

Summary

The Government's management of risk in
state-owned enterprises (RiR 2015:15)



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The Government's management of risk in state-owned enterprises

The Swedish National Audit Office has audited whether the Government has ensured that risk management in state-owned enterprises is appropriate for the State.

Audit background

Reasons: The Government has been tasked by the Riksdag to administer the State's ownership of the enterprises so as to achieve the best possible long-term value growth. To achieve long-term value growth and dividend for the State the Government, as shareholder representative of the State, should ensure that the state-owned enterprises have efficient risk management.

All business activities entail risks and all business activities must take risks to develop and achieve profitability. However, risks must be managed so that negative consequences are limited as far as possible. In recent years state-owned enterprises have implemented or planned investments and acquisitions associated with risks.

In several cases the investments have had negative effects on the enterprises' finances, brand and reputation and on the value of central government assets in and dividends from the enterprises. For example, this applies to Vattenfall's investments abroad, SAS' profitability problems including considerable pension commitments, Telia Sonera's investments in Uzbekistan, the summons application against SAS for restrictive practices, Swedfund's and Vattenfall's investment in natural rubber trees in Liberia and accusations of corruption against officials in Svevia.

The state-owned enterprises constitute a considerable part of central government assets. In 2013 the Government estimated the value of the state-owned enterprise portfolio to be about SEK 500 billion. The companies also provide a considerable contribution to the public treasury in the form of dividend, which in 2013 was just under SEK 18 billion. The Government administers 49 enterprises, 41 of which are wholly owned by the State and the other 8 are part-owned. The state-owned enterprise portfolio is thus large and diversified with companies operating in different markets and under different conditions.

Most of the state-owned enterprises operate on a commercial market but competitiveness and business rationale are not maintained through independent review for example by investors and lenders to the same extent as in private companies. A large part of the State's shareholdings is in companies linked to infrastructure that is important for society, which restricts the ability of central government to spread risk by selling holdings. In addition a Riksdag decision is necessary for selling or otherwise reducing the State's shareholding.



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In light of this the Swedish NAO has assessed that an audit in this area is warranted.

Purpose: One purpose of the audit was to assess whether the Government has ensured that risk management in state-owned enterprises is appropriate for the State. Another purpose was to assess whether the Government provides the Riksdag with adequate information concerning material risks in state-owned enterprises. The audit did not cover how well individual state-owned enterprises deal with their risk management. The Swedish NAO has gathered certain information on risk management by the company boards in order to obtain a basis for assessing the Government's governance of state-owned enterprises with reference to risk management.

Grounds for assessment: The Swedish NAO based its audit on the provisions of the Instrument of Government and the Budget Act together with the Riksdag's guideline decisions forming a hierarchy of rules and decisions that describe responsibilities with regard to the use of central government funds. Under the Instrument of Government the Government administers and has at its disposal central government assets. The Riksdag decides on the fundamentals of administration and disposal of central government assets. Central government assets include shares in state-owned enterprises. The Budget Act contains basic requirements for a high degree of effectiveness and good economy to be observed in central government activities. According to guideline decisions from the Riksdag, in its administration of state-owned enterprises the Government must actively monitor the companies' development and take measures necessary for them to meet requirements for effectiveness, yield and structural adjustment. It follows from this, according to the Swedish NAO, that the Government is responsible for ensuring that the day-to-day administration of central government assets in the form of shares in state-owned enterprises is based on the requirements for a high degree of effectiveness and good economy. The Swedish NAO further based its audit on the assumption that the Government's administration of state-owned enterprises includes the task of ensuring and following up that the boards of these enterprises assume responsibility for the companies risk analyses being satisfactory and for obtaining knowledge of material risks in the enterprises and their potential consequences.

Implementation: In the audit the Swedish NAO interviewed representatives of the Government Offices' Division for state-owned enterprises for the purpose of gathering information on how they work with risks in the state-owned enterprises. Furthermore, interviews were conducted with and written questions put to board chairs in wholly-owned and majority-owned state enterprises to obtain an overall understanding of how boards in state-owned enterprises work on risk management. In addition the Swedish NAO has examined the board documentation of ten wholly-owned or majority-owned enterprises. The examination was based on experience based key points



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as to what should be included in efficient board work in relation to risk management. The key points were used to reflect what has emerged in the examination of board documentation. External legal experts were assigned to carry out in-depth legal research, partly on the provisions of the Companies Act concerning responsibilities and roles of shareholders, board and management, partly on the provisions of the Instrument of Government and the Budget Act concerning the Government's responsibility for central government assets. In addition the Swedish NAO has made document studies of current audit files at the Government Offices, board evaluations, publications from the Government, interpellations and questions in the Riksdag and annual reports for ten state-owned enterprises.

Audit findings

The Government has been tasked by the Riksdag to administer central government assets in the form of shares in state-owned enterprises so that the requirements concerning a high degree of effectiveness and good economy are met. The Government's responsibility for administering the state-owned enterprises includes ensuring that risk in the state-owned enterprise portfolio is managed so that the value of the State's shareholdings develops positively as far as possible, and so that in the long term the State receives dividends from state-owned enterprises.

In recent years the Government has taken measures to develop governance of the state-owned enterprises. The Swedish NAO assesses, however, that corporate governance still remains to be developed as regards risk management. The audit shows that the Government has not ensured appropriate management of risk in the state-owned enterprise portfolio for the State. The Swedish NAO notes that the Government does not regularly compile information on material risks in individual companies and the consequences for value and dividend if the risks were to be realised. Nor does the Government compile information on the overall risks in the state-owned enterprise portfolio. The Swedish NAO further notes that the Riksdag does not receive adequate information on material risks in the state-owned enterprises. Consequently the Government has not ensured that the Government's and the Riksdag's strategic decisions are based on complete reference data, which may have negative consequences on the value of central government assets and annual dividend from the state-owned enterprises to the public treasury. Moreover, the consequence may be that central government needs to provide capital contributions to the state-owned enterprises.

No established procedure for updating risks

The Swedish NAO notes that the corporate governance by the government lacks an established procedure for regularly updating information on material risks in individual companies and evaluating the consequences if the risks were to materialise. Updated information on material risks in the companies and consequences if the risks were to materialise provides decision support on such things as development strategies for the state-owned enterprises, for the purpose of ensuring the long-term value of the State's shareholdings and dividends to the State.



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The Government has several tools for obtaining information on risks in the state-owned enterprises. However, risks are not a standing item at the regular meetings between government representatives and board chairs, despite the fact that these meetings are one of the Government's most important policy instruments. The procedure, between government representatives and board chairs, to coordinate major strategic changes in the companies, occurs rarely and does not aim to gather information on material risks in the companies on a regular basis.

The audit has also shown that it is not clear how and to what extent central government representation on the boards of the state-owned enterprises can be used to obtain information about risks in the companies. The administration of the state-owned enterprises in the Government Offices is organised in "company groups". The Swedish NAO notes that work in the company groups does not mean that information on material risks and consequences are routinely and regularly updated.

Moreover, the audit has shown that some risks are analysed when economic targets are set and sustainability analyses carried out but that the analyses are implemented at intervals of several years. According to the Swedish NAO the analyses thus are of limited use as current reference data for updating information on material risks in the companies. According to the Swedish NAO, monitoring of economic targets does not mean that information on material risks and consequences is updated on a current basis.

There are no binding risk management requirements

By making clear requirements that the boards take responsibility for the state-owned enterprises' risk management the Swedish NAO believes that the Government can ensure that the boards are aware of the significance of sound risk management and the expectations the State as owner of the enterprises has in this respect. The audit shows, however, that there are no clear and legally binding guidelines for the boards of these enterprises that explicitly specify that the boards are responsible for ensuring that they have sound risk management. The Government's most important policy document, the State's ownership policy, does not explicitly state that the board has this responsibility. Nor has the Government ensured that the ownership policy is adopted by the general meetings of shareholders of the state-owned enterprises, which means that it is not legally binding on the enterprises.

The audit also shows that the Government's monitoring of how the enterprises and boards work on risk management is of a limited extent. Hence the Government, according to the Swedish NAO, has a limited ability to determine whether risk management in the enterprises is efficient and if the boards are taking their responsibility for the enterprises' risk management.



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Board documentation is not sufficiently transparent to determine whether the boards' risk management is efficient

To gain an understanding of how boards of large state-owned enterprises work on corporate risk management the Swedish NAO examined the board documentation in ten large state-owned enterprises. The purpose of the examination was not to assess how well boards in individual enterprises deal with their responsibility for risk management or how efficient risk management is in individual state-owned enterprises.

The Swedish NAO's examination shows that it is not possible to determine from the board documentation whether the boards comply with the key points prepared by the Swedish NAO that contain overall requirements as to what should be included in efficient board work regarding risk management. The examination also indicates that the work of the boards on risk management seems in some respects to deviate from the key points. Furthermore, it is difficult to determine from the board documentation how material risks are reported to the board and how the board monitors risk management in the enterprise. According to the Swedish NAO this indicates a need to improve the documentation to enable transparency and follow-up of the state-owned enterprises' risk management.

No overall risk picture in the state-owned enterprise portfolio

To be able to make decisions on overall strategic issues concerning state-owned enterprises the Swedish NAO believes that the Government must take into account developments in the entire state-owned enterprise portfolio, including overall risks in the portfolio. Overall strategic issues may include large acquisitions or foreign investments in an individual company that may impact the total value growth and dividends to the State of the enterprise portfolio.

The Swedish NAO notes that the Government does not collect and compile information on risks and consequences from the individual enterprises aimed at obtaining an overall picture of the risks to which the state-owned enterprise portfolio is exposed. Consequently the Government has incomplete information on the risks that may affect the situation for the entire state-owned enterprise portfolio and ultimately the total value of the State's shareholdings and future dividends to the State.

The Riksdag does not receive information on the overall risks in the state-owned enterprise portfolio.

The audit shows that the Government gives the Riksdag limited information on risks in the activities of state-owned enterprise. According to the Swedish NAO it is thus doubtful whether the Government meets its accountability requirements in relation to the Riksdag, so that the Riksdag can follow up its delegation to the Government of powers and resources as regards administration of state-owned enterprises.



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Considering the importance of the State's shareholdings for public finances, the Riksdag needs reference data that provides an overall picture of the risks that may affect the value of the shareholdings and future dividends from state-owned enterprises to the State. The Swedish NAO notes that the Government does not provide the Riksdag with such an overall picture of the risks in the state-owned enterprise portfolio.

The Swedish National Audit Office's recommendations

The Government needs to ensure that risks in the state-owned enterprise portfolio are managed so that the value of the State's shareholdings develops positively and so that in the long term the State receives dividends from state-owned enterprises. The Swedish NAO assesses that this requires greater focus in the Government's administration of the state-owned enterprises on risks and consequences if these risks are realised.

According to the Swedish NAO the Government also needs to make clearer requirements of the boards of the state-owned enterprises to ensure that the enterprises' risk management is satisfactory. In its corporate governance the Government has a number of tools that can be better used to collect and update information on risks in the enterprises and consequences if these risks are realised. According to the Swedish NAO, an increased focus on risks and risk management could therefore be incorporated into the existing available resources for management of state-owned enterprises within the Government Offices.

According to the Swedish NAO the Government should take a more active role in the governance of state-owned enterprises as regards risks and risk management. In light of this the Swedish NAO makes the following recommendations to the Government:

- The Government should draw up clear guidelines to the boards of the state-owned enterprises on risk management. The guidelines should be adopted by the general meetings of shareholders to be legally binding on the enterprises.
- The Government should follow up the efficiency of the boards of the state-owned enterprises as regards risk management. The follow-up should take into account the development in the area and what characterises efficient board work as regards risk management.
- The Government should develop its tools so that information on risks and consequences can be updated and compiled on a current basis.
- The Government should regularly compile information on risks and consequences from the state-owned enterprises to obtain an overall picture of the risks in the state-owned enterprise portfolio. This overall picture should also be reported to the Riksdag.

