment of dividends. In 2015 dividends paid to the state budget amounted to 130.07 mln MDL, of which 59.6 mln MDL was from SEs (the amount of received dividends is 18.07 mln MDL greater than 2014) and 70.47 mln MDL from JSC SOEs (15.51 mln MDL less compared to 2014).

158. The Government revises its dividend policy periodically and recent revisions could be assessed as uncompetitive hidden subsidies. Government decision no. 193 of April 24, 2015, requires that ministries and other public authorities should promote a dividend policy for the year ended December 31, 2014, of no less than 50 percent of profit in all SOEs. Some SOEs, though, could be exempted from distribution and payment of dividends, even against the wishes of the Minister of Finance, as it could be seen as a hidden form of subsidies for SOEs and thus could affect competition in the market. For example, 24 SEs and 7 JSC SOEs were exempted from distribution of dividends by Government decision no. 482 of June 25, 2014. However, the Competition Council has concluded that exempting SOEs from payment of dividends for fiscal year 2013 does not distort competition.

151 Source: PPA 2015 annual report.
152 http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=358169
154 http://unimedia.info/stiri/disensiuni-intre-lazar-si-arapu-Intreprinderi-de-stat--scutite-de-plati-in-valoare-de-24-mln-de-lei-78481.html
159. Moldova needs to strengthen dividend policies for SOEs so they are clear, transparent and predictable, this will require certain legal and financial considerations. Dividend policies should be applied by SOEs over multi-year time spans and allow for income and cash flow planning for the state. Given that financial performance of SOEs in recent years significantly deteriorated and many of them are loss-making, the authorities need to reconsider how dividend policies are set and taking into account specifics of entities and their businesses. For legal considerations, the fundamental rule is that dividends can only be paid out of profits without impairing entities’ capital. For financial considerations, SOEs’ management should have a clear expectation of the dividend size, retaining a degree of flexibility for crisis situations and market fluctuations. Although several different models of setting dividend policies can be applied, ultimately dividends need to be set through negotiation with SOEs boards.

160. Other factors to consider in establishing open and transparent dividend policy:

i. *Type of industry*: industries that benefit from relative stability of earnings may enjoy a more consistent dividends policy than those with an uneven flow of income or subject to market volatility. For example, public utilities have a more stable income flow allowing them to adopt a relatively fixed dividend rate unlike extractive industries or industrial producers, which are dependent on commodity market prices.

ii. *Age of a company*: newly established enterprises/entities need their earnings to re-invest into plant improvements or expansion, while established entities may afford distribution of their net income.

iii. *Need for additional capital*: the capital needs for business expansion or new investments/projects influences the dividend policy greatly, and must be taken into account in assigning a dividend requirement.

iv. *Business cycle*: prudent management in good times creates sufficient reserves for a company to face potential market downturns or crisis situations. Dividend policy should account for potential effects of business cycles on SOEs’ activities and provide flexibility for reserves accumulation.

v. *Profit trends*: SOEs past profit trends should be thoroughly examined to find out the average earning position of leading companies. The average earnings should be subjected to the trends of general economic conditions. If depression or downturn are approaching, only a conservative dividend policy can be regarded as prudent.
OEC principles and good international practice

161. In most OECD countries there is a trend to emulate private sector practices when it comes to the governance of SOEs and parastatals. While appointment processes and remit may vary from country to country, SOE boards have a vital governance role for public service providers in areas such as healthcare and education. The independence of boards and competences of their members are important: high level officials do not normally act as board members, and the nomination process takes into account competences and issues of independence (especially if the state is both regulator of a sector and the owner of an entity in the same sector). Carefully composed boards should be empowered to effectively advise and oversee management and to ensure an appropriate mix of knowledge and experience with only limited government representation.

162. Generally, and depending on legislative requirements, governments exercise their ownership rights in SOEs by application of either one-tier or two-tier governance systems. The board fulfills the central governance function for SOEs in this structure, while the important role of day-to-day management of an entity is exercised by the executive body. As per the OECD, the board has ultimate responsibility for SOE performance and requires the authority, autonomy, and independence to make decisions that determine performance. It also acts as the intermediary between the state (as the owner or shareholder) and the management of the company and has a duty to act in the best interests of both.

163. Good practice increasingly calls for an empowered board to appoint and, subject to clear terms, remove a CEO. In many jurisdictions with two-tier SOE board systems the supervisory board is typically responsible for choosing the management board. This reinforces the key function of the board in overseeing management and ensures that the CEO is accountable to the board rather than to the government. It also reduces the scope for government interference in operational decision making.

164. It is good practice to limit the appointment of government representatives to the board, where they are appointed their role must be appropriate and effective. Boards composed mainly of government representatives often lack the objectivity (especially when they have responsibility for policies in the SOE’s sector of operations) and skills vital to well-functioning boards. Therefore, more and more countries are limiting ministers and other political appointees from serving on boards, restricting the number of government representatives on boards, while increasing the share of independent private sector
members. If government representatives are on SOE boards they should meet the necessary qualifications, be able to devote sufficient time, and have the same obligations and roles as any other board member. They should not have any direct responsibility for key policy functions in the sector of SOE activity.

**Board structure, composition and nomination process**

165. While some common minimum legal requirements exist for SOE boards in Moldova, the board size, internal structure, and composition typically varies by SOE and by their legal form, i.e. SE or JSC. According to the Law on SE, the founder exercises the rights of administration of the state enterprise through the board and the administrator (chief executive). **SOEs that are SEs** have a collegial administration body; this board represents the interests of the state and exercises its activity in accordance with the law and regulation, approved by the founder. Its numerical composition is set by the founder, depending on the economic-financial indicators of the SE, for a period of no more than 3 years and with no fewer than 3 persons. The chairperson of the SE board is appointed by the founder. A member of the board may simultaneously be on a maximum of 3 SEs boards and is recalled by the founder in case of violation of the legislation; expiration of the mandate; liquidation of a SE; and other cases in accordance with legislation in force. **SOEs that are JSCs** have a board representing the shareholders’ interests between general meetings. It is accountable to the general shareholders meeting, and is required to act in the company interest. A general meeting of the shareholders appoints and eventually dismisses the board. The JSC board should consist of not fewer than three persons; for majority owned SOEs the law requires a minimum of five persons. The maximum number of board memberships in JSC boards is restricted by law to five for any single person. Board members can be reelected an unlimited number of times; the minimum mandate is for 4 years. The Chair of the JSC SOE board is appointed by an annual general meeting unless the charter of company delegates this power to the board. He/she presides over the meetings of the board and in case of a tie in voting; the Chair’s vote will be decisive.

166. The majority of board members of SOEs in Moldova are mandatory representatives of the MOE and the MOF, and board members are often involved in policies in sectors where SOEs operate; there are no requirements for independent board members of economically significant SOEs. OECD Guidelines set aspirational recommendations that SOE board composition should allow the exercise of objective and independent judgment. Independent directors typically bring commercial and/ or industry expertise to the board,

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157 The function of the founder of the SE is exercised on behalf of the Government by the public authority specified in the Government Decision on establishment of this respective SE.

158 Government decision no 770 of 20.10.1994

159 Representation of state interests in the JSCs is performed by a person, appointed by the public authority, responsible for administration of this respective JSC.
and ensure a balanced approach between the management, and political and social goals in the process of decision-making. The majority of board members of SEs and JSCs where the state holds more than 50% include mandatory representatives of the MOF and MOE and/or PPA. Representatives of the founder, staff, and other central public administration authorities may also be included, in addition to specialists in the field of activity of the enterprise, economists and lawyers. Public servants are earning significant additional revenues from SOE board membership on top of their regular civil servant salary. This gives a perception that public servants have divided loyalties, serving the public by making policies while serving selected subjects of policy making through SOE board membership. The involvement of independent board members for at least economically significant SOEs widely held as good practice for corporate governance in both the public and private sector, is not legally required in Moldova.

167. **There are no formal procedures for the nomination of board members of SOEs and the existing decision-making for specific nominations remains non-transparent.** The legislation in force does not set explicit professional and/or independence requirements for the board members of SOE, but stipulates that board members perform their primary ministerial functions as well as their board membership role and responsibilities. The Regulation on State Representation in JSCs\(^{160}\) intended to regulate some aspects with regard to the nomination of state representative on JSC boards. For example, Article 10 provides that heads of public institutions, persons holding public positions, and persons having a financial interest in the company, cannot be appointed as state representatives. Additionally, nominated state representatives should have at least 3 years of experience in public service; although it is difficult to assess how this requirement is implemented as no detailed information on board members is available. Personal connections and preferences appear to play a key role in the nomination of state representatives to the board of SOEs. This has a negative consequence as it affects the credibility of the board member, and complicates evaluation of his/her performance and analysis of his/her voting on specific issues. In light of the worsening economic performance of SOEs, civil society is increasingly voicing its concerns about the lack of meritocracy in appointing members to the boards of SOEs, public servants sometimes appear to have neither adequate training nor the appropriate skill-set and experience to serve as board members. Often there is a conflict of interest because state representatives on SOE boards are responsible for sectoral policies in the same area as the SOE operates; and in addition these people cannot devote sufficient time for meaningful board membership. The appointment system would be strengthened by establishing a pool of qualified professionals that could be appointed to boards or executive structures (including as independent members) who could professionally play this role on behalf of the state and transparently serve the public interest.

\(^{160}\) http://lex.justice.md/md/336655/
168. Often the information on board composition is not available on SOEs’ websites. Examination of a limited number of SOEs’ websites revealed that information about board members is missing, or only limited information is published such as board members names.\textsuperscript{161} The 2012 policy report, published by the MOE\textsuperscript{162}, also pointed out that information on the composition of boards and their resumes, including the name of the administrator and the name of the founder is limited. MOE published on its website information about board members\textsuperscript{163} of the SOEs which are under its administration; however as of July 26, 2016, this information is outdated.

169. Neither the Law on JSC nor the Law on SE requires boards to set up specialized committees such as audit, risk management and remuneration committees. As already mentioned in Chapter 6 of this report, a JSC Censors’ Committee is charged with exercising control over the financial and economic activities of the company including checking and confirming the year-end financial statements. The functions of the Censors’ Committee are not, however, the same as those of an Audit Committee. At the end of 2015, the National Commission on Financial Markets approved the Code of Corporate Governance\textsuperscript{164} which came into force on March 04, 2016 and is mandatory for PIE JSCs and recommended for implementation by all JSCs. Article 49 of the Code states that the board could establish committees for the preliminary examination of major issues of the company, such as remuneration committee, risk management committee, etc. Also, the Code recommends that at least one third of board members should be independent. In practice, implementation of the Code will need significant effort and time.

170. A conflict of interest arises from the fact that ownership and policy making functions are not separated. Conflict of interest is not defined at all in the Law on SE; there is a separate chapter included in the Law on JSC to address potential conflicts of interest issues. The new draft Law on State and Municipal Enterprises\textsuperscript{165} seeks to define conflicts of interest that might affect board members, in particular potential material interest in the state enterprise. Such an attempt, however, is rather counterproductive as it tries to define different paradigms where the conflict of interest emerges, but fails to specify the inherent conflicts of interest when the same person(s) acts as board member and develops policies for a particular industry. This conflict is worse because board members that are civil servants also receive significant additional remuneration for membership in boards. Neither the SE nor the JSC law call for an open, competitive, meritocratic and professionally capable process of identification and appointment of board members, and there is no pool or roster of members (including independent members) that could professionally play this role on behalf of the state and for serving the public interest.

\textsuperscript{161} http://www.moldtelecom.md/content/consiliul-de-administrare
\textsuperscript{162} http://www.mec.gov.md/ro/content/politici-de-administrare-si-deetatizare-proprietatii-publice
\textsuperscript{163} http://www.mec.gov.md/ro/content/politici-de-administrare-si-deetatizare-proprietatii-publice
\textsuperscript{164} http://lex.justice.md/md/363619/
\textsuperscript{165} available to the team in draft format
**171. Other key issues identified** as being out of line with good practice and aspirational recommendations by the OECD Guidelines are summarized below:

a) It seems that the Board of SE is accountable only to the owner; the law doesn’t stipulate that board members should act in the best interest of the entity;

b) SE Boards have no power to appoint and remove the administrator (chief executive); the board can only propose to the founder the candidate for the position of administrator, but the final decision is with the founder. JSCs law only allows delegation of such functions to the board while the final responsibility is with the general meeting of shareholders.

c) The founder decides on the level of remuneration of the administrator; the board can only propose an increase in salary based on the available financial resources and following the recommendations of Contract with administrator template, as regulated by the Government decision no. 780;

d) Conflict of interest is not defined by the Law on SE;

e) The role of the chairperson is not clearly defined by the Law on SE;

f) Even if employee representation on the board of SE is mandated, there are no mechanisms to guarantee that this representation is exercised effectively;

g) There are no legal provisions in respect of annual evaluation of board’s performance and efficiency;

h) Internal audit function is not mandatory for SOEs.

**Selection and the role of chief executive**

**172.** The founder appoints/dismisses the administrator (chief executive) of the SE directly (not through the management board); his/her responsibilities are prescribed by the legislation. The administrator is not permitted to be a member of the board but can be invited to attend, and normally does so. The founder is not permitted to interfere in the operations of the SE (except in accordance with the provisions of the contract between the founder and the administrator), and the board is not allowed to interfere in the work of the administrator where that work is undertaken in accordance with the contract with the founder. In practice, however, these limitations do not prevent an (actual or perceived) overlap of responsibilities or interference.

**173.** The executive body of a JSC can be either collegiate (directorate) or comprised of one person (general director, director). According to the provisions of the JSC law, the competences of the general shareholders meeting include approval of the regulation on the executive body, as well as decisions on the election of the executive body and appointment of the chief executive body and ahead-of-time termination of his/her authorities. The
general meeting of shareholders approve the head of the executive body’s pay, remuneration and compensation; and hold him/her to account or relieved of liability, unless the charter envisions otherwise (in some JSCs these functions could be delegated to the Board). The JSC SOE’s Board has no power to appoint the executive body. Thus, there could be situations in fully owned JSCs where the executive body is appointed by the founder (shareholder), similar to SEs. Though not required by the JSC law, in some majority owned JSCs the chief executive enters into a performance contract with the founder ministry for a certain period, for example three years. This practice, common in SEs, is problematic since it interferes with the powers of the JSC board, disrupts the corporate hierarchy, and provides for possibilities of conflicts between the board and the chief executive. The duty of the management of majority owned JSCs to deliver financial information directly to the founder ministry may also hamper equal treatment of shareholders. The aspirational OECD guidelines give substantial and relatively detailed recommendations regarding disclosure and transparency of financial information. At present very few JSC SOEs would be in a position to fully follow these recommendations. The chief executive may not be a member of the board; although he/she is normally present at board meetings. The law requires the executive body of majority owned JSCs to submit company economic and financial activity reports and a copy of auditor’s report to the administration authority (line ministry/agency) annually.

**Remuneration and performance evaluation of board and administrator/ chief executive**

174. **Board remuneration is limited, and is seen as an additional source of income to civil servants who are SOE board members.** Remuneration of SOE boards, of SE administrators, and of majority owned JSC chief executives, is in accordance with the Law on Remuneration No. 847 of February 14, 2002. Article 24 of the law limits board remuneration in SOEs to three times the minimum salary per country per month (for instance, in 2016 this amounted to 3,300 MDL per month (~152 USD)). The remuneration can be canceled if the board member fails to fulfill his/her functions. In fact, the inclusion of civil servants on the board of various SOEs is viewed by many as an additional source of income. Local media have reported the significantly high remuneration of SOEs’ administrators and board members, even when entities reported significant losses.

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166 http://lex.justice.md/document_rom.php?id=7E59381D:B617DDCA
168 https://point.md/ru/novosti/obschestvo/functzionarii-care-sunt-remuneratzi-cu-zeci-de-mii-de-lei-pentru-cateva-shedintze
The 2012 policy report\textsuperscript{170} also highlighted other inefficiencies that have been referred to by the Court of Accounts and the Financial Inspection Service of the MOF, these include errors in remuneration calculations resulting in overpayments to officials.

\textbf{175. SOE performance could be improved by introducing more accountability and establishing processes for evaluating senior management and the board or its members against pre-defined targets.} Weak financial reporting and auditing arrangements also mean any assessment of performance based on financial indicators is not reliable: indeed, the risk of manipulation of indicators is significant especially in the absence of strong audits\textsuperscript{171}. There are no mechanisms to assess the performance of the board of an SOE and/or chief executive. The problem of inefficient remuneration was only partially addressed by amendments to the Government Decree no. 770 approved on November 20, 2015\textsuperscript{172}, which states that any supplements to the basic salary of the administrator of an SE should be paid based on target returns, e.g. return on sales\textgreater{}20; return on assets\textgreater{}10; and financial profitability\textgreater{}15. Even if such targets could be justified, often these are not sufficient because SOEs may need other performance assessment criteria especially if they are not straightforward businesses but fulfill some public policy or public service delivery objectives.

There are currently no mechanisms to assess the performance of board members and/or the SE administrator; nor are there any practices to make them liable for poor performance of duties (around 41\% of SEs and 55\% of JSCs recorded losses for the year ended December 31 2015\textsuperscript{173}), even if the legislation in force states that they are liable in accordance with labor, civil, administrative and criminal law\textsuperscript{174}. Government Decree no. 568 of May 16, 2008\textsuperscript{175}, requires SOEs to annually submit information to the PPA on the number of meetings attended by each board member, including information on unjustified absences and the total remuneration paid to him/her. It would be easy to conclude that state representatives on SOE boards could decide to comply with their board mandates, staying passive and voting on the instructions of line ministries/agencies, but making little effort to make their work effective.

\textbf{176. There is no direct link between the long term interest of the SOE and the remuneration of administrators (chief executives) and the members of the board of SOEs, moreover the remuneration is not directly linked to their performance.} Performance should be judged against pre-defined targets, determined in accordance with the objectives indicated in the ownership policy (i.e. economic performance, public policy or service delivery objectives, or both), and it should be measured on the basis of indicators drawn from the audited financial statements and management reports of each SOE.

\textsuperscript{170} http://www.mec.gov.md/ro/content/public-property-administration

\textsuperscript{171} chapter 6 provides additional details on this issue.

\textsuperscript{172} http://lex.justice.md/md/361869/

\textsuperscript{173} Source: annual report prepared by PPA and available to the team.

\textsuperscript{174} http://lex.justice.md/md/336655/ (art. 29)

\textsuperscript{175} http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=327849
CHAPTER 11: PRIORITIZATION OF ACTIVITIES FOR SOE REFORM

Challenges in SOEs governance in Moldova

177. State ownership remains an element of many countries’ economic strategies. Major companies around the world will retain state ownership for years, if not decades, to come. Given this reality it is important for governments to tackle problems associated with SOE governance, performance and management. The key challenges for Moldova identified in this report include:

- Moldova has two forms of SOE, State Enterprise and Joint Stock Company, which differ in requirements and governance practices.;
- Significant number of SOEs are making losses and their long-term debt is rising. Financial performance as a whole worsened in recent years as a result of an unreformed public sector and poor SOE governance;
- Financial discipline of SOEs is weak in Moldova; the state is only starting to develop a system for assessing fiscal risks to the national public budget;
- SOEs in Moldova deliver important public services: low level of citizen satisfaction with the quality of and access to these services is an important indicator that SOEs performance in service delivery needs to be improved;
- Although the basic objectives of state ownership are outlined the legislation in force does not provide for objectives of the ownership, functions of and governance principles, and requirements toward specific SOEs;
- The practice in Moldova of combining SOE policy-making and ownership in one entity (usually a ministry, sometimes even with the same staff involved) creates potential conflicts of interest;
- There is fragmentation of the state ownership function and a lack of clarity in the numbers and forms of SOEs; centralized ownership by a single public institution would reduce duplication, improve co-ordination, and address discrepancies and inherent conflicts of interests;
- Issues exist with the identification and nomination of board members and executives of SOEs, including the appointment of independent board members; decision-making for specific nominations is non-transparent;
- Absence of audit committees negatively impact the quality of financial reporting and corporate governance;
• Limited accountability and established processes for evaluating senior management and boards or its members against pre-defined targets;
• Even though the law requires SOEs to make their financial statements publicly available, this requirement is rarely observed in practice;
• Economically significant SOEs are not classified as public interest entities, and therefore are subject to the National Accounting Standards (NAS) rather than the more demanding International Financial Reporting Standards (IFRS);
• Financial statements prepared in accordance with NAS have significant issues of compliance and limited disclosures;
• Even though annual audit is required for SOEs of significant size, the information on compliance with this requirement is limited;
• The quality of financial information prepared by SOEs is not reliable for economic decisions;
• There are issues with SOE compliance with legal requirements and market expectations on transparency and disclosure;
• PPA and MOF monitor a set of financial key performance indicators (KPI) that SOEs should achieve, however, the final responsibility to establish and evaluate the performance indicators of SOEs remains with line ministries;
• Unreliable data quality affects SOEs financial monitoring as it does not provide an adequate basis for assessing their performance;
• The state in its capacity of owner publishes only limited aggregated information on SOEs as a whole;
• SOEs procurement controls are weak in Moldova and are a significant risk factor for resource leakages;
• Insufficient protection for minority shareholders in Moldova JSC SOE’s raises issues of consistent application of good practices and market expectations;
• Weaknesses in governance are also reflected in weak competitive conditions and competition policies, which contribute to a high degree of operational business risk for firms in Moldova.

Prioritization of activities for SOEs reform

178. The Government has recently initiated a new draft Law on SOEs that will address some weaknesses in SOE Governance. The draft law includes proposals to address some issues of performance management for senior managers and appointment of board members. The team though familiarized with the draft law, did not review it in close detail.
However, such a review may be undertaken as part of phase II of the technical assistance, delivered by the World Bank Governance team in collaboration with the UK’s Good Governance Fund. Policy makers may wish to draw on the findings and recommendations of this report in finalizing the draft law.

179. **Three reform measures are of primary importance and merit high level Government Support:**

   (i) adopting an explicit ownership rationale and ownership policy;

   (ii) strengthening and consolidating the ownership function and board practices;

   (iii) improving incentives for better performance.

These policy-based proposals seek to help the Government of Moldova strengthen its ownership role of SOEs and thereby support overall economic growth and development in the country. The three mutually reinforcing measures are closely linked and aim to increase accountability across the whole ownership structure of SOEs, from their ultimate owners, the citizens, to their employees. This report outlines the main areas for consideration, all of which contribute to one or more of the three reform measures either over a short period of time or in a long term perspective. However, while improvements in SOE governance are important, these will not in themselves guarantee financial sustainability and improved performance of SOEs and some of the best practices from OECD countries may not be feasible for Moldova in short term.

180. **Within the three areas of proposed reform there are a number of specific recommendations, some deserve immediate attention others are more long term.** Reforms in SOEs governance are challenging and it is often difficult to find suitable and feasible solutions. This report outlines the main areas for consideration, all of which contribute to one or more of the three reform measures. A **suggested prioritization of activities and actions for SOE reform is provided below:**

<table>
<thead>
<tr>
<th>I. Short term reform actions</th>
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<tr>
<td><strong>Rationale and characteristics of state ownership</strong></td>
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<tr>
<td>• Facilitate learning for PPA, MOF, SOE boards and management, and other relevant key stakeholders, to raise awareness, explain good international practices in SOE governance, and build commitment for reforms.</td>
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<tr>
<td>• Create a proper rationale of state ownership, stating clearly why enterprises are owned and how this benefits society as a whole;</td>
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<td>• Create a comprehensive SOE database;</td>
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<tr>
<td>• Complete a detailed stock-take and analyze whether the existing legal form is suitable for the purpose of each SOE, which is particularly important for non-</td>
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economic activities. This could help ensure SOEs legal forms are fit for purpose and may result in the need to reform the legal forms of some types of SOEs which offer public services and do not undertake economic activities;

**Transparency, disclosure and controls**

- Designate large\(^{176}\) SE and large JSCs, where the state holds at least 50% of shares, as Public Interest Entities. Require them to prepare and publish IFRS-based financial statements, and ensure that these SOEs are subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies;

- Establish system of monitoring and enforcing publication of audited financial statements and managements reports on corporate websites by SOEs;

- Ensure ownership policies are publicly available and accessible on websites, including the aggregate situation and performance of SOEs and measures taken to ensure the SOE sector is well governed.

### II. Longer-term reform actions

**The state’s role as an owner**

- Move towards a centralized ownership function with a specific public institution responsible for overall coordination. As a first step, improve coordination among PPA and MOF, especially in the area of financial monitoring of SOEs to avoid possible duplications\(^{177}\). Further capacity building is needed for sound financial monitoring activities and proper scrutiny of financial reporting and auditing of SOEs, and assessment of fiscal risks;

- Separate policy making and ownership. Over the medium to long term line ministries should be responsible for policy, the ownership function should be in the hands of a professionalized and specialized central body;

- Establish a program of gradual transition to professional board membership. Initially this might include training and on-boarding programs, and over time the establishment of a roster of state representatives in boards and independent directors (the qualifications and experience requirements for independent board members need to be addressed by legislation and corporate governance arrangements for at least economically significant SOEs);

\(^{176}\) Based on the criteria defined by the art. 3 of the Accounting Directive (2013/34/EC), which will be transposed into new Accounting Law, i.e. (i) balance sheet total \(\geq\) EUR 20 000 000; (ii) net turnover \(\geq\) EUR 40 000 000 and average number of employees \(\geq\) 250.

\(^{177}\) At the date of completion of the report, the team was informed about the initiation of legal procedures to improve the coordination between the PPA and MOF in respect of requesting reports from the SOEs, respectively some changes were made to Government Decision No 568/2008 (http://lex.justice.md/md/368431/).
• Develop clear guidelines for line ministries/agencies on how information is passed from the owner to SOE board members; clarify and define responsibilities of ownership function, boards, and management to avoid political interference in daily management of companies;

State-owned enterprises in the marketplace

• Establish a system to identify and cost public policy objectives that are assigned to SOEs as part of their mandate;

Equitable treatment of shareholders and other investors

• Develop and require consistent application and enforcement of a Corporate Governance Code for economically significant SOEs; introduction of a “comply or explain” principle will gradually influence the behavior of governance structures of SOEs;

• Establish a policy on access to information, respecting the rights of all stakeholders in SOEs to access sufficient relevant and reliable information on a timely and regular basis. This will help stakeholders to better exercise their rights;

Transparency, disclosure and controls

• Benchmark aggregate reporting on SOEs to good international comparators and identify missing quantitative and qualitative information. Improve the system for scrutinizing financial reporting by SOEs to ensure that audits are undertaken and audited financial information is used for such reporting;

Performance monitoring and management

• Design a proper SOEs compliance dashboard, with required financial reporting and audit requirements (including appointment of auditors) and KPIs; develop and publish individual SOE’s performance results and evaluations in public domains for better accountability of SOE boards and management;

• Develop medium to long-term business plans for each (or at least the largest) SOEs (medium-term budgeting can be considered a good start for business planning). Business plans should include financial and non-financial KPIs for each SOE. This document may serve as a basis for formal performance agreements between SOEs and the GoM;

• Over the medium to long term, develop a SOE performance monitoring system, including performance agreements with each SOE and covering key financial and non-financial performance indicators. Over time this will also enable introducing merit-based (linked to KPIs) compensation policies and practices for governing structures of SOEs;
Financial discipline and fiscal risk

- Create an appropriate set of incentives for improving controls in the area of procurement by clarifying the responsibilities of boards and management, and addressing conflicts of interests. Over the medium to long term the professionalization of boards, stronger management and internal control systems would lead to better controls, including improvements in procurement by SOEs. Long-term, a centralized or coordinating ownership function could introduce guidelines and recommendations on controls in procurement to be followed by SOEs;

The responsibilities of the boards of state-owned enterprises

- Move towards the professionalization of board membership. Initially concentrate on training, coaching and on-boarding, and developing guidance for boards. Promote and build capacity of audit committees for significant SOEs. Good practice requires board members to be nominated based on competence and transparent selection criteria;

- Amend the current legislation to require independent members for SOEs boards for at least economically significant SOEs and create a pool of independent and professional directors;

- Strengthen the role of SOE boards, handing them respective responsibilities and ensuring their accountability as advised by good corporate governance practices. For example, boards should be able to hold the CEO accountable.
ANNEX 1: EXTRACT OF OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

**Rationales for State ownership:** The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

**The State’s role as an owner:** The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

**SOEs in the marketplace:** Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

**Equitable treatment of shareholders & other investors:** Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders’ equitable treatment and equal access to corporate information.

**Stakeholder relations and responsible business:** The state ownership policy should fully recognize SOEs’ responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

**Disclosure and transparency:** State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

**Responsibilities of the boards of SOEs:** The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.
ANNEX 2: INFORMATION FROM THE REGISTRY OF PUBLIC PROPERTY ON NUMBER OF ECONOMIC AGENTS WITH STATE SHARE UNDER THE ADMINISTRATION OF CENTRAL PUBLIC ADMINISTRATION AUTHORITIES AND THE VALUE OF STATE PATRIMONY

<table>
<thead>
<tr>
<th>No</th>
<th>Name of central public authority</th>
<th>TOTAL</th>
<th>JSC</th>
<th>SE</th>
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</thead>
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<td></td>
<td></td>
<td>No.</td>
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<td>No.</td>
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<td>71,695</td>
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<tr>
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178 Source: 2015 PPA report
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<td>4,315,048</td>
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### ANNEX 3: A&A REQUIREMENTS IN TOP 20 SOEs WITH LARGEST ASSET SIZE

<table>
<thead>
<tr>
<th>SOE</th>
<th>State share %</th>
<th>Total assets (thousand MDL)</th>
<th>Sales revenue</th>
<th>Net Profit/loss</th>
<th>Accounting standards</th>
<th>Audit requirements /Enforcement for FY15</th>
<th>Availability of the financial statements on their websites</th>
<th>Managing Central Government Authority</th>
</tr>
</thead>
<tbody>
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<td>2 SA &quot;Moldtelecom&quot;</td>
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<td>NAS</td>
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<td>NO</td>
<td>PPA</td>
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179 As of January 01, 2016
180 Source: MOF 2015 annual report
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<th></th>
<th>SOE</th>
<th>State share</th>
<th>Total assets</th>
<th>Sales revenue</th>
<th>Net Profit/loss</th>
<th>Accounting standards</th>
<th>Audit requirements</th>
<th>Availability of the financial</th>
<th>Managing Central</th>
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<tr>
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<tr>
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<td>MOE</td>
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<tr>
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<td>IS &quot;Air Moldova&quot;</td>
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<td>SA &quot;RED Nord&quot;</td>
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<td>MOE</td>
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<tr>
<td>SOE</td>
<td>State share</td>
<td>Total assets</td>
<td>Sales revenue</td>
<td>Net Profit/loss</td>
<td>Accounting standards</td>
<td>Audit requirements</td>
<td>Availability of the financial</td>
<td>Managing Central</td>
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<tr>
<td>8 IS &quot;Aeroportul International Chisinau&quot;</td>
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<td>864,360</td>
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<td>NAS</td>
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<td>NO</td>
<td>PPA</td>
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<tr>
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<td>643,943</td>
<td>0</td>
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<td>no website</td>
<td>MOE</td>
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<td>194,644</td>
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<td>MAFI</td>
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<td>518,929</td>
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<tr>
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<td>Total assets</td>
<td>Sales revenue</td>
<td>Net Profit/loss</td>
<td>Accounting standards</td>
<td>Audit requirements</td>
<td>Availability of the financial</td>
<td>Managing Central</td>
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<td>15 SA &quot;EnergoCom&quot;</td>
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<td>458,937</td>
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<td>16 SA &quot;Franzeluta&quot;</td>
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<td>Accounting standards</td>
<td>Audit requirements</td>
<td>Availability of the financial</td>
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