

Summary of report: Government's administration and governance of six State-owned enterprises (RiR 2004:28)

Riksrevisionen (the Swedish National Audit Office) has audited the way in which the Government has administered and supervised six wholly State-owned enterprises (SOEs). What emerged from the audit is presented in this report.¹ The Swedish National Audit Office has engaged legal experts for a more detailed analysis of certain observations. This analysis centres *inter alia* on the term "*rapporteur*" (person responsible for reporting) in the Instrument of Government (Appendix 1) and aspects of the double roles of the SOE Administrator at the Government Offices (Appendix 2).

Background

The State is one of the biggest corporate owners in Sweden. It owns, wholly or partly, nearly 60 companies. Of these, several rank among Sweden's biggest companies. In 2003, turnover for Sweden's State-owned enterprises amounted to SEK 299 billion. These companies have a total of some 200,000 employees, compared to the approximately 220,000 employees of Sweden's public administration. In addition, several SOEs have important social functions.

The State-owned corporations are administered by the Government, which represents the owner, i.e. the Swedish Parliament and ultimately the Swedish people. Every year, the Government is required to report to Parliament and present a summarized account of the activities and finances of the companies. This is in accordance with the will of Parliament. Insight into the circumstances of companies owned by the State is also gained through the right of members of parliament to attend and ask questions at annual general meetings. Members of parliament may also be appointed as directors or lay auditors at SOEs.

The Government has a political responsibility for State-owned enterprises. In turn, the companies are legally obliged to comply with the Swedish Companies Act and other legislation, and to observe the resolutions passed at the annual general meeting.

The Prime Minister has instructed the Minister for Industry and Trade to act as *rapporteur* on administrative issues that relate to the State's corporate ownership and that raise demands for a consistent ownership policy or concern board nominations.

The Ministry for Industry and Trade supervises around 40 companies. Other ministries supervise 16 companies.

¹ Certain linguistic and editorial corrections were made to this report before printing.

Issues on which the audit focused

Transparency and clarity of governance are important in terms of Parliament's scope for insight, the company's ability to maintain an efficient organization operation and to the possibility to demand that responsibility in the broad sense be exercised in the way in which operations are conducted.

The audit focused on the following issues:

- Does the Government supervise State-owned enterprises via their annual general meetings, and are these meetings open?
- Is the Owner Administration consistent and can this be followed up?
- Are board members nominated in a systematic and consistent way?

The audit comprises the Government's administration and supervision of Posten AB, Samhall AB and V & S Vin & Sprit AB, all companies administered by the Ministry of Industry and Trade. The audit also takes in AB Svenska Spel, which is administered by the Ministry of Finance, Apoteket AB and Systembolaget AB, which are administered by the Ministry of Health and Social Affairs. The audit concentrated mainly on the 2001–2003 period.

“Owner Administration” in this report refers to the administration and supervision of the companies by the Government and the Government Offices.

Conclusions

Does the Government supervise State-owned enterprises via their annual general meetings?

According to the Swedish Companies Act, the annual general meeting is a company's highest decision-making body. The Act states that decisions requiring approval at the annual general meeting include those on the company's articles of association, dividend and discharge from liability for and election of board members and auditors. Thus, certain vital decisions must be made by the annual general meeting.

When other important decisions, for example on “owner's directives”, are to be taken, the decision must be approved by the annual general meeting to acquire legal force.

The audit reveals that at some companies the person representing the State at the annual general meeting had delivered “owner's directives” to a company representative without the Government having approved the said directives. Moreover, these directives were not approved by the annual general meeting either, and so did not comply with the Swedish Companies Act's requirement of submission to the annual general meeting for approval. Such a procedure creates lack of clarity as to who bears responsibility for the directives. There is much to suggest that any company that follows directives that have not been formally approved runs the risk, in practice, of being held solely responsible.

The Government has approved instructions on the State-owned enterprises. These instructions, including the Government's instructions on

conditions of employment at State-owned enterprises and its instructions on external financial reporting, have been presented to the companies without first being formally approved by the companies' annual general meetings. As a result, the instructions have no unquestionable validity under the Swedish Companies Act. This creates the possibility that the companies will on their own initiative test the extent to which, and when, they should observe the instructions. The audit also indicates that issues relating to the strategic direction of the companies have not been submitted to the annual general meetings for approval.

So the companies are supervised both via the annual general meeting and Government decisions on instructions for State-owned enterprises, in some cases via "owner's directives" and in others via agreements between the State and the company. It has also emerged from board minutes, memoranda and interviews that "informal" governance (i.e. there has been governance, but it has not been documented with regard to decisions taken) is not unusual.

In conclusion, the Swedish National Audit Office finds that the annual general meetings held at the six companies during the 2001–2004 period were used to a limited extent for governing the companies. As a result, attendance at the annual general meeting produced limited insight into the direction of the companies and how they are actually being governed by the Government as owner's representative.

One important task for the annual general meeting is to decide on dividend as proposed by the board of directors. At several companies, the Owner Administration has without any documentation dealt with the board's proposal for ordinary dividend from the companies. This makes it more difficult to determine afterwards whether the Owner Administration's proposed dividend differs from that proposed by the company's board, and if so what issues lie behind this difference.

There are no guidelines or regulations common to the Owner Administration, as to how the State's representative at the annual general meeting is to be appointed and how this representation is to be exercised. The procedure differs from one ministry to the next, and there are also differences as regards which documents are to be generated and registered.

The Swedish National Audit Office's conclusion is that the annual general meeting is little used by the Owner Administration for governing the companies. This adversely affects transparency, clarity and the scope for following up the way in which the Owner Administration governs the State-owned corporations.

Are annual general meetings open?

The value of "open" annual general meetings has been emphasized by both the Joint Standing Committee on Trade and Industry and the Government. The Swedish National Audit Office concludes that the number of open annual general meetings – involving, for example, information events before, during and after the meeting – was higher in 2004 than before. Openness has been limited in the sense that only two out of the six companies had invited the public to attend their meeting. The scope for greater insight is limited by the fact that – as mentioned earlier – the Government's governance as the owner's representative has been exercised only partly via the annual general

meeting. Attendance by members of parliament at the annual general meetings has been fairly low.

In summary, The Swedish National Audit Office finds that the annual general meetings have become more open, but that the scope for genuine insight into issues of essential importance has for several reasons been limited.

The Swedish National Audit Office's conclusion is that active use of the annual general meeting as a means for governance by the owner's representative, combined with open meetings, would considerably extend the scope for information about the company's strategic direction, as well as for insight into how the Government, as owner's representative, actually governs the companies.

Can the Owner Administration be monitored?

The Owner Administration and the SOEs have – and must have – both formal and informal contacts. Such contacts often involve the exchange of information, and probably also support. Informal supervision of the companies – supervision that has actually been exercised but not documented via decisions taken – is in the view of The Swedish National Audit Office not unusual at these companies, even on issues of essential importance.

Documentation of meetings and contacts between the Owner Administration and the companies is not systematically maintained via external or internal memoranda. This makes it difficult for the majority of those involved to keep track of who decided what and how the decision was arrived at, and almost impossible for external observers to establish afterwards. The prerequisites for gaining insight, or demanding the exercise of responsibility (e.g. via the parliamentary process), are thus limited. However, the Ministry of Health and Social Affairs, which supervises two companies, departs from the general pattern. Since 2002, notes have routinely been taken at meetings between companies and the Ministry. This has made it possible to determine afterwards which issues had been addressed at these meetings, although not to obtain information on any decisions that might have been taken.

Inadequate documentation and the lack of standard routines among the Ministries for documenting major sequences of events and contacts, support and control signals that have taken place between Owner Administration and companies, have made it difficult, or impossible, for decisions and decision-making processes to be followed up. This indicates that internal control of the Owner Administration's governance of State-owned enterprises is weak.

The Swedish National Audit Office's view is that the existence of undocumented supervision considerably complicates the task of following up the decisions and actions of the Owner Administration. There is limited scope for insight afterwards in the case of major sequences of events. There are clear shortcomings in the internal control of the Owner Administration's governance of State-owned enterprises.

Is the Owner Administration consistent?

The audit reveals several substantial differences in the way in which Owner Administration has functioned, relative to the companies. These differences

appear to have their origin in different traditions and routines in the Ministries, rather than in specific circumstances at the individual companies. Differences have been observed on the following seven points:

Proposed amendment of the company's articles of association. The articles of association are legally the most important document of control. It is normally there that the owner's means of long-term control are laid down. At some companies, the articles of association require Government approval for amendment of the articles of association, while in one or two cases a decision by Parliament is necessary. However, for most of the six companies, amendment of the articles of association are not conditional on Government approval.

Agreement or "owner's directives".

Two of the companies included in the audit have agreements with the State via "owner's directives". A third company is governed only via an agreement with the State. According to the Government, all three companies have a particular social function to fulfil. The fourth company with a particular social function operates neither under "owner's directives" nor an agreement. Management via an agreement is thus more common than via "owner's directives", despite the fact that agreements do not imply any duty to obey under the Swedish Companies Act, unlike "owner's directives" approved by the annual general meeting, i.e. instructions agreed by the meeting.

Documentation on the Owner Administration's proposals for decision by the annual general meeting.

Decisions by the Owner Administration are not always reported via a registered document. Such decisions may include, for example, proposed amendment of the company's articles of association, the size of the dividend in a specific year, election of directors and auditors.

Liability insurance for boards of directors.

Five of the six company boards of directors included in the audit have approved a decision to take out liability insurance on behalf of the board. It has emerged that several companies have requested guidance and clarification from the Owner Administration as regards liability insurance.

Lay auditors.

The extent to which lay auditors have been appointed among the companies varies. At two of the six companies, lay auditors have been appointed on the basis that the companies have a particular social function. No lay auditors are appointed at the two other companies with a particular social function.

Decision-making mandate for owner's representative.

Differences among the Ministries have been identified in the extent to which documents are generated and registered.

Prior to the annual general meetings, the audited Ministries issue documents appointing one representative of the State to cast votes on its behalf at the meeting, as well as instructions as to how the State's representative is to vote. Prior to the meetings, two of the ministries issues powers of attorney to the persons who are to represent the State.

Role of SOE Administrator.

The Ministries use different models as to how the companies are to be administered. The most important difference for companies governed by the Ministry for Trade and Industry is that the SOE Administrator also serves as a member of the board of the company which he or she has been appointed to administer.

The Swedish National Audit Office's view is that important but unjustified differences exist in the Owner Administration of the companies. The suitability of the model for administration used by the Ministry for Trade and Industry should be questioned in the cases where the Corporate Administrator also serves as a director on the board of the companies that person has been appointed to administer. This double role may be a problem in connection with the requirements of the constitution, in that in such cases objectively based doubts may be raised as to the impartiality of a Government official. This kind of double role, combined with the informal administration applied, creates further difficulties in achieving a reasonable level of internal control over the Owner Administration's governance of State-owned enterprises.

Are directors nominated in a systematic and consistent way?

The Ministry of Trade and Industry has attached great importance to the process of deciding the composition of the companies' boards and how the boards should operate. Internal memoranda, including timetables, have been prepared to serve as guidance on the process of nominating directors. These memoranda have been distributed to the other Ministries. However, no standard guidelines exist among all the ministries on the nomination process.

There are differences in the nomination procedure within and between the Ministries, for example in the extent to which the ministries engage external recruitment expertise to identify candidates for board positions, and with regard to the parliamentary political parties that are contacted to request suggestions for candidates for the company boards that, by generally accepted practice, include members of parliament. In the case of listed companies where the State has a stake, nomination committees are used, which may be expected to bring a higher level of impartiality and transparency to the nomination procedure. The Owner Administration has not availed itself of nomination committees to appoint directors to the board of the six wholly State-owned companies in this audit.

According to the Minister for Industry and Trade's "section 5 appointment" as defined in the Instrument of Government, this person is the *rapporteur* in the Government with regard to board nominations. The Minister for Industry and Trade has approved the proposals for the persons who are to be elected as directors at the annual general meeting. This approval has thus not been given via a Government decision.

The audit indicates that the Corporate Administrators who are directors of a company participate, in their role of company official, both in the scrutiny of the board and during preparations for the issue of presenting proposals to the board on which they serve or may serve in the future.

The Swedish National Audit Office's view is that confidence in the nomination procedure may be adversely affected in the cases where persons in the Government Offices, who also serve as board members and at the same time act as SOE Administrators, take an active part in the preparation of nominations to the board of the same company. The Swedish National Audit Office also questions whether the practice in which the Minister for Industry and Trade alone decides on board nominations complies with the requirement of the "section 5 appointment", i.e. that the Minister for Industry and Trade is the rapporteur in the Government with regard to board nominations.

Recommendations

The Swedish National Audit Office's overall conclusion is that it is both necessary and possible to increase clarity and transparency and to improve the internal controls used in the supervision of the State-owned corporations. The following recommendations should and could deliver substantial improvements in all these respects.

The Swedish National Audit Office recommends the following to the Government:

- To review whether the practice in which the Minister for Industry and Trade alone decides on board nominations complies with the requirement of "section 5 appointments", i.e. that the Minister for Industry and Trade is the rapporteur with regard to board nominations.
- As owner's representative, to order that in normal circumstances the annual general meetings of State-owned enterprises shall be open to the public. To the public, a higher level of supervision via the annual general meeting, and open meetings, could bring a higher level of democratic legitimacy to the Owner Administration, in that this would create greater scope for providing information about the company's activities and about how the Government, as owner's representative, is governing the company.
- Regularly to decide on proposed resolutions to the annual general meeting, since the Government should be responsible for this type of decision. This includes proposed "owner's directives" of a fundamental nature, or clarifications of particular social functions, as well as proposed amendments to articles of association, dividend policy, size of dividend in a particular year and election of directors.
- To a large extent to use the annual general meeting for supervision of the company and, in order to eliminate any doubt as to the validity of decisions under the Swedish Companies Act, always to submit "owner's directives" to the annual general meeting, as well as such Government decisions that are intended to apply to all State-owned enterprises (e.g. Government instructions on conditions of employment at State-owned enterprises and Government instructions on external financial reporting).

- To establish standard guidelines among the ministries on the procedure for nomination of directors and to consider also using the instrument of the nomination committee for nomination of members of the boards of wholly State-owned enterprises.
- To dispense with the present model of administration at the Ministry for Industry and Trade, under which a Corporate Administrator at the Ministry serves simultaneously as a member of the board of the company administered.
- In guidelines, to clarify the circumstances in which employees in the Government Offices can serve on the boards of State-owned enterprises.
- To establish standard guidelines among the Ministries on documentation of the Owner Administration to make it possible to follow up important sequences of events afterwards, as well as contacts and control signals that have occurred between the Owner Administration and State-owned enterprises.