

Evaluation of the Corporate Governance
Practices of 5 Panamanian State-Owned
Enterprises

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Glossary

BVP	Bolsa de Valores de Panamá, S.A. (Panama Stock Exchange)
ENA	Empresa Nacional de Autopistas, S.A. (National Highway Company)
ETESA	Empresa de Transmisión Eléctrica, S.A. (Electric Transmission Company)
IDAAN	Instituto de Acueductos y Alcantarillados Nacionales (Institute of National Aqueducts and Sewers)
IDB	Inter-American Development Bank
IFRS	International Financial Reporting Standards
IGC-P	Instituto de Gobierno Corporativo–Panamá (Corporate Governance Institute–Panama)
ISA	International Standards on Auditing
Labor Law	Código del Trabajo Decreto de Gabinete No. 252 de 1971
Metro	Metro de Panamá, S.A. (Metro of Panama)
OECD	Organisation for Economic Co-operation and Development
OECD Guidelines	OECD Guidelines on Corporate Governance of State-Owned Enterprises 2015 Edition
Procurement Law	Ley 22 que Regula la Contratación Pública de 2006
ROSC	Reports on the Observance of Standards and Codes
SMV	Superintendencia del Mercado de Valores de Panamá (Panama Securities Exchange Commission)
SOE	State-Owned Enterprise
Tocumen	Aeropuerto Internacional de Tocumen, S.A. (Tocumen International Airport)
Transparency Law	Ley 6 de Acceso a la Información de 2002
UNCTAD	United Nations Conference on Trade and Development

Preface

We have always known that corporate governance is an important determinant of performance in private sector enterprises. What is not so broadly acknowledged is how important corporate governance is to the performance of state-owned enterprises (SOEs). It is important to note that when we say “performance” we do not just mean economic performance, but also the social performance of said enterprises and their capacity to provide the Panamanian public with essential services.

Studies consistently demonstrate the link between the quality of corporate governance and SOE performance. The appropriate corporate governance of SOEs takes on even greater importance when we consider that they provide the crucial infrastructure that allows the economy to run and that they profoundly touch so many aspects of our daily lives.

Cognizant of this fact, in 2015 the Institute for Corporate Governance-Panama (IGC-P) set out to explore the issue of corporate governance in Panamanian state-owned enterprises and commissioned this independent study to deepen our understanding and generate valuable information that may promote the discussion and development of action plans in this field.

The study compares the corporate governance of five Panamanian SOEs to an international benchmark. It makes observations regarding the corporate governance of each enterprise, followed by recommendations. It also makes general observations and recommendations regarding SOE corporate governance in Panama. These recommendations should not be considered the final word, but rather the starting point for a discussion that may bring Panama closer to internationally-recognized best practice.

We would like to acknowledge and thank the SOEs that participated in the study and W. Richard Frederick, the independent consultant who conducted the analysis on behalf of the Institute for Corporate Governance and developed the final report.

Members of the Board of Directors of IGC-P

Introduction and summary

What is the main point?

This study compares the governance of five SOEs to a benchmark of the Organisation for Economic Co-operation and Development (OECD). A summary report of the findings is presented, along with a detailed analysis of each of the enterprises examined. In conclusion, the selected enterprises show considerable gaps with respect to the international benchmark, which may be quickly closed at low expense.

What is the benchmark?

The OECD Guidelines on Corporate Governance of State-Owned Enterprises (2015 Edition) are the only existing international standard of corporate governance for SOEs. The OECD Guidelines comprise a set of best corporate governance practices found in the world's most economically and socially advanced countries. The performance indicators used in this study were developed from the OECD Guidelines. Better compliance with OECD practices is in the long-term interest of Panama.

What is corporate governance?

There are different definitions of corporate governance. One of them is simply the accountability of the corporation to its stakeholders. A more specific definition might be the process whereby those who are entrusted with an asset are held accountable for its proper use. This study is concerned with the proper oversight of Panama's SOEs, which constitute national treasures that the State holds in trust on behalf of the Panamanian people.

Good corporate governance is provided by structures and practices that help achieve accountability. The essential structure is a good board of directors with clearly defined roles, responsibilities and decision-making powers. The essential practices are defined by written policies and procedures, systems that ensure transparency and the reliability of information, systems that ensure compliance, as well as policies for acting responsibly toward stakeholders.

Why is SOE corporate governance important?

One cannot imagine modern life without the products and services provided by SOEs. They facilitate transport, provide us with the water we drink as well as the electricity for our homes and the electronic equipment we depend on. In most countries, SOEs provide the fundamental infrastructure for economic and social development.

Yet, when things go wrong, SOEs can become a financial and political burden and may fail to fulfill their social commitments. Studies on SOE performance show that weak corporate governance is usually linked to poor SOE performance. Good corporate governance, on the other hand, translates into better results, raises the value of the SOE and increases its capacity to meet social commitments.

What is the purpose of this report?

This report is a first attempt to analyze SOE governance in Panama. Together with the World Bank 2004 Report on the Observance of Standards and Codes (ROSC), which analyzes the corporate governance of private enterprises, it allows for a more complete overview of the status of corporate governance in Panama's SOEs. It endeavors to be constructive and make recommendations that may contribute to solutions. It is hoped that its findings and proposals are considered and discussed and lead to the development of action plans for achieving a closer approximation of the corporate governance of Panama's SOEs to the international benchmark.

Approach

The study group

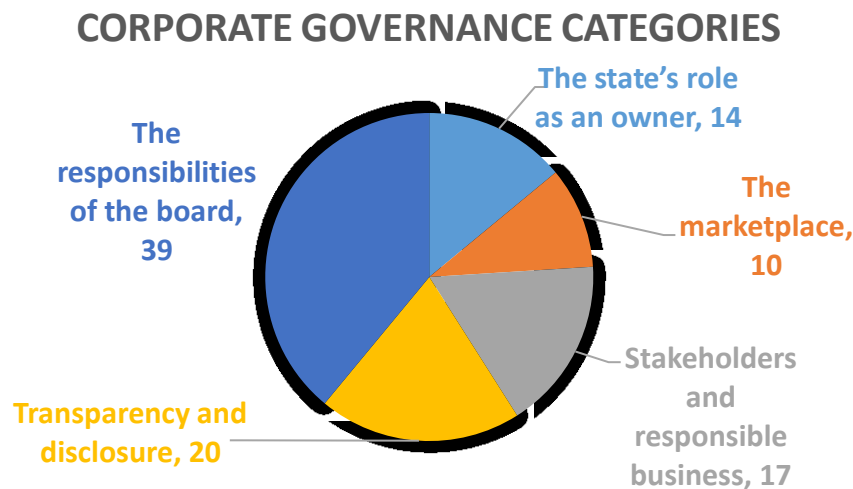
There is a total of 15 SOEs in Panama. A subset of 5 SOEs was selected for this study, because of their central role in the Panamanian economy.

- ENA: Empresa Nacional de Autopistas, S.A. (National Highway Company)
- ETESA: Empresa de Transmisión Eléctrica, S.A. (Electric Transmission Company)
- IDAAN: Instituto de Acueductos y Alcantarillados Nacionales (Institute of National Aqueducts and Sewers)
- Metro: Metro de Panamá, S.A. (Metro of Panama)
- Tocumen: Aeropuerto Internacional de Tocumen, S.A. (Tocumen International Airport)

Each SOE operates in a regulated sector and is currently conducting large investment projects, which are expected to bring significant social and economic benefits, but which are also vulnerable to inefficiency and the potential misuse of public funds.

Categories and indicators

One hundred indicators were taken from the OECD Guidelines. These indicators were then used to measure the corporate governance practices of each SOE. The five broad governance categories and the number of indicators per category are shown below.



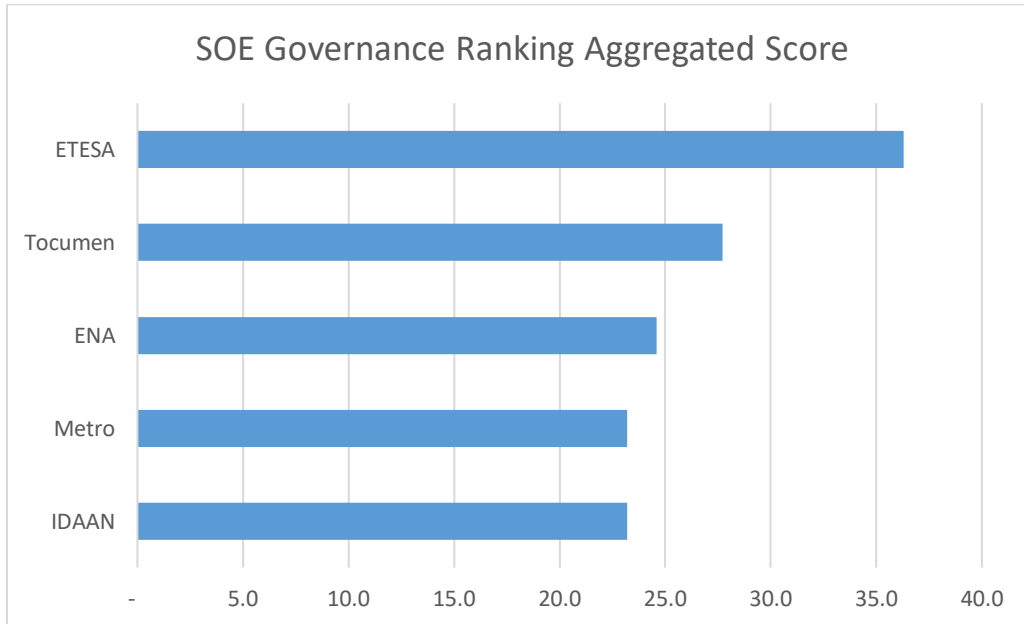
Report structure

The remainder of the report is divided into two parts. *Part I: Aggregated findings* presents a synthetic view of the governance of 5 Panamanian SOEs and also draws some general conclusions. This part is mainly addressed to the general reader. *Part II: Individual Enterprise Reports* presents analyses of each of the 5 SOEs with specific recommendations. The individual enterprise reports are addressed mainly to the organizations themselves.

Part I: Aggregated Findings

SOE rankings

The aggregate level of compliance in the surveyed SOEs ranges from 23% to 36% of the selected indicators. The average level of compliance is 28%.



This low level of compliance can be explained to some extent by the high level of performance established by the OECD benchmark. Although the OECD Guidelines were developed with knowledge of global practices in SOE corporate governance, they mainly reflect best practice in the most advanced OECD countries. As a consequence, considerable differences from OECD practices can be expected.

It is to be noted that the individual SOE scores are grouped closely around the mean. In other words, practices do not differ dramatically from one SOE to the other. The reason is that many corporate governance practices in Panama are established by law and regulation and that SOEs have little leeway to alter their practices within the legislative framework.

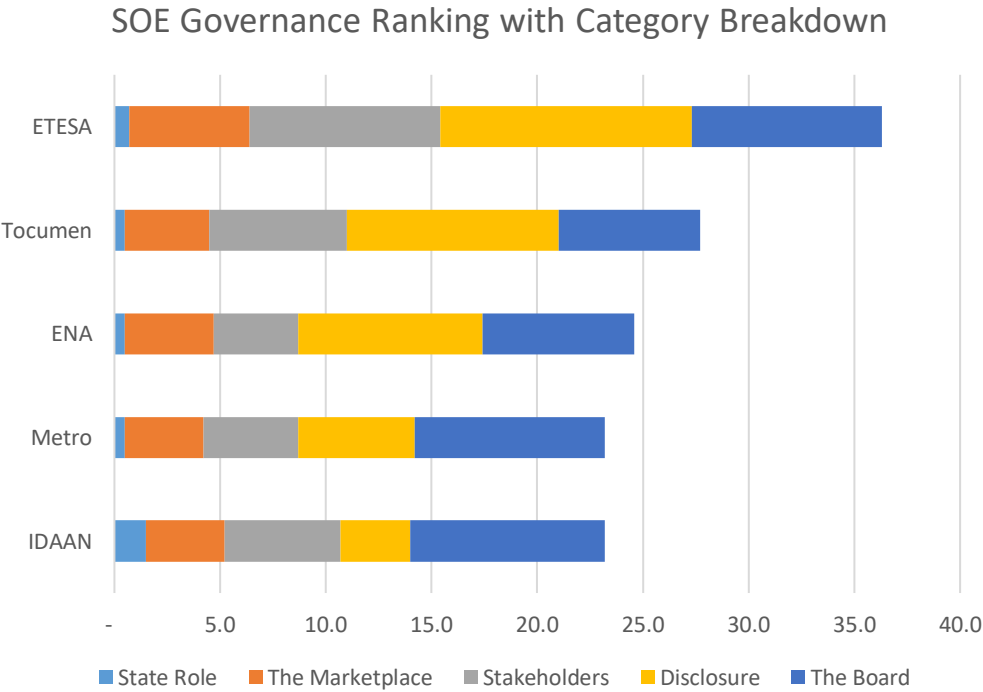
Four of the 5 SOEs are established as public limited companies with their founding legislation based on a similar prototype. IDAAN is somewhat different as it is established as an Autonomous State Entity (Entidad Autónoma del Estado), with independent legal personality and assets separated from the State, as well as somewhat different corporate governance characteristics.

The positive side of similar incorporation papers is that they create a clear and uniform approach to corporate governance. The drawback is that SOEs generally have limited flexibility to adopt best practice. Thus, for example, greater independence and diversity in SOE boards may only be achievable through changes in legislation.

All of the SOEs are subject to the same laws as the private sector (labor law, for example) as well as additional laws that are specific to the public sector (procurement, civil service rules, public sector ethics code, etc.).

SOE performance by indicator category

Although founding legislation and other rules and regulations provide a common framework, some differences may be discerned among the SOEs. These differences are mainly found in the area of disclosure practices.



ETESA as well as Tocumen distinguish themselves in their information disclosure. ETESA shows strength in the presentation of stakeholder reports, while Tocumen differentiates itself from the rest for its corporate governance disclosure.

In the area of financial reporting, each of the SOEs that is constituted as a public limited company is required to produce and disclose financial reports compiled under IFRS (International Financial Reporting Standards). These reports must be audited by a reputable auditor using ISA (International Standards on Auditing).

In practice, the level of compliance varies considerably. Metro de Panama, though obliged to produce audited financial statements according to IFRS, has failed to publish them on its website. On the other hand, ETESA regularly produces and discloses IFRS compliant financial statements. ENA discloses financial statements, but these received “qualified” opinions from the external auditor for four consecutive years. Tocumen periodically submits financial reports; however, the 2013 reports were restated in 2014. ENA trusts guarantee the financing of bonds. They disclose signed but unaudited quarterly financial statements as well as audited annual reports on the BVP website. In the case of Tocumen, it is a guarantee trust, but no financial statements are disclosed.

IDAAN, the autonomous state entity, follows public sector accounting and reporting rules. This results in financial reports that are not comparable to IFRS reports and which are less useful to the general user.

The best and worst of SOE corporate governance

The best and worst generic features of SOE governance are shown below. They refer to general corporate governance practices (and not to the specific SOE practices that are discussed in *Part II: Individual Company Reports*).

The 10 best features

1. Most SOEs are established as corporations
2. Most financial statements use IFRS and are audited according to ISA
3. All SOEs have websites and use them for transparency and disclosure
4. Board sizes are in line with best practice
5. CEO and Chairman positions are separated in line with best practice
6. The legal framework provides clear guidance on many corporate government practices
7. Transparency law sets down disclosure requirements
8. Procurement rules are clear
9. SOEs have internal audit functions that answer directly to boards
10. A whistle-blowing obligation is enshrined in the law

The 10 worst features

1. Weak implementation of the procurement law
2. Board composition excessively biased towards political appointments and interest groups
3. Boards have little authority or autonomy and no independence
4. Board nomination processes are politically driven, opaque and not explicitly merit-based
5. Weak monitoring by the board of corporate governance, control and reporting systems
6. Absence of audit committees operating according to best practice
7. An almost complete lack of transparency with respect to corporate governance
8. Limited systems for controlling and disclosing conflicts of interest
9. Public administration culture
10. Lack of awareness of good corporate governance practices

One of the general conclusions that can be drawn from the study is that the laws and policies that provide for the governance of SOEs in Panama are generally appropriate. The problem is that the structures and systems for implementing these laws and policies (especially with respect to the board of directors) are not sufficiently effective for providing the accountability and assurances which the public and the State require.

Accordingly, while it may be necessary to work on legislation and rules, the focus should be mainly on implementation and ensuring that the systems for ensuring compliance are in place and functional. The best and worst features are discussed in greater detail in the following section.

The 10 best features (in greater detail)

- 1. Most SOEs are established as corporations:* Corporatization of a state function or autonomous state entity is often considered the first step in improving its corporate governance. The goal is to create positive incentives by subjecting the state activity to the same laws as private sector companies.
Recommendation: Organize as a corporation whenever practical and ensure that the differences in legal treatment between private companies and SOEs are minimized.
- 2. The financial statements use IFRS and are audited according to ISA:* IFRS compliant financial statements together with an ISA compliant independent audit provide essential information and assurances. Financial statements prepared according to IFRS provide information on related-party transactions, government subsidies and guarantees, risks, and responsibilities for managing risk that would otherwise not be available.
Recommendation: Full compliance with IFRS appears to be challenging for some SOEs, resulting in qualified financial statements, restatements or non-disclosure. Such incidents should be minimized. In addition, systems should be put in place at the board level to oversee the external auditor and provide assurances that the external auditor remains independent.
- 3. All SOEs have websites and use them for transparency and disclosure:* All of the SOEs comply to different degrees with the transparency law by providing well-organized disclosures on their websites. However, in some cases disclosure is superficial.
Recommendation: More material and analytical information should be provided and not just raw data.
- 4. Board sizes are in line with best practice:* Board sizes range from 5 to 7 members. This is considered optimal, although somewhat larger boards could be useful for allowing a greater diversity of board members.
Recommendation: Some flexibility in board size may be useful for some SOEs. Five-member boards may be too small to provide capacity, independence, diverse experiences or effective committees. One may wish to consider permitting board sizes ranging from 5 to 10 people.
- 5. CEO and Chairman positions are separated:* This is considered best practice. The reason is to ensure that oversight and executive functions are distinct and to prevent excessive concentration of power. However, such separation is no guarantee against excessive government or board intervention in SOE operations or the accumulation of power by one individual.
Recommendation: No change is recommended. SOEs should be aware that the ultimate goal of the separation of the CEO and Chairman is a balance of powers between management and oversight.
- 6. The legal framework provides clear guidance on many good corporate governance practices:* The procurement and labor laws provide good guidance on ethics and responsible business conduct. SOEs may, thus, draw upon common documents, such as a code of ethics, and need not expend resources developing their own. In addition, such common policies have the force of law.

Recommendation: The law can be used to promote better governance for the entire SOE sector. At the same time, the law should provide sufficient flexibility to SOEs so that they may adapt their policies to their needs and circumstances.

7. *The transparency law sets down disclosure requirements:* Law 6 on Transparency clearly sets out disclosure requirements for all SOEs. A positive feature is that the National Transparency and Access to Information Authority (ANTAI) evaluates the degree of compliance of SOEs with Law 6. A significant problem is that disclosure of corporate governance practices is not required under Law 6.

Recommendation: Law 6 on Transparency should require disclosure of critical information on corporate governance. Such disclosure should include:

- a. Information on board members;
- b. Conflict of interest policies;
- c. Information on potential conflicts of interest and conflict of interest declarations of board members;
- d. Information on systems that ensure that conflicts of interest are controlled and that related party transactions occur at arm's length;
- e. Board member nomination processes;
- f. Board and committee charters; etc.

8. *Procurement rules are clear:* SOEs are expected to comply with public sector procurement rules. As with the general corporate governance framework, uniform rules are useful. Nevertheless, strong rules can be subverted and, in fact, there have been reports of bid rigging and corruption in procurement.

Recommendation: The danger of malfeasance lies less in the rules than in the weakness of the control systems which should ensure that malfeasance is difficult if not impossible. SOEs should review their controls to ensure compliance with procurement rules and review the role of the board in ensuring that effective control systems are in place.

9. *SOEs have internal audit functions that answer directly to boards:* In all cases there are internal audit functions that report to the board of directors. This corresponds with best practice. On the other hand, it could not be determined whether the boards passively receive audit plans and reports, or whether they actively use the internal audit to ensure that their effective risk control and management systems are in place.

Recommendation: Boards need to actively use the internal audit function to assure themselves and the public that control, compliance and risk management systems are in place and that they are functioning properly. The internal audit function should have the capacity to evaluate the control and compliance systems and ensure its own adherence to the standards of best practice for internal audit.

10. *A whistle-blowing obligation is enshrined in the law:* SOE employees have an obligation under labor law to report illegal and unethical activities. However, none of the SOEs provide information on their websites on whistle-blowing procedures, points of contact or guarantees of anonymity.

Recommendation: All SOEs should develop their own whistle-blowing policy that describes the procedures to be taken and guarantees anonymity. This policy should be posted on the SOE's website. SOEs should consider the use of independent service providers to manage their whistle-blowing programs.

The 10 worst features (in greater detail)

- 1. Weak implementation of procurement law:* Procurement gives the impression of being well regulated. However, SOE governance structures do not appear to be sufficiently strong to provide assurances that procurement is done fairly or transparently and that abusive related party transactions and malfeasance do not occur.

Recommendation: Control systems should be sufficiently robust to ensure fair and transparent procurement in spite of attempts to subvert the rules. Boards should be able to exercise more independent oversight of procurement and controls.
- 2. Board composition is excessively skewed toward political appointments and interest groups:* Boards are dominated by civil servants and, occasionally, high-level political figures, as well as representatives of interest groups whose primary loyalty may not be to the SOE. None of the SOEs in the study could demonstrate that they have independent members and there is almost no gender diversity.

Recommendation: The Presidency of the Republic should use its authority to reduce political appointments, introduce independence and enhance competence. The Presidency would be aided by developing a nominations policy specifying that appointments be based on merit and encouraging greater independence. Non-Panamanian citizens should be allowed to be CEOs and board members.
- 3. Boards have limited autonomy and no independence:* Boards are constituted primarily to provide political oversight and to serve as conduits for high-level politically-driven imperatives. They operate as compliance mechanisms and have limited capacity for independent decision making.

Recommendation: Boards should assume greater responsibility for SOE performance. Their roles and responsibilities must be updated in accordance with best governance practices. Likewise, they should have a minimum number of independent members. The independence status of board member should be disclosed, as well as the definition of independence used in determining that status.
- 4. Board nomination processes are opaque and not explicitly merit-based:* Board nomination processes are not transparent. Given the dominance of political profiles and appointments, it is clear that the selection process favors personal contacts and political loyalties. The identities of the board members were not disclosed on the web pages of 3 of the 5 SOEs.

Recommendation: There should be a central policy that defines the selection criteria and requires that selection be merit-based. Some board positions should be publicly advertised. In addition, the use of independent search consultants should be considered.
- 5. Weak monitoring by the board of corporate governance, control and reporting systems:* Boards do not take responsibility for crucial governance processes that ensure that systems of compliance, control, safeguarding of the independence of the external audit, risk management, control of related party transactions and conflicts of interest are in place and functioning properly.

Recommendation: The legal roles and responsibilities of boards should be assessed and updated. A revision of the laws or the development of company bylaws could be required. All current as well as potential board members should be trained in good governance. Technical services should be acquired from reputable providers (such as auditors or consultants) to strengthen control and reporting systems.

6. *Absence of best practice audit committees*: Only one SOE formally discloses an audit committee. Three others report that they are in the process of establishing one.
Recommendation: Boards should ensure that audit committees comply with best practice and staff them, to the extent possible, with independent board members with experience in finance. Committee members should understand and comply with best practice for audit committees. SOEs, in turn, should disclose information on the audit committee including its charter and composition.
7. *An almost complete lack of transparency with respect to corporate governance*: Corporate governance disclosure is almost entirely absent. Frequently, such basic information as the identity of board members is missing. The information required to assess boards and control systems is even less frequent.
Recommendation: Corporate government disclosure must be significantly improved. Law 6 on Transparency may need to be revised in order to require corporate government disclosure. UNCTAD's Guidance on Good Practices in Corporate Government Disclosure may serve as a model for good corporate governance disclosure. Sufficient information should be disclosed on board members to evaluate competence, independence, integrity and potential for conflicts of interest.
8. *Limited systems for controlling and disclosing conflicts of interest*: Prohibitions on conflicts of interest are found in the laws establishing SOEs, the law on ethics for civil servants and procurement laws. However, legal documents frequently lack detail. In addition, press reports suggest that systems for controlling conflicts of interest may fail in practice.
Recommendation: More detailed policies, rules, supporting documentation and better disclosure are required to discourage abuse. The reform should also aim at ensuring effective implementation.
9. *Public administration culture*: SOEs frequently operate under public administration rules and practices. This leads to an administrative culture which can, at times, be bureaucratic and inflexible.
Recommendation: SOEs should not be extensions of the public administration. Whenever possible, the rules and practices of the private sector should serve as a model, especially in the areas of human resources management, incentive compensation and management by objectives (MBO).
10. *Lack of awareness of good corporate governance practices*: Many of the shortcomings existing in SOEs governance are due to a lack of knowledge of good practices. For example, it is not widely known that SOEs should report on their corporate governance in a consolidated report, that annual reports should be preceded by a statement of the board, or that it is necessary to prepare an annual report on stakeholder relations.
Recommendation: SOE executives, board members, authorities who name board members and supervise SOEs (including State executive, legislative and judicial authorities) should receive training in good governance practices. SOEs should conduct annual evaluations of their corporate governance practices and subsequently develop remedial action plans.

Conclusion

SOE governance in Panama has some very strong features, but there are other very weak ones as well. Overall, SOE governance falls short of the benchmark established by the OECD and the gaps should eventually be closed. The good news is that it is fairly easy to identify the weaknesses and develop a remedial action plan. Some actions will be the responsibility of the Government. Others can be made at the level of the SOE. Cooperation and coordination between the two will be required in order to ensure progress.

Although this study makes many recommendations, it does not purport to cover all the issues or provide all the answers. Its purpose is to call attention to the issue of corporate governance, make some reasoned proposals and start a discussion. It is hoped that these findings will eventually encourage the Government and SOEs to develop their own action plans. Some basic action plans for SOEs are included in Part II of this report.

Achieving results will require that far more attention be paid to implementation. Panama is a country where the legislative framework is strong in many ways, but where rules are also easily circumvented. That is why systems for monitoring and control need to be strengthened. This also explains why strong governance structures are needed. In conclusion, Panama needs to recognize good SOE governance for what it is: an investment without which its financial and physical investment in infrastructure and society are put at risk.

It is not infrequent for people to complain about the costs of good corporate governance. Consider that Panama invested \$18 billion in infrastructure in the last administration and continues to invest. How much was invested in good corporate governance? Relatively little if not nothing. Shouldn't the corporate governance foundations of our SOEs be as solid as those of our bridges, roads and canals? Only strong corporate governance can ensure that our infrastructure is properly built, operated and maintained in the public's interest.

Carlos Barsallo, former SMV Superintendent and former IGC-P Board member

Part II: Individual Enterprise Reports

Structure of individual enterprise reports

Part II of the study contains an analysis of the individual governance practices of each of the 5 SOEs. Each individual SOE report has the following structure:

- Background
- Main governance challenges
- Performance by corporate governance category
- Performance by corporate governance sub-indicator
- Discussion and recommendations
- Corporate governance action plan prioritization

The different sections are largely self-explanatory. However, the *action plan prioritization* requires additional explanation.

The *action plan prioritization* section of each SOE report is useful for prioritizing the potential actions in terms of the ease of implementation and the benefit expected from the reforms. To this end, a matrix is used that shows the expected benefit of the reform (marginal utility) on the x-axis and the degree of control which the SOE has over the proposed reform on the y-axis.

SOEs should focus on activities where they exercise a high degree of control over the proposed reform and where there is a high marginal return (Box 1).



The SOE should subsequently focus on the supporting recommendations (Boxes 2-4). Within each box recommendations are listed in order of highest benefit. These assessments of both control and expected benefit are, of course, based on judgment and should be discussed at board level.

ENA Corporate Governance Report

Background

<i>ENA Summary Data</i>	
Legal structure: Public limited company	<i>Board size: 7</i>
Establishing law: Law 76 de 2010	<p>A pie chart illustrating the composition of the 7-member board. The chart is divided into three segments: a blue segment representing Government (4 members), an orange segment representing Interest groups (3 members), and a very small, unlabeled segment representing Independent members (0 members).</p>
Activity: Road transportation	
Percentage of state ownership: 100%	
Bond financing: Yes, through trusts	
Financial reports: IFRS, 2015 with qualified opinion	
Auditor: Deloitte	Women: 1, from unions
<i>Board Composition</i>	
<i>Government</i>	
Representative of the Executive Body (1) who shall be President of the board	Representative of the Executive Body (2)
Representative of the Executive Body (3)	Representative of the Executive Body (4)
<i>Civil Society</i>	
Chamber of Commerce	Construction Chamber of Commerce of Panama
National Council of Organized Workers and National Confederation of Independent Labor Unions	

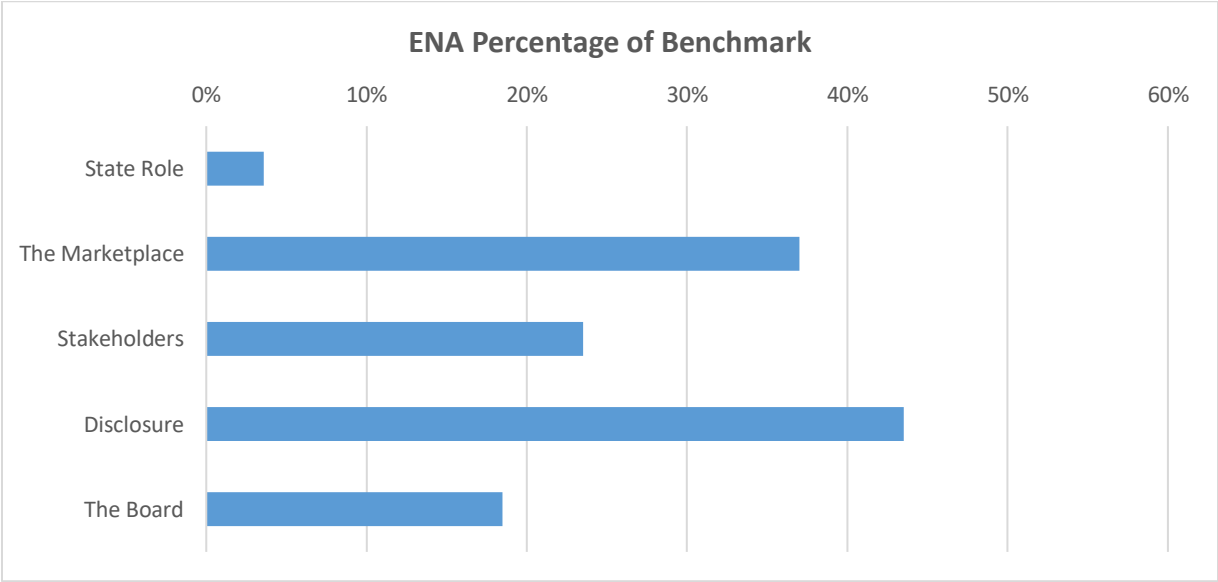
Main corporate governance challenges

ENA neither stands out positively nor negatively according to publicly available information. On the other hand, information gathered through interviews sheds a more positive light. Recent changes in Government have led to a more professional board of directors and CEO which allows ENA to make more economically sound decisions. Its board now includes individuals with business experience and ENA is reportedly able to operate free from political influence with no interference in hiring, firing or contracting. Greater transparency has been introduced into contracting processes and a motivated staff with private sector experience has been hired.

Nevertheless, there is more to be done. There are two essential remaining challenges: a complete lack of transparency with respect to governance practices (whether good or bad), as well as corporate governance that is vulnerable to changes in political administrations. Better and more stable practices and systems need to be put in place to professionalize and stabilize ENA's corporate governance and board. ENA should compare itself to best practice and develop a remedial action plan to close the gaps, in

particular, with respect to the roles and responsibilities of its board. A board action plan has, reportedly, been introduced recently and is being implemented.

Performance by corporate governance category



CG Category	Corporate governance sub-indicator	Evaluation
<i>The State's role as owner</i>	Undue interference by the State into SOE and SOE autonomy	🔍
	Board nomination processes	🚫
<i>The marketplace</i>	Undue advantage or disadvantage in relation to private sector	🟡
	Distinction and separation of State functions from those of SOEs	🔍
<i>Stakeholders and responsible business</i>	Stakeholders and responsible business conduct	🟡
	Board responsibility for controls	🚫
	Use of SOE for political purposes	🔍
<i>Transparency and disclosure</i>	Financial reporting	🟡
	Disclosure of public interest commitments	🟡
	Governance	🚫
	Risk	🟡
	Related parties	🟡
	Audit	✅
<i>The responsibilities of the board</i>	Role and powers	🟡
	Nominations	🚫
	Composition	🚫
	Independence	🚫
	Conflict of interest	🚫
	Structure and processes	🟡

Performance by corporate governance sub-indicator

Discussion and recommendations

The state's role as owner

Undue interference by the state into SOE and SOE autonomy

Best practice suggests that the state not interfere unduly in the business and/or operational decisions of the SOE. It also suggests that the board be able to act autonomously, without political interference, and that it be ultimately responsible and accountable for SOE performance.

- ❓ Publicly available information is insufficient to arrive at a reasonable conclusion. In fact, governance practices at ENA are, arguably, better than what public data might suggest.

Recommendation: It is of utmost importance that ENA improve its corporate governance disclosure practices. Furthermore, though ENA has, according to anecdotal information, undergone significant improvement in the quality of its board, professional practices and structures need to be systematized and protected from changes in political administrations.

Board nomination processes

According to best practice, board members should be nominated through an open and transparent process that yields a diverse board composed of members chosen based on merit and who are able to exercise objective judgment on SOE affairs free from political influence.

- ❌ The board members are nominated by the President of the Republic with the approval of the National Assembly. In contrast to good practice, the nominations process remains a political decision that makes board candidates subject to political compromise as well as possible political influence. Likewise, boards formed by interest groups are not considered good practice. Changing these customs may take time until current ones cede ground to best practice.

Recommendation: Professional board members from different fields of expertise will yield better results for SOEs. As a consequence, board nominations need to be depoliticized over time. This could require changes to the laws establishing SOEs, which could be difficult. In the shorter term, it could be possible for ENA to change its by-laws and enhance its board member profiles by specifying, for example, the need for political independence, proven integrity, or private sector experience. ENA may wish to explore establishing a board nominations committee whose purpose would be to recommend candidates when board vacancies arise. Board size may need to be expanded slightly for greater diversity of background and opinion.

No undue advantage or disadvantage versus private sector

Best practice suggests that the SOE not have any undue advantage or disadvantage with respect to other SOEs or the private sector. The SOE should not have any special legal or tax exemptions and should obtain its financing under market conditions.

- ⊖ ENA is not directly comparable to a private sector business since it does not compete directly with private companies, and because of its role in fulfilling the development strategy of the State. ENA does benefit from certain tax exemptions according to its annual report. This being said, ENA is legally obliged to charge and pay for services on a full cost basis. An anecdotal illustration is that ENA recently began collecting toll charges from official state vehicles, which it had previously subsidized, thus ending a form of cross-subsidization. ENA does not benefit from any other special conditions or legal protection.

Recommendation: Publicly available information suggests that ENA operates without any undue advantage or disadvantage compared to the private sector or other SOEs. However, this could be explicitly clarified in ENA's disclosures, possibly in its annual report.

Distinction and separation of State functions from SOE functions

According to best practice, there should be a clear separation between the State, the SOE and regulatory functions. Public procurement should be competitive, non-discriminatory and transparent.

- ❓ Publicly available information does not clearly show the degree to which ENA is separated from the State in terms of decision making and control. Nevertheless, some steps demonstrate movement in this direction. For example, ENA has begun charging tolls from government vehicles thus ending a form of government cross-subsidization. ENA is mainly self-financed and receives only limited contributions from the State budget. Such contributions are clearly disclosed in its financial statements. Furthermore, it abides by the State's procurement laws.

Recommendation: Greater transparency is required regarding the precise decision making roles of ENA and the State. A disclosure could be included in ENA's annual report or in an annual report on corporate governance. There should be a clear separation between the SOE and the State, and between state ownership and State regulatory functions.

Stakeholders and responsible business conduct

Best practice suggests that the SOE recognize and respect stakeholder rights, as well as develop and disclose a stakeholder policy. Large SOEs should issue an annual report on stakeholder relations. In addition, stakeholders should be provided with relevant information on a timely basis. In addition, SOEs should observe high standards of responsible business conduct and disclose compliance mechanisms.

- ⊖ ENA does not have a formal stakeholder policy. Rather, ENA's internal regulations follow the State's standards. Stakeholder communications take place on the ENA website which keeps the public informed of potential works and closures. Furthermore, stakeholder reporting is made to the banks and trusts that are involved in ENA's debt issues. Overall, the quality and timeliness of stakeholder communications are assessed to be poor by ANTAI (National Transparency and Access to Information Authority). Though Executive Decree 246 contains basic rules of responsible business conduct, the extent to which they are observed by ENA is unknown.

Recommendation: ENA could be more transparent with respect to its stakeholder relations. It could consider issuing an annual report on stakeholder relations, or devote a section of its annual financial report to a discussion of stakeholder issues. In addition, ENA could consider developing a stakeholder policy statement and post it on its website.

Board responsibility for controls

According to best practice the board is expected to develop, implement, and monitor internal controls, ethics, compliance, and anti-corruption programs. The SOE should have standards of responsible business conduct and disclose the mechanisms for ensuring their implementation. Best practice suggests that SOEs establish whistleblowing policies and procedures.

- ✖ There is no public disclosure indicating that the ENA board has developed any of the above-listed policies or oversees their implementation or that it recognizes this responsibility. Anecdotal reports suggest that controls are receiving greater attention at both the executive and board levels. ENA is subject to the Government's ethics code and the internal regulations also contain many requirements that are usually found in an ethics code. Employees are obliged to report any illegal activity under both law and internal regulations. However, this obligation is not equivalent to a formal whistleblower program.

Recommendation: The board needs to recognize that the development, implementation and monitoring of internal controls, ethics, compliance and anti-corruption programs are its responsibility. The board's responsibility needs to be disclosed as do its actions in support thereof. ENA should develop and implement a formal whistleblower policy and may wish to consider the services of an independent service provider for its whistleblower program.

Use of the SOE for political purposes

Best practice requires that the SOE not make political campaign contributions or finance political activities, or run charities or provide social services that are unrelated to its main area of activity.

- ❓ ENA does not disclose a formal policy on political contributions. There is no publicly available information that suggests that ENA either does or does not make such contributions. Anecdotal reports suggest that ENA makes no political contributions and that it has no power over discretionary funds. This is, however, not discussed in any public disclosure.

Recommendation: ENA should develop a policy on political contributions, disclose and discuss it on its website and ensure that the policy is enforced. Such a policy may be part of an ENA ethics code or could be a separate policy document.

Financial reporting

Best practice recommends that SOEs produce annual financial reports in line with International Financial Reporting Standards (IFRS). A directors' report should be part of the annual financial statement.

- ⊖ ENA produces its annual financial reports according to IFRS. This is positive, since IFRS-based statements provide significant amounts of information on the enterprise's governance practices. Unfortunately, ENA's financial statements have received a qualified opinion from auditors in each of the past four years, and had to be restated in the past. Restatements are not, per se, a negative indicator. However, persistent difficulty in producing unqualified statements is often an indicator of serious underlying problems. Anecdotal information suggests that the 2015 annual report will be free of such qualifications. Likewise, ENA's annual financial report contains no statement by the board.

Recommendation: ENA needs to break the string of qualified financial reports and produce statements that are fully compliant with IFRS. The board needs to take it upon itself to ensure that proper IFRS reporting occurs. It may be helped in this task by establishing an audit committee of the board. In addition, more board members with experience in finance and financial reporting may be needed. The board should report on its stewardship in each annual financial report.

Disclosure on public interest commitments

Best practice is that SOE reports include information on areas of significant concern to the state and the general public, and provide statements on activities carried out in the public interest including financial and operating results associated with the achievement of public policy objectives. SOEs should also disclose financial assistance, guarantees, and any other commitments made by them or to them by the state.

- ⊖ There is no discussion of significant concerns of the State and the public in a formal report. ENA does have a significant amount of stakeholder reporting. However, there is little qualitative discussion of outcomes that are in the public interest. The annual report discusses guarantees and commitments made by the State. In addition, anecdotal information suggests that quarterly servicing reports are used internally. Nevertheless, there is no single easy to read statement regarding the relationship between ENA and the State and its public interest commitments. There is also the perception that the mission of ENA and the ownership of the transportation corridors (Corredores) are not well understood by the public.

Recommendation: ENA should enhance its reporting on public interest commitments, as well as the achievement of goals under these commitments and its relations with the State. Such information could be part of an annual stakeholder report, or it could be part of the annual financial report.

Corporate governance

A best practice is that SOEs report on their corporate governance. Disclosures should, at a minimum, include the identity of board members, their qualifications, other posts held, the selection process, and the degree of board diversity. Information should be sufficient to assess the board members' contribution to the SOE, competence, potential conflicts of interest, and independence.

- ✘ Governance disclosure at ENA (as in the other surveyed SOEs) is deficient. Even the most basic information such as the identity of the members of the board of directors is missing.

Recommendation: ENA needs to improve its governance disclosure. It should devote a special section of its website to governance and include, among other things, information on board members, conflict of interest policies, and so on. It should also devote a section of its annual report to corporate governance, or issue a separate annual report on its governance. The annex includes a detailed list of common governance disclosures, which should be made under the responsibility of and monitored by the board.

Risk

Best practice suggests that SOEs should disclose material foreseeable risk factors and remedial measures, and the systems they use to identify, manage, control and report on risks.

- ☹ ENA's annual reports include a discussion of risk. Material foreseeable risks are disclosed according to IFRS, as is the board's responsibility for and oversight of risks. This disclosure is, however, minimal. The board, on its part, does not disclose or discuss this matter.

Recommendation: The ENA board should describe its responsibility for risk oversight in the annual report. It may, in addition, wish to discuss its responsibility for all systems of control and risk management in an annual governance report.

Related parties

Best practice requires disclosure of material transactions with the State and other related entities. International Accounting Standard 24 requires disclosure of material related party transactions.

- ☹ ENA complies with this requirement in its financial reports. Furthermore, various laws, including the procurement law, prohibit transactions between parties where there is a conflict of interest. However, government regulations give only general definitions of related parties, and provide no guidance on how to oversee or manage related party transactions so that they always occur at arm's length.

Recommendation: The ENA board should develop and oversee the implementation of a conflict of interest/related party transaction policy and report annually on its oversight of systems for

controlling conflicts of interest and related party transactions. Such reporting could be part of an annual governance report or the annual financial reports.

Audit

Best practice requires that SOE annual financial reports be subject to audit by an independent external (non-state) auditor. The audit should be conducted in accordance with International Standards of Audit (ISA). The board has the responsibility for overseeing the auditor and the audit process and assuring that the external auditor is independent.

- ✔ ENA's annual financial reports are audited by Deloitte, a reputable independent auditor, who uses ISA as a matter of policy. This helps provide assurances that ENA's financial reports and disclosures fairly represent the enterprise. On the other hand, public disclosure is insufficient to tell whether the board actively oversees the audit process or whether it fulfills its obligation to oversee the auditor's independence.

Recommendation: The ENA board should report on its responsibilities for the oversight of the independent auditor including its approach to ensuring auditor independence.

The responsibilities of the board

Role and powers

Best practice suggests that the board have a clear mandate and ultimate responsibility for the SOE's performance. SOE boards should not merely be conduits for instructions from political powers, nor should their main role be to ensure compliance with political orders. The board should understand its legal obligation to act in the best interest of the SOE. It should have the power to set strategy, supervise management, as well as to hire and fire the CEO. The board should also be able to decide (subject to limitations set by the State) on CEO compensation and ensure that top executive remuneration is tied to the achievement of objectives.

- ☹ The law under which ENA was established clearly describes the board's mandate. However, public disclosure is insufficient to determine the degree to which the board exercises its duties of loyalty and care to the SOE under company law. Nor could it be determined the extent to which the board might be subject to political influence, although anecdotal evidence suggests that ENA is free from any such interference. The board does not appear to have the explicit power to hire or fire the CEO. This power lies in the Presidency. Although the board is reportedly in full control of the strategy, this is not disclosed. Finally, the board does not appear to be responsible for executive remuneration and the CEO is not eligible for incentive compensation.

Recommendation: The ENA board cannot deviate from the law under which it was established. Nevertheless, ENA could enhance its responsibilities either through bylaws or a board charter.

There is concern regarding the board's awareness of what its responsibilities are according to best practice. This is not a problem unique to ENA. As a consequence, training for all existing and potential board members should become mandatory nationally.

Nominations

According to best practice, all board members should be nominated based on merit. The rules and procedures for nominations should be transparent and appointments should be based on professional criteria and a competitive selection process. Independent search experts may be used to enhance the process. In addition, the SOE should have some say in the selection process.

- ✘ The authority for nominations is clear and is set down in the law establishing ENA. However, the process is not transparent, nor is there any indication that merit is the essential selection criterion. Public disclosure provides no indication that there is a competitive search process or that search consultants have ever been hired to find the best candidates for board appointments. The current process seems to rely on networks of personal contacts. Such a process may work when the nominating power clearly understands the needs of the SOE and of corporate governance processes, but is vulnerable to failure when the nominating power is less interested in assuring good governance.

Recommendation: ENA has no power to make board member nominations. However, it is possible to create a process whereby ENA's needs are taken into consideration. The goal should be for ENA to conduct annual evaluations of its board needs and to report them to the nominating authorities when there are vacancies on the board. Potential nominees should be open to review by ENA executives and board members. The use of independent search consultants is also recommended. Eventually rules should be developed that prevent the total change of board members as a result of election cycles in order to give boards some level of stability. A proposal might be to only allow a certain percentage of the board to change as a result of a change in the government administration. Another proposal would be to stagger board terms (i.e., have them end at different times).

Composition

The board should be diverse and have competencies useful to the SOE. It should have some private sector experience and an appropriate gender mix. Board members should be free from political links and should not represent interest groups. Board members linked to Executive Body powers should not serve on the board and the number of civil servants should be kept small.

- ✘ The composition of the ENA board is not disclosed on its web page. There is concern regarding diversity because 4 members are nominated by the Executive Body and the remaining 3 are nominated by interest groups. Anecdotal information suggests that the board has significant private sector experience and that there is one female board member who represents the unions. However, this information is not available on the ENA website. Lastly, anecdotal information

suggests that ENA is aware of the benefits of diversity on the board and will be working on the issue in future.

Recommendation: ENA needs to disclose information on its board composition. Nominating powers should consider the need for diversity, experience and gender distribution. ENA should be in a position to suggest to nominating powers both needed profiles and names.

Independence

Best practice in terms of board composition promotes objective and unpoliticized decision making in the interest of the SOE. A minimum number of independent board members should be required. The roles of chairman and CEO should be separated.

- ❌ Publicly available data was insufficient to confirm the presence of independent board members. However, using a narrow definition of independence that would exclude relationships with high political powers, and given that board members are nominated exclusively by the Executive Body, it is fair to assume that no truly independent members are on the board. All can be assumed to have political or other external loyalties. A positive point is that ENA (as well as all other SOEs surveyed) separate the roles of chairman and CEO.

Recommendation: Independence is not a panacea and should never be considered a substitute for competence. Nevertheless, nominating powers should consider the need for objective judgement at board level and nominate some independent-minded board members. A strict percentage is not useful. However, 1 or 2 strong independent board members can have a positive impact on board decisions. The status of independent board members should be disclosed as should the definition of independence used in determining that status. Given that existing interest groups are unlikely to be willing to give up a board seat in favor of an independent, it may be appropriate to increase the board size by a small amount to make room for independent members. This would call for amending ENA's establishing law.

Conflict of interest

Boards operating according to best practice should have policies and mechanisms in place to manage conflicts of interest. All board members should disclose potential conflicts of interest to the board in writing. In addition, board member interests should all be clearly disclosed on the company's website. Control systems should be capable of guaranteeing observance of the conflict of interest policy.

- ❌ Under law, board members (who are considered public officials) should not have conflicts of interest. However, the law is imprecise and proposes no systems for managing potential conflicts. Nor does it require board members to disclose potential conflicts publicly or to the board. ENA does not disclose its conflict of interest policy nor any information on how it controls potential conflicts of interest.

Recommendation: The ENA board would benefit from the establishment of a conflict of interest policy that goes beyond the requirements set by law. This policy should be disclosed on ENA's website and its implementation should be monitored by the board and possibly the internal auditor and corporate secretary.


Structure and processes


Best practice suggests that the board consider establishing committees. The committee that is widely considered essential is the audit committee. Audit committees oversee a large number of issues related to the reporting and control environment. It may also be useful to establish remuneration and nominations committees. At the same time, board sizes should be kept reasonably small. The board should conduct an annual self-evaluation and develop a remedial action plan. All SOEs should have an internal audit function with a direct reporting relationship to the independent members of the board.

- ⊖ According to publicly available information, ENA has no committees, although anecdotal information suggests that it may be in the process of establishing some. A positive point is that ENA's board size (7) is within the range suggested by best practice. Furthermore, it has an internal auditor who reports directly to the board. On the other hand, there are no annual evaluations of ENA's own governance.

Recommendation: ENA should establish an audit committee which should include independent board members with experience in financial reporting, and knowledge of audit and the control environment. The board should conduct an evaluation of its own governance processes, possibly with the assistance of an independent external consultant, and devise an annual plan for removing any gaps between ENA's corporate governance and best practice. The fact that an annual governance evaluation is being carried out should be disclosed.

Corporate governance action plan prioritization

 Implement	HIGHEST	<p>MODERATE BENEFIT HIGH CONTROL:</p> <p>2</p> <ul style="list-style-type: none"> ▪ Provide feedback to nominating powers on desired board member profiles ▪ Develop a stakeholder policy and disclose an annual stakeholder report ▪ Institute a whistleblower policy and program ▪ Enhance disclosure of public interest commitments and advantages and disadvantages of ENA compared to private sector 	<p>HIGHEST BENEFIT AND HIGH CONTROL:</p> <p>1</p> <ul style="list-style-type: none"> ▪ Unqualified annual report ▪ Enhance CG disclosure ▪ Board responsibility for: control; risk; ethics; compliance; anti-corruption; and external audit and disclosure thereof ▪ Establish policies on conflict of interest and political contributions ▪ Establish an audit committee ▪ Annual evaluation of board CG ▪ Mandatory national training for all board members on best CG practice
	LOWER	<p>MODERATE BENEFIT LOW CONTROL:</p> <p>4</p> <ul style="list-style-type: none"> ▪ Increase legal board size to permit more independent board members 	<p>HIGHEST BENEFIT AND LOW CONTROL:</p> <p>3</p> <ul style="list-style-type: none"> ▪ Board nominations processes should be depoliticized, transparent and merit-based ▪ Protect board from changing political tides ▪ More financial experience on board ▪ Board's role should be enhanced and closer to best practice ▪ Nominate minimum number of independent board members
	LOWER		HIGHEST



Expected Benefit of Reform

ETESA Corporate Governance Report

Background

<i>ETESA Summary Data</i>	
Legal structure: Statutory limited liability (SA)	<i>Board size: 5</i>
Establishing law: Law 6 of 1997	<p>A pie chart illustrating the composition of the 5-member board. The largest slice is blue, representing 'Government' with 4 members. A smaller orange slice represents 'Other constituency' with 1 member. The 'Independent' category is listed as 0 members.</p>
Activity: Electricity transmission	
Percentage state ownership: 100%	
Bond financing: No, however, planned for 2015	
Financial reports: IFRS, 2015 unqualified	
Auditor: KPMG	Women: Unknown
<i>Board Composition</i>	
<i>Government</i>	
Representative of Executive Body (1) who shall be Chairman	Representative of Executive Body (2) who shall be Treasurer
Representative of Executive Body (3) who shall be Secretary	Representative of Executive Body (4)
<i>Civil Society</i>	
A workers' representative	

Main corporate governance challenges

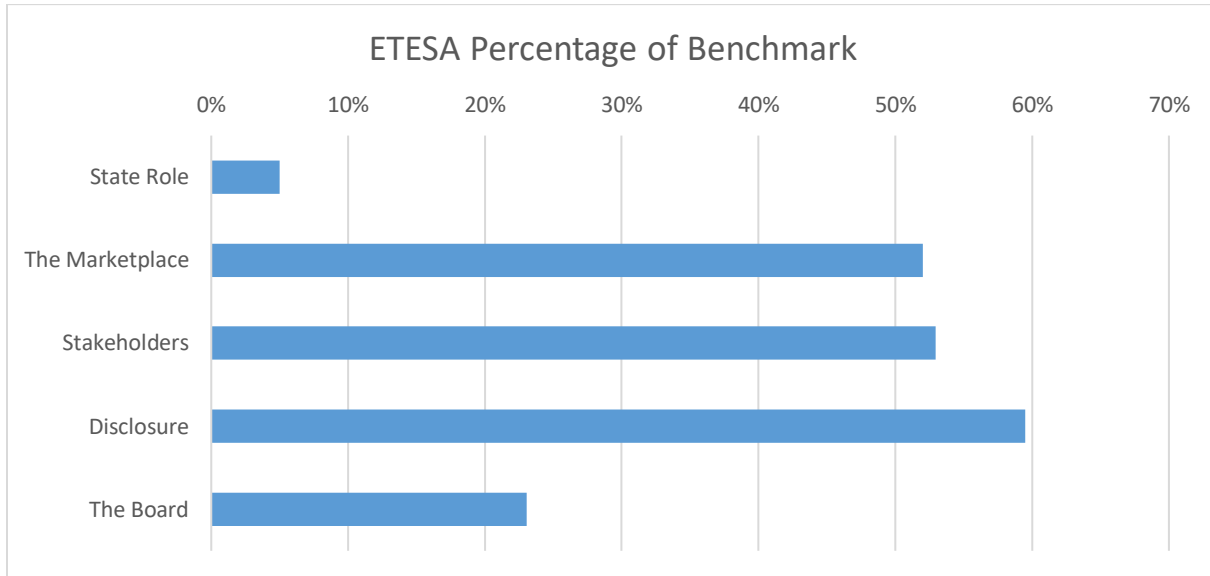
ETESA faces various corporate governance challenges: a) the executive function is at times limited in making key operating decisions; b) the board is focused on verifying compliance versus adding value; c) inflexible procurement practices; d) mandatory prior approval by the state of payments; and e) contractual constraints that force the company to operate at close to a loss. As a consequence, ETESA operates at a higher cost and at a disadvantage vis-à-vis its peers in the private sector.

These practices hurt the consumer, suppliers and the State. For example, too many disbursements need to be pre-approved by the State. The consequence is that payments to contractors may take up to 300 days. Contractors factor the cost of these delays into their offers, which means that the State almost always ends up paying more. Likewise, burdensome procurement practices mean that investments are delayed, operations are affected and public services suffer.

It is estimated that emulating private sector governance practices could increase Return on Assets from a current 1% to 10% and improve ETESA's capacity to serve the public. A key challenge is, thus, how to create both effective and efficient controls.

ETESA has undergone governance evaluations by the IDB every four years since 2008. It was reported that the evaluations recommend only marginal change. In contrast, this study would suggest that such evaluations may be too optimistic and that more rigorous evaluations are needed. ETESA reports that it plans to establish an audit committee in 2016.

Performance by corporate governance category



Performance by corporate governance sub-indicator

<i>CG Category</i>	<i>Corporate governance sub-indicator</i>	<i>Evaluation</i>
The state's role as an owner	• Undue interference by the State into SOE and SOE autonomy	?
	• Board nominations processes	✗
The marketplace	• No undue advantage or disadvantage versus private sector	=
	• Distinction and separation of state functions from SOE functions	=
Stakeholders and responsible business	• Stakeholders and responsible business conduct	✓
	• Board responsibility for controls	=
	• Use of SOE for political purposes	?
Transparency and disclosure	• Financial reporting	✓
	• Disclosure on public interest commitments	=
	• Governance	✗
	• Risk	=
	• Related parties	=
The responsibilities of the board	• Audit	✓
	• Role and powers	=
	• Nominations	✗
	• Composition	✗
	• Independence	✗
	• Conflict of interest	✗
	• Structure and processes	=

Discussion and recommendations

The state's role as an owner

Undue interference by the State into SOE and SOE autonomy

Best practice suggests that the state not interfere unduly in the business and/or operational decisions of the SOE. It also suggests that the board be able to act autonomously, without political interference, and that it be ultimately responsible and accountable for SOE performance.

- ❓ Publicly available information is insufficient to arrive at a reasonable conclusion.

Recommendation: ETESA should improve its corporate governance disclosure practices in order to allow for a better assessment of this indicator.

Board nomination processes

According to best practice, board members should be nominated through an open and transparent process that yields a diverse board composed of members chosen based on merit and who are able to exercise objective judgment on SOE affairs free from political influence.

- ❌ Board members are nominated by the President of the Republic with the approval of the National Assembly. In contrast to good practice, the nominations process is a political decision that makes board candidates subject to political compromise and possibly political influence. ETESA, in contrast to the other participants of this study, has the highest proportion of board members nominated directly by the Executive Body. Such a process makes the ETESA board vulnerable to changes that may occur as a result of changes in political administration.

Recommendation: Board nominations need to be depoliticized with the goal of having a more professional and stable board. This will eventually require changes to the laws establishing SOEs. In the meantime, it may be possible for ETESA to alter its by-laws to define needed board member profiles specifying, for example, the need for political independence, proven integrity, or private sector experience. ETESA may wish to explore establishing a board nominations committee whose purpose would be to recommend candidates when board vacancies arise. ETESA's board size is quite small and towards the bottom limit of the usual range. Board size may need to be expanded slightly to promote greater diversity and to add capacity.

The Marketplace

No undue advantage or disadvantage versus private sector

Best practice suggests that the SOE not have any undue advantage or disadvantage with respect to other SOEs or the private sector. The SOE should not have any special legal or tax exemptions and should obtain its financing under market conditions.

- ☹ Publicly available information suggests that ETESA operates without any undue advantages or disadvantages compared to the private sector or other SOEs. ETESA is a regulated natural monopoly and, as such, is not directly comparable to a private sector business. On the other hand, the concept of competitive neutrality and fair competition with the private sector are embedded in its statutes. According to Law 6, public goods must be paid by the State, for which reason ETESA receives subsidies and benefits from certain tax exemptions. These are disclosed in its annual report. The government policy is to self-fund 75% of ETESA and to provide support for the remaining 25%.

Recommendation: ETESA may wish to include a discussion of competitive neutrality and its relations with the private sector in its annual report or in an annual governance report.

Distinction and separation of State functions from SOE functions

According to best practice there is a clear separation between the State, the SOE and regulatory functions. Public procurement should be competitive, non-discriminatory and transparent.

- ☹ Tariffs are set by the Regulatory Entity (Ente Regulador) or Public Services Authority (Autoridad de los Servicios Públicos), an autonomous combined regulator established under Law 26 of 1996. Thus, the key regulatory function is clearly separated from the ownership function. The Commission on Energy Policy (Comisión de Política Energética) determines global policy and strategy for the energy sector. This suggests a separation between regulation and policy making. ETESA is subject to state procurement laws.

Recommendation: ETESA's statutes and other laws provide more precise information on the separation of state ownership and regulatory functions than other SOEs. Nevertheless, (in addition to the recommendation above) greater transparency could be achieved by providing a consolidated discussion of the separation of ownership, policy and regulation in ETESA's annual report or in an annual corporate governance report.

Stakeholders and responsible business

Stakeholders and responsible business conduct

Best practice suggests that the SOE recognize and respect stakeholder rights, as well as develop and disclose a stakeholder policy. Large SOEs should issue an annual report on stakeholder relations. In addition, stakeholders should be provided with relevant information on a timely basis. In addition, SOEs should observe high standards of responsible business conduct and disclose compliance mechanisms.

- ✔ One of ETESA's relative strengths is its stakeholder policy and its reporting on stakeholder relations. The Ethics Code (Código de Ética y Conducta Empresarial) specifies respect of stakeholder rights. The Social Responsibility Policy (Política Responsabilidad Social de Empresa) also covers stakeholders extensively. There is a Volunteer Policy (Política de Voluntariado) that helps organize volunteers to help certain stakeholders. ETESA also reports on its compliance with the UN Global Compact in its Global Compact Progress Report (Informe Progreso de ETESA con el Pacto Mundial). Furthermore, ETESA has an Environmental Policy (Política Ambiental). ETESA's Annual Review (Memoria 2015) is a strong piece of stakeholder disclosure. Executive Decree 246 contains basic rules of responsible business conduct. The extent to which it is observed is uncertain.

Recommendation: This is undeniably one of ETESA's strengths. ETESA may wish to study best practice in stakeholder practices and in stakeholder disclosure in order to further improve its already good practices.

Board responsibility for controls

According to best practice, the board is expected to develop, implement, and monitor internal controls, ethics, compliance, and anti-corruption programs. The SOE should have standards of responsible business conduct and disclose mechanisms for ensuring their implementation. Best practice suggests that SOEs establish whistleblowing policies and procedures.

- ☹ All of these features are described in ETESA's Ethics Code and Internal Procedures Manual (Manual de Procedimientos Internos). However, there is no public disclosure that indicates that the ETESA board has input into the above-listed policies or oversees their implementation or that it takes responsibility for their proper function. Monitoring of the Ethics Code is done by a corporate Ethics Committee (Comité de Ética) as opposed to the board. The Ethics Code also contains a description of whistleblower procedures.

Recommendation: The board needs to take overt responsibility for the development, implementation and monitoring of internal controls, ethics, compliance and anti-corruption programs. The board's responsibility needs to be disclosed as do its actions in support thereof. ETESA may wish to consider the services of an independent service provider for its whistleblower program.

Use of the SOE for political purposes

Best practice requires that the SOE not make political campaign contributions or finance political activities, or run charities or provide social services that are unrelated to its main area of activity.

- ❓ ETESA does not disclose a formal policy on political contributions. Thus, there is no publicly available information that suggests that ETESA either does or does not make such contributions. In principle, financing of political activities should not be possible since ETESA's budget, which is examined by the General Comptroller's Office, does not include any line items for those activities.

Recommendation: ETESA should develop a policy on political contributions, disclose it on its website and ensure that the policy is enforced. Such a policy could either be part of ETESA's ethics code or a separate policy document.

Transparency and disclosure

Financial reporting

Best practice recommends that SOEs produce annual financial reports in line with International Financial Reporting Standards (IFRS). A directors' report should be part of the annual financial report

- ✔ ETESA produces its annual financial reports according to IFRS. This is a strong positive aspect since statements prepared according to IFRS provide significant amounts of information on governance practices. Annual reports were available on the ETESA website dating back to 2008, thus allowing for historical comparisons. Draft statements for 2015 were already publicly available at the time of writing this report which is an indication that ETESA takes timely disclosure seriously.

Recommendation: ETESA's annual financial report contains no preliminary statement by the board. This suggests that the board may not be exercising the oversight role over the financial reporting process that is described under best practice. The board should not only preface the annual report but, in addition, report on its stewardship of ETESA in each annual financial report or in an annual corporate governance report.

Disclosure on public interest commitments

Best practice is that SOE reports include information on areas of significant concern to the state and the general public, and provide statements on activities carried out in the public interest including financial and operating results associated with the achievement of public policy objectives. SOEs should also disclose financial assistance, guarantees, and any other commitments made by them or to them by the state.

- ☹ ETESA provides public interest reporting through a combination of annual reports prepared according to IFRS and the Annual Review (Memoria). The financial statements cover financial and operating results with a good discussion of public policy objectives in broad terms and numbers in the notes. While these reports provide information on guarantees and commitments made by the State, there is no single easy to read statement regarding the relationship between ETESA and the State and its public interest commitments.

Recommendation: ETESA can enhance its disclosure on public interest commitments, its achievement of goals under these commitments, and its relations with the State. It would be even more transparent if such reporting were consolidated either in an annual stakeholder report, an annual report on corporate governance or as part of the annual financial report.

Corporate governance

A best practice is that SOEs report on their corporate governance. Disclosures should, at a minimum, include the identity of board members, their qualifications, other posts held, the selection process and the degree of board diversity. Information should be sufficient to assess the board members' contribution to the SOE, their competence, potential conflicts of interest, and independence.

- ☹ Governance disclosure at ETESA (as well as in the other surveyed SOEs) is deficient. Even the most basic information such as the identity of the members of the board of directors is missing.

Recommendation: ETESA needs to improve its corporate governance disclosure. To this end, it should devote a special section on its website to corporate governance and include, among other things, information on board members, conflict of interest policies, and so on. It should either devote a section of its annual report to corporate governance, or issue a separate annual report on its corporate governance. A detailed list of common corporate governance disclosures is included in the annex. Governance disclosure should be made under the responsibility of and monitored by the board.

Risk

Best practice suggests that SOEs disclose material foreseeable risk factors and remedial measures, and the systems they use to identify, manage, control and report on risks.

- ☹ ETESA's annual reports clearly disclose and discuss risks. Furthermore, the board's responsibility for risk oversight is clearly indicated. However, no reference is made to remedial measures taken to manage such risks.

Recommendation: The ETESA board should describe its responsibility for risk oversight, either in the annual report or in an annual governance report.

Related parties

Best practice requires disclosure of material transactions with the State and other related entities. International Accounting Standard 24 requires disclosure of material related party transactions.

- ☹ Related party disclosures are included in the Annual Report. Furthermore, various laws, including the procurement law, prohibit transactions between parties where there is a conflict of interest. However, much of government regulation gives only general definitions of related parties and provides no guidance on how to oversee or manage related party transactions so that they occur at arm's length. Given indications in the press of past abusive related party transactions, boards and executives may not be fully disclosing potential conflicts of interest, and control systems may not be sufficiently strong to prevent abuse.

Recommendation: The ENA board should develop and oversee the implementation of a conflict of interest/related party transaction policy and report annually on the effectiveness of the policy. Such reporting could be part of an annual governance report or of the annual financial reports.

Audit

Best practice requires that SOE annual financial reports be subject to audit by an independent external (non-state) auditor. The audit should be conducted in accordance with International Standards of Audit (ISA). The board has the responsibility for overseeing the auditor and the audit process and assuring that the external auditor is independent.

- ✔ ETESA's annual financial reports are audited by KPMG, a reputable independent auditing firm, which uses ISA as a matter of policy. This helps provide assurances that ETESA's financial reporting and disclosure fairly represent the enterprise. On the other hand, public disclosure is insufficient to tell whether the board actively oversees the audit process or whether it fulfills its obligations under best practice to oversee the auditor's independence. So, for example, the ETESA board should be in a position to explain why they remain confident that the external auditor is able to maintain their independence, despite auditing ETESA for at least 8 years.

Recommendation: The ETESA board should report on its responsibilities for the oversight of the annual independent auditor including its approach to ensuring auditor independence.

The responsibilities of the board

Role and powers

Best practice suggests that the board should have a clear mandate and ultimate responsibility for the SOE's performance. SOE boards should not merely be conduits for receiving instructions from political powers. Nor should their main role be to ensure compliance with political orders. The board should understand its legal obligation to act in the best interest of the SOE. It should have the power to set strategy, supervise management, as well as to hire and fire the CEO. The board should be able to decide (subject to limitations set by the State) on the CEO's compensation, and ensure that the remuneration of top executives be tied to the achievement of objectives.

- ⊖ The law under which ETESA was established clearly describes the board's mandate. However, public disclosure is insufficient to determine the degree to which the board exercises its duties of loyalty and care of the SOE under company law. Nor could it be determined the extent to which the board might be subject to political influence. The board does have the explicit power to hire and fire the CEO though, practically, it is unlikely that this power would be exercised without the approval of the Presidency of the Republic. No information was publicly available to confirm the board's responsibility for strategy or top executive remuneration. Recommendation: SOE boards cannot deviate from the laws under which they are established. Nevertheless, ETESA could enhance its board's responsibilities in its bylaws or in a board charter. The analysis of various ETESA disclosures suggests that the board's understanding of its responsibilities differs from best

practice. This problem applies to all SOEs in this survey. As a consequence, training for all existing and potential board members should become mandatory.

Nominations

According to best practice, all board members should be nominated based on merit. The rules and procedures for nominations should be transparent and appointments should be based on professional criteria and a competitive selection process. Independent search experts may be used to enhance the process. In addition, the SOE should have some say in the selection process.

- ❌ The authority for nominations is set down in the law whereby ETESA was established. However, as with the other SOEs subject to this study, the process is not transparent, nor is there any indication that merit is the essential selection criterion. Public disclosure provides no indication that there is a competitive search process or that search consultants have ever been employed to find the best candidates for board appointments. The current process seems to rely on personal networks of contacts. Such a process may work when the nominating power has a good understanding of the needs of the SOE and of corporate governance processes, but is vulnerable to failure when the nominating power is less interested in assuring good governance processes.

Recommendation: ETESA has no power to make nominations. However, it is possible to create a process whereby ETESA's needs are taken into consideration. The goal should be to conduct annual evaluations of the board's needs and report these needs to nominating authorities when board posts become vacant. Potential nominees should be open to review by ETESA's executives and board members. The use of independent search consultants is also advised. Eventually, rules should be developed that prevent the complete change of board members as a result of election cycles in order to give the boards some level of stability. A proposal might be to only allow the change of a certain percentage of the board, as a result of a change in Government administration. Another proposal would be to stagger board terms (i.e., have them end at different times).

Composition

The board should be diverse with competencies useful to the SOE. It should have some private sector experience and an appropriate gender mix. Board members should be free from political links and should not represent interest groups. Board members linked to the Executive Body should not serve on the board and the number of civil servants should be kept small.

- ❌ The composition of the ETESA board is not publicly disclosed. However, questions should arise regarding its composition and diversity since 4 members are nominated by the Executive Body (by political powers) and the remaining member is nominated by an interest group (in this case, labor).

Recommendation: First and foremost, ETESA needs to disclose full information on its board members. It is also suggested that nominating powers consider the need for diversity, experience and gender distribution.

Independence

Best practice in terms of board composition promotes objective, unpoliticized decision making in the interest of the SOE. A minimum number of independent board members should be required and the roles of chairman and CEO should be separated.

- ❌ Publicly available data was insufficient to verify the independence of board members. However, using a narrow definition of independence that would exclude close relationships with high political powers and, given that board members are nominated exclusively by the Executive Body, it is fair to assume that no truly independent members are on the board. All can be assumed to have political or other external loyalties. A positive point is that ETESA (as well as all other SOEs surveyed) separate the roles of chairman and CEO.

Recommendation: Independence is not a panacea and should never be considered a substitute for competence. Nevertheless, nominating powers should consider the need for objective judgement at the board level and nominate some independent-minded board members. One or two independent board members can have a positive impact on board deliberations and decisions. The status of independent board members should be disclosed as should the definition of independence used in determining their status.

Conflict of interest

Best practice boards should have policies and mechanisms in place to manage conflicts of interest. All board members should disclose potential conflicts of interest to the board in written form. In addition, board member interests should be clearly disclosed on the enterprise website. Systems of control need to ensure observance of the conflict of interest policy.

- ❌ There are legal requirements under law that public officials should not have conflicts of interest. However, the law is imprecise and proposes no systems for managing potential conflicts. Nor does it require board members to disclose potential conflicts publicly or to the board. ETESA covers the issue of conflict of interest in its Ethics Codes. However, there is no indication that there is a board-level policy or that the board has any mechanism to control potential conflicts of interest.

Recommendation: The ETESA board should establish a conflict of interest policy that goes beyond the requirements set by law. This policy should be disclosed on ETESA's website, along with the mechanisms for its implementation.

Structure and processes


Best practice suggests that the board consider establishing committees. The committee that is widely considered essential is the audit committee. Audit committees oversee a large number of issues related to the reporting and control environment. It may also be useful to establish remuneration and nominations committees. At the same time, board sizes should be kept reasonably small. The board should conduct an annual self-evaluation and develop a remedial action plan. All SOEs should have an internal audit function that has a direct reporting relationship to the independent members of the board.

- ⊖ According to publicly available information ETESA has no board committees, although it is unofficially reported that it is in the process of establishing an audit committee. ETESA's board size (5) is at the lower range suggested by best practice. ETESA has an internal auditor with a direct reporting relationship to the board and this is well-described in ETESA's disclosure. No annual evaluations are conducted of ETESA's governance.

Recommendation: ETESA should ensure that the planned audit committee complies with best practice. Ideally, an audit committee would be staffed by independent board members with experience in financial reporting and a knowledge of audit and the enterprise control environment. The board should conduct an evaluation of its own governance processes, possibly with the assistance of an independent external consultant, and devise an annual plan for removing any gaps between its governance and best practice. The fact that an annual governance evaluation takes place should be disclosed.

Corporate governance action plan prioritization

Implement	HIGHEST	<p>MODERATE BENEFIT HIGH CONTROL:</p> <p style="font-size: 48px; opacity: 0.5; text-align: center;">2</p> <ul style="list-style-type: none"> ▪ Provide feedback to nominating powers on desired board member profiles ▪ Develop a stakeholder policy and disclose an annual stakeholder report ▪ Institute a whistleblower policy and program ▪ Enhance disclosure of public interest commitments and advantages and disadvantages of ETESA compared to private sector 	<p>HIGHEST BENEFIT AND HIGH CONTROL:</p> <p style="font-size: 48px; opacity: 0.5; text-align: center;">1</p> <ul style="list-style-type: none"> ▪ Enhance CG disclosure ▪ Increase board responsibility for: control; risk; ethics; compliance; anti-corruption; and external audit and disclosure thereof ▪ Establish policies on conflict of interest and political contributions ▪ Establish an audit committee ▪ Annual evaluation of CG and board ▪ Mandatory national training for all board members on best CG practice
	LOWER	<p>MODERATE BENEFIT LOW CONTROL:</p> <p style="font-size: 48px; opacity: 0.5; text-align: center;">4</p> <ul style="list-style-type: none"> ▪ Increase legal board size to permit more independent board members and more diversity 	<p>HIGHEST BENEFIT AND LOW CONTROL:</p> <p style="font-size: 48px; opacity: 0.5; text-align: center;">3</p> <ul style="list-style-type: none"> ▪ Board nominations processes should be depoliticized, transparent and merit-based and aim at diversity ▪ Protect board from changing political tides ▪ More financial experience on board ▪ Legal responsibilities of board should be enhanced and closer to best practice ▪ Nominate minimum number of independent board members
	LOWER		HIGHEST



Expected Benefit of Reform

IDAAN Corporate Governance Report

Background

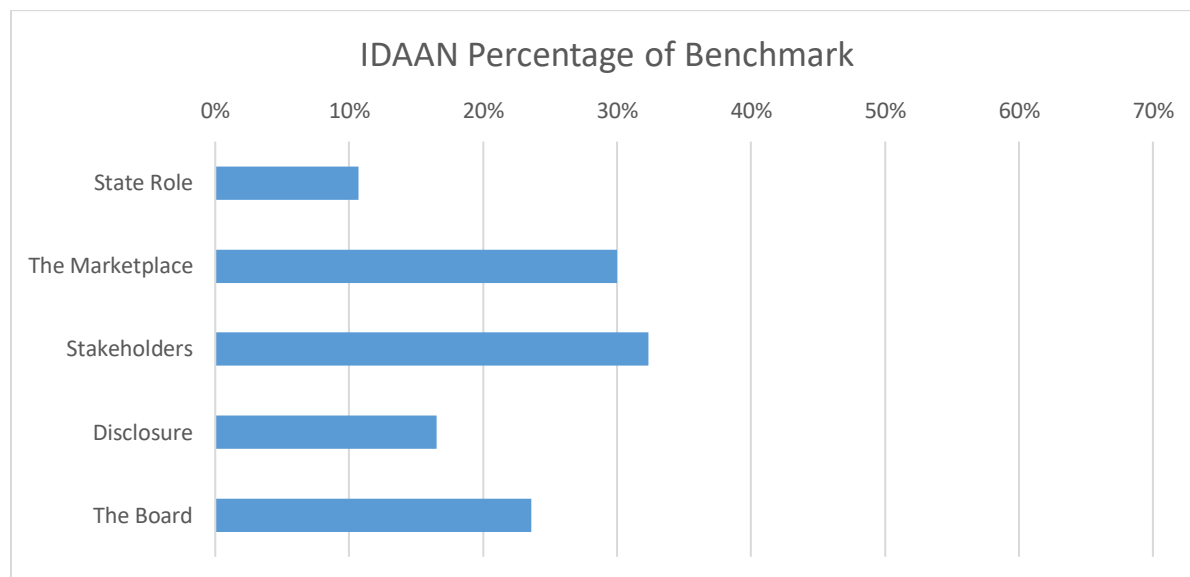
<i>IDAAN Summary Data</i>									
Legal structure: Autonomous state entity	<i>Board size: 7</i>								
Establishing law: Law 77 of 2001	<p>A pie chart illustrating the composition of the 7-member board. The largest slice is orange, representing 'Other constituency' with 5 members. A smaller blue slice represents 'Government' with 2 members. The 'Independent' category is listed as 0 members.</p> <table border="1"> <caption>Board Composition Data</caption> <thead> <tr> <th>Category</th> <th>Count</th> </tr> </thead> <tbody> <tr> <td>Other constituency</td> <td>5</td> </tr> <tr> <td>Government</td> <td>2</td> </tr> <tr> <td>Independent</td> <td>0</td> </tr> </tbody> </table>	Category	Count	Other constituency	5	Government	2	Independent	0
Category		Count							
Other constituency		5							
Government		2							
Independent		0							
Activity: Water and sanitation									
Percentage state ownership: 100%									
Bond financing: No									
Financial reports: Public sector accounting									
Auditor: No independent external audit	Women: 1, from unions								
<i>Board Composition</i>									
<i>Government</i>									
The Minister of Health	Representative of Executive Body								
<i>Civil Society Organizations</i>									
Panamanian Association of Company Executives	Panamanian Society of Engineers and Architects								
Panamanian Chamber of Construction	Association of Property Owners								
Representative of a recognized workers' organization									

Main corporate governance challenges

IDAAN's corporate governance as a state autonomous entity is different from that of a statutory limited liability company. One area where there are significant differences between IDAAN and other SOEs is in the disclosure of financial and other governance-related information. The lack of annual IFRS reports means that information on IDAAN's governance is scarce. Limited liability companies generally operate according to standards that are closer to best practice.

IDAAN is conscious of the fact that some of its governance practices limit it in its capacity to provide the public services contemplated in its mission. It is in the process of evaluating its governance practices with the goal of developing an improvement plan whose object is to improve its capacity to fulfill its mission.

Performance by corporate governance category



Performance by governance sub-indicator

<i>CG Category</i>	<i>Corporate governance sub-indicator</i>	<i>Evaluation</i>
The state's role as an owner	• Undue interference by the state into SOE and SOE autonomy	⊖
	• Board nominations processes	✗
The marketplace	• No undue advantage or disadvantage versus private sector	⊖
	• Distinction and separation of state functions from SOE functions	⊖
Stakeholders and responsible business	• Stakeholders and responsible business conduct	⊖
	• Board responsibility for controls	✗
	• Use of SOE for political purposes	?
Transparency and disclosure	• Financial reporting	✗
	• Disclosure on public interest commitments	⊖
	• Governance	✗
	• Risk	✗
	• Related parties	✗
	• Audit	✗
The responsibilities of the board	• Role and powers	⊖
	• Nominations	✗
	• Composition	✗
	• Independence	✗
	• Conflict of interest	✗
	• Structure and processes	⊖

Discussion and recommendations

The state's role as an owner

Undue interference by the state into SOE and SOE autonomy

Best practice suggests that the state not interfere unduly in the business and/or operational decisions of the SOE. It also suggests that the board be able to act autonomously, without political interference, and that it be ultimately responsible and accountable for SOE performance.

- ☹ Publicly available information is insufficient. Despite the fact that it is not corporatized, IDAAN is an autonomous state entity with control over its own finances. There is no evidence of direct political intervention in its affairs. Yet, certain contracting and financial decisions are subject to approval by the Executive Body, while the budget is approved by the cabinet and the National Assembly. IDAAN funds must be deposited in specific banks, while the Ministry of Health has the final say on some issues. Given its legal structure, there is reason to believe that the board is neither autonomous nor ultimately responsible for the SOE's performance as the OECD Guidelines would suggest.

Recommendation: Ideally, IDAAN should be corporatized. Despite the fact that corporatization, by itself, would not result in major changes in governance practices, two immediate benefits would be the requirement to produce IFRS based financial statements and the conduct of an independent external audit. Modernizing the legal structure of IDAAN could result in a board and governance practices more in line with best practice.

Board nomination processes

According to best practice, board members should be nominated through an open and transparent process that yields a diverse board composed of members chosen based on merit and who are able to exercise objective judgment on SOE affairs free from political influence.

- ☹ The composition of IDAAN's board differs somewhat from the other SOEs in the survey. IDAAN's founding law requires the Minister of Health to be a board member. A single additional board member is nominated by the Executive Body. The other members are representatives of civil society. Civil society representatives are subject to ratification by the National Assembly and all board members must be ratified by the Executive Body. Such a process makes the board directly beholden to political powers and vulnerable to changes as a result of changes in the administration.

Recommendation: The board nominations process needs to be more transparent and have less political influence with the goal of having a more professional and stable board. This may require changes to the law establishing IDAAN or it may be addressed through corporatization.

No undue advantage or disadvantage versus private sector

Best practice suggests that the SOE not have any undue advantage or disadvantage with respect to other SOEs or the private sector. The SOE should not have any special legal or tax exemptions, and should receive its financing under market conditions.

- ☹ IDAAN aims mostly at the achievement of social goals and is subsidized by the State. It benefits from tax exemptions, lending on preferential terms and a variety of other benefits. It must, at the same time, comply with regulations like any private sector company. IDAAN works through private sector contractors who are supposed to operate under market conditions and without any undue advantage or disadvantage compared to other private sector entities.

Recommendation: IDAAN may wish to include a discussion of competitive neutrality and its relations with the private sector in its annual report or in an annual governance report.

Distinction and separation of state functions from SOE functions

According to best practice, there is a clear separation between the State, the SOE and regulatory functions. Public procurement should be competitive, non-discriminatory and transparent.

- ☹ Tariffs are set by an independent regulator (Ente Regulador de los Servicios Públicos). This suggests a separation between regulation and policy making. The degree to which other regulatory functions may be carried out via the supervising line ministry was not ascertained from public disclosure. However, policy and operational functions seem closely linked as witnessed by the fact that the Minister of Health is on the board. IDAAN must comply with public sector procurement laws which seek to ensure competitive, non-discriminatory and transparent procurement.

Recommendation: IDAAN's current legal structure as an autonomous state entity may not create sufficiently clear distinctions between operations, the ownership functions of the State, and regulatory functions. A longer-term goal may be to reconsider IDAAN's legal structure with a view to a better definition of these different functions and greater distinctions in practice.

Stakeholders and responsible business conduct

Best practice suggests that the SOE recognize and respect stakeholder rights, as well as develop and disclose a stakeholder policy. Large SOEs should issue an annual stakeholder report on stakeholder relations. In addition, stakeholders should be provided with relevant information on a timely basis. In addition, SOEs should observe high standards of responsible business conduct and disclose compliance mechanisms.

- ☹ The rights of stakeholders are extensive and are protected by the law whereby IDAAN was established, as well as laws on public sanitation, user rights and consumer protection. General standards of business conduct are specified in the ethics code promulgated under Executive Decree 246. There is no stakeholder or responsible business conduct policy developed directly by IDAAN. IDAAN reports on client/stakeholder interactions. The Social Management Report (Reporte de Gestión Social) is a weak document that focuses narrowly on stakeholder consultations. On the other hand, the section on public relations in the Annual Review (Memoria de 2014) illustrates active communications with stakeholders.

Recommendation: Stakeholder relations and responsible business conduct policies are largely embodied in law. It is uncertain the degree to which IDAAN has taken ownership of these policies as its disclosure appears, at times, half-hearted. Better disclosure of stakeholder and business social responsibility policies is encouraged in an annual stakeholder report.

Board responsibility for controls

According to best practice, the board is expected to develop, implement, and monitor internal controls, ethics, compliance, and anti-corruption programs. The SOE should have standards of responsible business conduct and disclose mechanisms for ensuring their implementation. Best practice suggests that SOEs establish whistleblowing policies and procedures.

- ☹ IDAAN has internal controls which are responsible for protecting against corruption. However, public information on IDAAN's controls is limited and there is no indication that the board oversees their implementation or that it takes responsibility for their proper functioning. The section on internal audit of the Annual Review of 2014 (Memoria 2014) shows that internal audit investigates complaints, but no further detail are provided, and there is no indication of a formal whistleblower program.

Recommendation: The board needs to take responsibility for the development, implementation and monitoring of internal controls, ethics, compliance and anti-corruption programs. It should not rely only on the law for ensuring that relevant policies and systems are in place. The board's responsibility should be disclosed as should its actions in support of strong corporate controls.

IDAAN may wish to consider the use of an independent service provider to manage its whistleblower program.

Use of the SOE for political purposes

Best practice requires that SOEs not make political campaign contributions or finance political activities, or run charities or provide social services that are outside of its main area of activity.

- ① IDAAN does not disclose a formal policy on political contributions nor is there any publicly available information that suggests that IDAAN makes such contributions. In principle, financing of political activities should not be possible since IDAAN's budget, which is examined by the General Comptroller's Office, does not include any line items for those activities.

Recommendation: IDAAN should develop a policy statement on political contributions, disclose it on its website and ensure that the policy is enforced.

Transparency and disclosure

Financial reporting

Best practice recommends that SOEs produce annual financial reports in line with International Financial Reporting Standards (IFRS). A directors' report should be part of the annual financial statement.

- ✔ No annual financial reports were available on IDAAN's website though some monthly financial figures are provided. The law establishing IDAAN does not specify any particular accounting standard though it can be surmised that this would be public sector accounting. (It should be noted that best practice in public sector accounting is increasingly taken to be IFRS.) Disclosure is voluminous and detailed. Some elements required under the transparency law are missing and others appear hastily prepared. Some disclosures are technical documents without discussion or analysis.

Recommendation: IDAAN needs to publish annual financial reports. Ideally, these should be produced using IFRS and be audited by an independent external auditor. The board should oversee this responsibility. Overall disclosure should focus less on volume and technical content, and more on providing interesting and useful information.

Disclosure on public interest commitments

Best practice is that SOE reports include information on areas of significant concern to the state and the general public, and provide statements on activities carried out in the public interest including financial and operating results associated with the achievement of public policy objectives. SOEs should also disclose financial assistance, guarantees, and any other commitments made by them or to them by the state.

- ☹ IDAAN provides public interest reporting in its strategic plan (the last of which was from 2012) and its Annual Review 2014 (Memoria). These appear to be relatively technical documents that do not focus as such on activities carried out in the public interest or the fulfillment of policy objectives. The Review provides mainly a description of IDAAN's different operational divisions and its regional authorities.

Recommendation: IDAAN could enhance its disclosure on public interest commitments within its Annual Review by providing high-level information on its mandates and their fulfillment. Similarly, it would be useful to add information on state support in exchange for commitments.

Corporate governance

A best practice is that SOEs report on their governance. Disclosures should, at a minimum, include the identity of board members, their qualifications, other posts held, the selection process, and the degree of

board diversity. Information should be sufficient to assess board members' contributions to the SOE, competence, potential conflicts of interest, and independence.

- ✘ Governance disclosure at IDAAN (as well as in other surveyed SOEs) is deficient. This being said, IDAAN and Metro de Panama were the only SOEs among the study group to disclose the identity of their board members. However, this positive feature does not make up for the lack of other governance disclosure.

Recommendation: IDAAN needs to improve its governance disclosure. It should devote a special section of its website to governance and include, among other things, information on board members, conflict of interest policies, and so on. In addition, it should consider issuing a separate annual report on its governance, perhaps as a section of its Annual Review. A detailed list of common governance disclosures is included in the annex. Governance disclosure should be made under the responsibility of the board.

Risk

Best practice suggests that SOEs disclose material foreseeable risk factors and remedial measures, and the systems they use to identify, manage, control and report on risks.

- ✘ IDAAN's Annual Review makes reference to the control of risk, however, the mention is limited. Furthermore, neither the board's responsibility for risk oversight nor any remedial measures are disclosed.

Recommendation: The IDAAN board should acknowledge its responsibility for risk oversight, ensure that proper systems are in place, and describe its risk oversight activities in the Annual Review.

Related parties

Best practice requires disclosure of material transactions with the State and other related entities. International Accounting Standard 24 requires disclosure of material related party transactions.

- ✘ Normally, related party transactions would be disclosed in an IFRS compliant annual financial report. Since IDAAN does not produce such reports, no consolidated information is available on related party transactions though it is possible to piece together information from government decrees and press reports. No information is available on IDAAN's policies with respect to related parties and/or conflicts of interest or systems for enforcement.

Recommendation: The IDAAN board should develop and oversee the implementation of a conflict of interest/related party transaction policy and report annually on the effectiveness of the policy. Such reporting could be part of the Annual Review.

Audit

Best practice requires that SOE annual financial reports be subject to audit by an independent external (non-state) auditor. The audit should be conducted in accordance with International Standards of Audit (ISA). The board has the responsibility for overseeing the auditor and the audit process and assuring that the external auditor is independent.

- ✘ Law 77, which provides for IDAAN's establishment, also calls for an annual audit by a reputable audit firm. There is, however, no specification in the law of the audit standard to be used. Public information is insufficient to ascertain if an annual audit occurs. And, while it is assumed that IDAAN is subject to state audits, these are no substitute for an external audit. No information on any past state audit was disclosed.

Recommendation: IDAAN's financial reports should be audited by an independent external auditor under ISA and then disclosed.

The responsibilities of the board

Role and powers

Best practice suggests that the board should have a clear mandate and ultimate responsibility for the SOE's performance. SOE boards should not merely be conduits for instructions from political powers. Nor should their main role be to ensure compliance with political orders. The board should understand its legal obligation to act in the best interest of the SOE. It should have the power to set strategy, supervise management, as well as to hire and fire the CEO. The board should be able to decide (subject to limitations set by the state) on the CEO's compensation, and ensure that the remuneration of the top executives be tied to the achievement of objectives.

- ☹ The law under which IDAAN was established clearly describes the board's mandate. Board members have no explicit duty of loyalty or care to the SOE since IDAAN is not established under company law. A positive is that the CEO post is open for tender and the search procedure and candidate profile are the responsibility of the board. A negative is that the CEO's term is directly linked to the approval and term of the Presidency of the Republic. No information was publicly available to confirm the board's responsibility for strategy. The board has no power over the CEO's remuneration as this is set by law to be equivalent to that of a minister. Other remuneration is set according to government pay scales.

Recommendation: SOE boards cannot deviate from the laws under which they are established. Nevertheless, IDAAN could enhance its board's responsibilities in its bylaws or in a board charter and seek to adopt some elements of best practice. Training for all existing and potential board members should become mandatory so that they become familiar with best practice standards.

Nominations

According to best practice, all board members should be nominated based on merit. The rules and procedures for nominations should be transparent and appointments should be based on professional criteria and a competitive selection process. Independent search experts may be used to enhance the process. In addition, the SOE should have some say in the selection process.

- ✘ The power to nominate is set down in the law whereby IDAAN was established. Most of IDAAN's board members are nominated by interest groups subject to approval by the President of the Republic. As with the other SOEs in this study, the process is not transparent, nor is there any indication that merit is the essential selection criterion. There is no indication that there is a competitive search process or that search consultants have ever been employed to find the best candidates for board appointments.

Recommendation: IDAAN has no power to make nominations. This power lies mainly with the Presidency of the Republic and with interest groups. It may, however, be possible to create a process whereby merit and IDAAN's needs are taken into consideration. Eventually, rules should be developed to prevent the complete change of board members as a result of election cycles. A proposal might be to maintain a certain percentage or number of board members irrespective of changes in government administration. Another proposal would be to stagger board terms (i.e., have them end at different times).

Composition

The board should be diverse and have competencies useful to the SOE. It should have some private sector experience and an appropriate gender mix. Board members should be free from political links and should not represent interest groups. Members linked to the Executive Body should not serve on the board and the number of civil servants should be kept small.

- ✘ IDAAN provides good disclosure on its board composition. The IDAAN board differs from others in that 5 of its 7 board members are nominated by interest groups and not directly by political powers. If this creates a different power balance or board dynamics compared to the other SOEs could not be determined. It was noted in the board member disclosure that some of board members have designated alternates, which is not typically a good practice.

Recommendation: It is suggested that the Presidency of the Republic and IDAAN's other interest groups nominate board members exclusively based on the criterion of merit. Those having nominating powers should consider the need for diversity, experience and gender distribution. The use of alternates should only occur under unusual circumstances and should not become a regular practice.

Independence

Best practice in terms of board composition promotes objective, unpoliticized decision making in the interest of the SOE. A minimum number of independent board members should be required. The roles of Chairman and CEO should be separated.

- ✘ According to common definitions of independence, none of IDAAN's board members would qualify as independent. All can be assumed to have either political or other external loyalties. A positive point is that IDAAN (as well as all other SOEs surveyed) separate the roles of chairman and CEO.

Recommendation: Independence is not a panacea and should never be considered a substitute for competence. Nevertheless, nominating powers should consider the need for objective judgement at board level and nominate some independent-minded board members. One or two independent board members can have a positive impact on board deliberations and decisions. The status of independent board members should be disclosed as should the definition of independence used in determining their status.

Conflict of interest

Boards operating according to best practice should have policies and mechanisms in place to manage conflicts of interest. All board members should disclose potential conflicts of interest to the board in written form. In addition, board member interests should all be clearly disclosed on the enterprise website. Systems of control need to ensure observance of the conflict of interest policy.

- ✘ There are legal requirements under law prohibiting public officials from having conflicts of interest. However, the law is imprecise and proposes no systems for managing potential conflicts. Nor does it require board members to disclose potential conflicts publicly or to the board. There is no indication that there is a board-level conflict of interest policy or that the board has any mechanism to control potential conflicts of interest.

Recommendation: The IDAAN board should establish a conflict of interest policy that goes beyond the requirements set by law. This policy should be disclosed on IDAAN's website, along with the mechanisms for its implementation.

Structure and processes

Best practice suggests that the board consider establishing committees. The committee that is widely considered essential is the audit committee. Audit committees oversee a large number of issues related to the reporting and control environment. It may also be useful to establish remuneration and nominations committees. At the same time, board sizes should be kept reasonably small. The board should conduct an annual self-evaluation and develop a remedial action plan. All SOEs should have an internal audit function that has a direct reporting relationship to the independent members of the board.

- ⊖ According to publicly available information IDAAN has no board committees. IDAAN's board is appropriately sized at 7 members. IDAAN has an internal auditor, however, there is no disclosure that confirms a direct reporting relationship to the board. Likewise, there is no disclosure that confirms that annual evaluations are conducted of IDAAN's own governance.

Recommendation: IDAAN should consider establishing an audit committee. Ideally, an audit committee should consist of independent board members with experience in financial reporting and a knowledge of audit and the enterprise control environment. The board should conduct an evaluation of its own governance processes, possibly with the assistance of an independent external consultant, and then devise an annual plan for a better approximation to best practice.

Corporate governance action plan prioritization

Implementation	HIGHEST	2	<p>MODERATE BENEFIT HIGH CONTROL:</p> <ul style="list-style-type: none"> ▪ Provide feedback to nominating powers on desired board member profiles ▪ Develop a stakeholder policy and disclose an annual stakeholder report ▪ Institute a whistleblower policy and program ▪ Enhance disclosure of public interest commitments and advantages and disadvantages of IDAAN compared to private sector 	<p>HIGHEST BENEFIT AND HIGH CONTROL:</p> <ul style="list-style-type: none"> ▪ Disclose annual IFRS financial reports and enhance CG disclosure ▪ Increase board responsibility for: control; risk; ethics; compliance; anti-corruption; and external audit and disclosure thereof ▪ Establish policies on conflict of interest and political contributions ▪ Establish an audit committee ▪ Enhance governance disclosure ▪ Annual evaluation of CG and board ▪ Mandatory training for all board members on best CG practice
	LOWER	4	<p>MODERATE BENEFIT LOW CONTROL:</p> <ul style="list-style-type: none"> ▪ Increase legal board size to permit more independent board members and more diversity 	<p>HIGHEST BENEFIT AND LOW CONTROL:</p> <ul style="list-style-type: none"> ▪ Introduce IFRS accounting ▪ Introduce external independent audit ▪ Corporatize ▪ Board nominations processes should be transparent, merit-based and aim at diversity ▪ Protect board from political tides ▪ Legal responsibilities of board should be enhanced and closer to best practice ▪ Nominate minimum number of independent board members
	LOWER			HIGHEST
Expected Benefit of Reform				

Metro de Panama Corporate Governance Report

Background

<i>Metro de Panama Summary Data</i>	
Legal structure: Statutory limited liability company (SA)	Board size: 7
Establishing law: Law 109 of 2013	<p>A pie chart illustrating the composition of the board. The chart is divided into three segments: a large blue segment representing 'Government' with a value of 5, a smaller orange segment representing 'Other constituency' with a value of 2, and a very small white segment representing 'Independent' with a value of 0.</p>
Activity: Metropolitan transit	
Percentage state ownership: 100%	
Bond financing: No	
Financial reports: Not publicly disclosed	
Auditor: Not publicly disclosed	Women: 0
<i>Board Composition</i>	
<i>Government</i>	
Representative designated by the President of the Republic who shall be Chairman	Representative designated by the Executive Body
The Minister of Public Works	Minister of Economy and Finance
Head of the Ground Transit and Transport Authority	
<i>Civil Society Organizations</i>	
National Council of Private Enterprise	Panamanian Chamber of Construction

Main corporate governance challenges

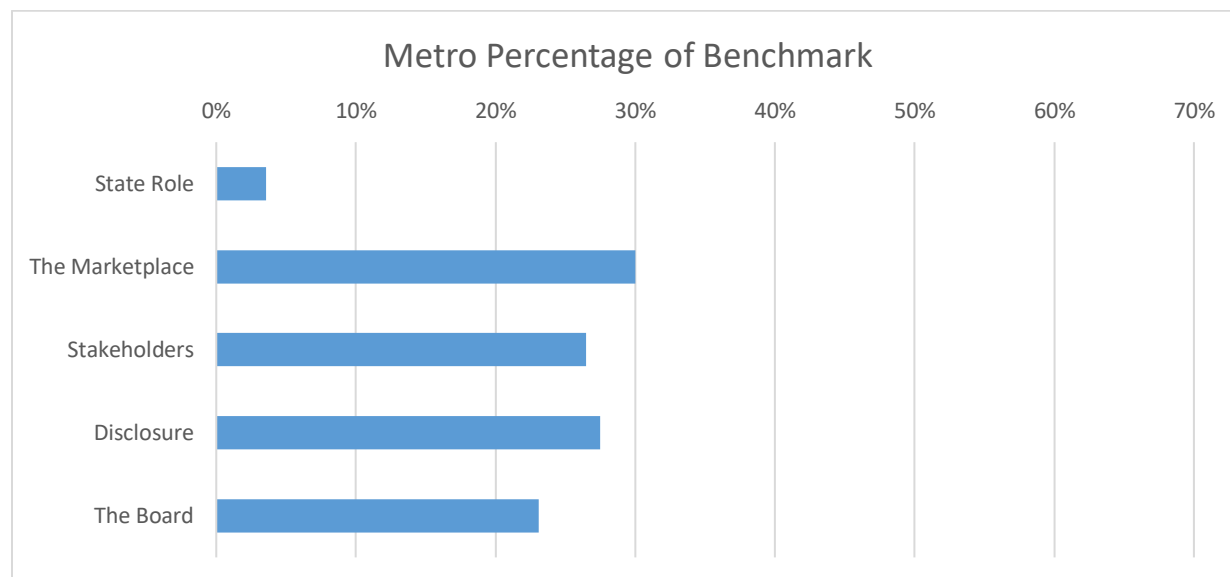
One of the main differences between Metro's corporate governance and best practice is the lack of financial statements audited according to IFRS. Statements based on IFRS generally have information on corporate governance, in particular: transactions with related parties; financial relations with the State; risk and risk management; board responsibilities; and control among other things. Metro submits financial reports to the Ministry of Economy and Finance. However, such statements would not be produced according to IFRS nor audited according to ISA. Metro explains the lack of financial statements as a result of its transformation in 2013 into a limited liability company and ongoing technical difficulties related to its transition to SAP corporate management software.

The Metro board has a strong representation of ministers, individuals closely related to the government and interest groups. Best practice is, normally, inclined towards fewer such figures. However, Metro considers strong government representation on the board as an asset and a necessary tool to help achieve its infrastructure and investment goals even though such a board composition may not be optimal in the longer run. Reports from Metro suggest that three of the seven board members are independent. The independent board members are not identified in public disclosure, nor is it clear what definition of independence is being used.

Metro has identified three key short-term governance challenges: a) production and publication of audited IFRS financial statements; b) enhanced corporate governance disclosure; and c) the establishment

of a best practice board audit committee. These changes would represent significant steps towards better governance and better governance disclosure.

Performance by corporate governance category



Performance by corporate governance sub-indicator

<i>CG Category</i>	<i>Corporate governance sub-indicator</i>	<i>Evaluation</i>
The state's role as an owner	• Undue interference by the state into SOE and SOE autonomy	?
	• Board nominations processes	✗
The marketplace	• No undue advantage or disadvantage versus private sector	=
	• Distinction and separation of state functions from SOE functions	=
Stakeholders and responsible business	• Stakeholders and responsible business conduct	=
	• Board responsibility for controls	✗
	• Use of SOE for political purposes	?
Transparency and disclosure	• Financial reporting	✗
	• Disclosure on public interest commitments	=
	• Governance	=
	• Risk	✗
	• Related parties	✗
	• Audit	✗
The responsibilities of the board	• Role and powers	=
	• Nominations	✗
	• Composition	✗
	• Independence	?
	• Conflict of interest	✗
	• Structure and processes	=

Discussion and recommendations

The state's role as an owner

Undue interference by the State into SOE and SOE autonomy

Best practice suggests that the state not interfere unduly in the business and/or operational decisions of the SOE. It also suggests that the board be able to act autonomously, without political interference, and that it be ultimately responsible and accountable for SOE performance.

- ❓ Metro has considerable autonomy according to the law under which it was established and there is no evidence of direct political intervention in its affairs. Despite the absence of evidence of undue interference, the preponderance of ministers on Metro's board suggests that political figures dominate the board's deliberations and the decisions of the enterprise. Metro itself reports that government figures on the board are an asset and permit Metro to: a) be more flexible; b) cut through bureaucracy; and c) be more effective in achieving its strategic goals.

Recommendation: No recommendation is made because undue interference or limitations to Metro's autonomy cannot be confirmed. Nevertheless, Metro's board composition suggests a close integration of the State and the board. The issue of board composition thus remains an important concern. Recommendations on board composition are found below.

Board nomination processes

According to best practice, board members should be nominated through an open and transparent process that yields a diverse board composed of members chosen based on merit and who are able to exercise objective judgment on SOE affairs free from political influence.

- ✘ The board's composition is clearly set out in the law whereby Metro was established, although the actual process of nomination is not transparent. There is no indication that the board is either diverse or that its members are selected based on merit, or that they can exercise objective judgement free from political influence. Metro's board is dominated by government appointments and government representatives who are members due to their government posts (The Minister of Public Works, the Minister of Economy and Finance and the Head of the Ground Transit and Transportation Authority). This approach to nominations makes the board directly beholden to political powers and vulnerable to changes as a result of changes in government administration.

Recommendation: The board nominations process needs to be more transparent and result in less political linkages between board members and the administration, with a view to having a more professional and stable board. This may require changes in the law under which Metro was established. In addition, the Presidency of the Republic should focus on nominating board members who correspond to best practice.

No undue advantage or disadvantage versus private sector

Best practice suggests that the SOE not have any undue advantage or disadvantage with respect to other SOEs or the private sector. The SOE should not have any special legal or tax exemptions, and should obtain its financing under market conditions.

- ⊖ There is very little information available to support an opinion on competitive neutrality. Metro benefits from tax exemptions, loans with preferential terms and a variety of other benefits. Metro considers that this special treatment is justified, inasmuch as it is in an investment phase, operating for the public good and because it does not compete directly with the private sector. It was not impossible to assess the degree to which financing was received on market conditions. Metro is required to comply with regulation like any private sector company and is free to contract banking services as it chooses.

Recommendation: Metro should disclose information on the degree to which it adheres to the concept of competitive neutrality with the private sector.

Distinction and separation of state functions from SOE functions

According to best practice, there is a clear separation between the State, the SOE and regulatory functions. Public procurement should be competitive, non-discriminatory and transparent.

- ⊖ There is insufficient information to assess the degree to which the regulatory, oversight and operational functions of the SOE are separated. As noted above, the board's composition raises concern regarding such separation. Metro must comply with public sector procurement laws which seek to ensure competitive, non-discriminatory and transparent procurement.

Recommendation: Metro should determine whether regulatory and pricing decisions are made by the same individuals who make operational decisions and those individuals who have responsibility for setting state policies. Efforts should be made to separate these three functions as they can have conflicting goals and lead to decision making at the board level that is not in the interest of the SOE.

Stakeholders and responsible business conduct

Best practice suggests that the SOE recognize and respect stakeholder rights, as well as develop and disclose a stakeholder policy. Large SOEs should issue an annual report on stakeholder relations. In addition, stakeholders should be provided with relevant information on a timely basis. SOEs should observe high standards of responsible business conduct and disclose compliance mechanisms.

- ⊖ Various stakeholder and client rights including consultation rights are established by law. General standards of business conduct are specified in the ethics code promulgated under Executive Decree 246. Metro does not produce a consolidated stakeholder report.

Recommendation: Stakeholder relations and responsible business conduct policies are largely embodied in the law. Metro should disclose its stakeholder and business social responsibility policies in an annual stakeholder report.

Board responsibility for controls

According to best practice, the board is expected to develop, implement, and monitor internal controls, ethics, compliance, and anti-corruption programs. The SOE should have standards of responsible business conduct and disclose mechanisms for ensuring their implementation. Best practice suggests that SOEs establish whistleblowing policies and procedures.

- ✖ There is no disclosure that confirms the board's role as specified above. However, according to informal sources, Metro is in the process of establishing an audit committee of the board. If the role of the audit committee corresponds to best practice, this would be a significant step forward. Law 109 whereby Metro was established, specifies that the external auditor has the role of detecting corruption. In practice, auditors are not usually expected to fulfill this role. There is the ability to file complaints as a consumer. However, disclosure does not show that Metro has an organized whistle-blower program.

Recommendation: The board needs to take responsibility for the development, implementation and monitoring of internal controls, ethics, compliance and anti-corruption programs. A key step in this respect is the establishment of the board's audit committee which is apparently already in process. Metro must ensure that the role and responsibilities of the new audit committee correspond to best practice. The board's responsibility for the control environment should be disclosed as should its actions in support of corporate controls. Metro may wish to consider the use of an independent service provider to manage its whistleblower program.

Use of the SOE for political purposes

Best practice requires that the SOE not make political campaign contributions or finance political activities, or run charities or provide social services that are outside of its main area of activity.

- ❓ Metro does not disclose a formal policy on contributions nor is there any publicly available information that suggests that Metro makes such contributions. Metro sources indicate that such use of funds cannot occur.

Recommendation: Metro should develop a statement regarding its restrictions on political contributions, disclose it on its website and ensure that it is enforced.

Transparency and disclosure

Financial reporting

Best practice recommends that SOEs produce annual financial reports in line with International Financial Reporting Standards (IFRS). A directors' report should be part of the annual financial report

- ✘ No annual financial report was available on Metro's website. Metro as a public limited liability company should be expected to produce audited annual financial reports according to IFRS. This is one of the most significant weaknesses in Metro's corporate governance. Metro reports that the absence of an annual financial report is mainly due to difficulties with the implementation of the SAP business management software, as well as the fact that Metro is still in a period of transition from a state administration to a statutory limited liability company. Metro provides financial reports to the Ministry of Economy and Finance, but such reports are neither IFRS compliant nor audited according to ISA.

Recommendation: Metro needs to publish annual financial reports on a timely basis. Reports should be produced according to IFRS and audited by a reputable independent external auditor applying International Standards of Audit (ISA). The board should acknowledge its responsibility for the reporting process.

Disclosure on public interest commitments

- ☹ Best practice is that SOE reports include information on areas of significant concern to the state and the general public, and provide statements on activities carried out in the public interest including financial and operating results associated with the achievement of public policy objectives. SOEs should also disclose financial assistance, guarantees, and any other commitments made by them or to them by the State. Metro makes significant public interest disclosure on its website that describes construction projects, progress against plans, tenders, complaints, and so on. However, such disclosure is not consolidated, nor does it contain a high-level discussion of policy goals, the means to achieve these goals, or a consolidated overview of the financial conditions under which Metro carries out its public commitments.

Recommendation: It would be useful to have an aggregated report on Metro's public interest commitments, its progress against commitments, and its agreements with the State in support of achieving such commitments.

Corporate governance

A best practice is that SOEs report on their corporate governance. Disclosures should, at a minimum, include the identity of board members, their qualifications, other posts held, the selection process, and

the degree of board diversity. Information should be sufficient to assess board members' contributions to the SOE, competence, potential conflicts of interest, and independence.

- ☹ The disclosure on Metro board members is very good providing all of the information necessary to assess the potential for conflicts of interest and independence. Furthermore, Metro's web disclosure is one of the better organized among the study group. This does not, however, make up fully for other corporate governance disclosures that are ignored, in particular, regarding policies such as conflicts of interest and the board's responsibility for ensuring that systems of control are in place and functioning properly.

Recommendation: Metro needs to improve its governance disclosure. It should devote a special section of its website to corporate governance and include, among other things, an annual governance report, conflict of interest policies, related party transaction policy, board nominations policy, risk management and so on. A detailed list of common governance disclosures (some of which Metro already makes) is included in the annex.

Risk

Best practice suggests that SOEs disclose material foreseeable risk factors and remedial measures, and the systems they use to identify, manage, control and report on risks.

- ☹ In the absence of an IFRS based financial report, there is no disclosure on risk nor on the board's responsibility for risk oversight or any remedial measures.

Recommendation: The Metro board should acknowledge its responsibility for risk oversight, ensure that proper systems are in place, and describe its risk oversight. A discussion of risks and systems to manage them should be included in every annual financial report.

Related parties

Best practice requires disclosure of material transactions with the State and other related entities. International Accounting Standard 24 requires disclosure of material related party transactions. International Accounting Standard 24

- ☹ Normally, related party transactions would be disclosed in an IFRS compliant annual financial report. Since Metro does not disclose such reports, no consolidated information is available on related party transactions. There is no public information available on Metro's policies with respect to related parties or conflicts of interest or systems for their enforcement.

Recommendation: The Metro board should ensure the timely publication of audited IFRS financial statements. In addition, it should develop and oversee the implementation of a conflict of interest/related party transaction policy and report annually on the effectiveness of the policy.

Audit

Best practice requires that SOE annual financial reports be subject to audit by an independent external (non-state) auditor. The audit should be conducted in accordance with International Standards of Audit (ISA). The board has the responsibility for overseeing the auditor and the audit process to ensure that the external auditor is independent.

- ✘ No financial reports are disclosed, nor is there any information on the audit (neither independent nor state).

Recommendation: The Metro board should ensure the timely publication of audited financial statements prepared according to IFRS. Financial reports should be audited by a reputable independent external auditor using International Standards of Audit.

The responsibilities of the board

Role and powers

Best practice suggests that the board have a clear mandate and ultimate responsibility for the SOE's performance. SOE boards should not merely be conduits for instructions from political powers. Nor should their main role be to ensure compliance with political orders. The board should understand its legal obligation to act in the best interest of the SOE. The board should have the power to set strategy, supervise management, and hire and fire the CEO. The board should be able to decide (subject to limitations set by the State) on CEO compensation, and ensure that top executive remuneration is tied to the achievement of objectives.

- ⊖ The law under which Metro is established clearly describes the board's mandate and powers. The board has the power to appoint and remove the CEO and can decide CEO remuneration among other things. Despite the fact that the board has significant powers, the concern is that the board is too closely associated with political powers and serves as a conduit for instructions and is, therefore, not a truly autonomous or independent-minded institution. Having said this, Metro considers that its close relationship with the government is needed in order to advance its investment projects efficiently and effectively.

Recommendation: The powers of the board are provided in the law under which Metro was established. Altering these powers is outside of Metro's control. However, it may be possible for marginal changes to be made. The Metro board should conduct a self-evaluation, compare itself to best practice and adopt those elements which may be feasible. Training of all existing and potential board members should become mandatory so that they become familiar with best practice standards.

Nominations

According to best practice, all board members should be nominated based on merit. The rules and procedures for nominations should be transparent and appointments should be based on professional criteria and a competitive selection process. Independent search experts may be used to enhance the process. In addition, the SOE should have some say in the selection process.

- ⊗ The power to nominate board members is provided in the law whereby Metro was established. Two of Metro's board members are selected based upon their ministerial positions and one because they are the head of a state agency. An additional two are nominated by the Presidency of the Republic. Two are nominated by interest groups and all board members are subject to presidential approval. As with the other SOEs in this study, the process is not transparent, nor is there any indication that merit is the essential selection criterion. There is no indication that there is a competitive search process nor that search consultants have ever been employed to find the best candidates for board appointments.

Recommendation: At present, the identity of board members is determined by the law which will likely be difficult to change. However, there are two positions at the discretion of the Presidency of the Republic which could use its powers to select persons that may enhance diversity, independence, and provide other needed skills. In addition, it may be possible to create a process whereby merit and Metro's needs for specific board profiles are taken into consideration. Rules should be developed to prevent the complete change of board members as a result of election cycles. A proposal might be to maintain a certain percentage or number of board members irrespective of changes in government administration. Another proposal would be to stagger board terms (i.e., have them end at different times).

Composition

The board should be diverse and have competencies that may be useful to the SOE. It should have some private sector experience and an appropriate gender mix. Board members should be free from political links and should not represent interest groups. Board members linked to the Executive Body should not serve on the board and the number of civil servants should be kept small.

- ✘ The Metro board is composed of board members with active political roles, as well as members from important interest groups. This contrasts with best practice. In addition, the board appears to have limited capacity for independent judgment. This being said, the backgrounds of board members suggest that they are diverse and have significant competencies.

Recommendation: It is suggested that the Presidency of the Republic and Metro's interest groups constituencies nominate board members exclusively based on the criterion of merit. Nominating powers should consider the need for diversity, experience and gender distribution.

Independence

Best practice in terms of board composition promotes objective, unpoliticized decision making in the interest of the SOE. A minimum number of independent board members should be required and the roles of chairman and CEO should be separated.

- ✘ Metro considers that three of its board members are independent. However, due in part to the nominations process, which is totally controlled by the government, and using narrow definitions of independence, it is not clear which Metro board members would qualify as independent. Although none of the board members has an executive function, it can be assumed that all have either political or other external loyalties. A positive point is that Metro (as well as all other SOEs surveyed) separate the roles of Chairman and CEO.

Recommendation: Independence is not a panacea and should never be considered a substitute for competence. Nevertheless, nominating powers should consider the need for objective judgement at board level and nominate some independent-minded board members. Having one or two independent board members can have a positive impact on board deliberations and

decisions. The status of independent board members should be disclosed as should the definition of independence used in determining their status.

Conflict of interest

Boards operating according to best practice should have policies and mechanisms in place to manage conflicts of interest. All board members should disclose potential conflicts of interest to the board in written form. In addition, board member interests should all be clearly disclosed on the enterprise website. Systems of control need to ensure observance of the conflict of interest policy.

- ✘ Metro makes sufficient disclosure on its website to begin to assess the potential for conflict of interest among its board. However, this is not sufficient in that not all relationships may be disclosed in a web-based CV. There is no disclosure of a requirement that all board members disclose potential conflicts publicly or to the board. Nor is there any indication that there is a board-level conflict of interest policy or that the board has any mechanism to control potential conflicts of interest. There are, on the other hand, legal requirements under law, that public officials not have conflicts of interest. However the law is imprecise and proposes no systems for managing potential conflicts.

Recommendation: The Metro board should establish a conflict of interest policy that goes beyond the requirements set by law. This policy should be disclosed on Metro's website, along with the mechanisms for its implementation.

Structure and processes

Best practice suggests that the board consider establishing committees. The committee that is widely considered essential is the audit committee. Audit committees oversee a large number of issues related to the reporting and control environment. It may also be useful to establish remuneration and nominations committees. At the same time, board sizes should be kept reasonably small. The board should conduct an annual self-evaluation and develop a remedial action plan. All SOEs should have an internal audit function that has a direct reporting relationship to the independent members of the board.

- ☺ Metro reports that it is in the process of establishing an audit committee of the board, although such information was not publicly disclosed at the time of writing. Metro's board is appropriately sized at 7 members. Metro has an internal auditor who reports directly to the board, which corresponds well with best practice. There is no disclosure that confirms that Metro conducts annual evaluations of its own governance.

Recommendation: The Metro board should obtain information on audit committee best practice and follow such practices when establishing its own committee. Ideally, an audit committee would be staffed by independent board members with experience in financial reporting and a knowledge of audit and the enterprise control environment. The board should conduct an evaluation of its own governance processes, possibly with the assistance of an independent external consultant, and then devise an annual plan to better approximate itself to best practice.

Governance action plan prioritization

Implementation	HIGHEST	2	<p>MODERATE BENEFIT HIGH CONTROL:</p> <ul style="list-style-type: none"> ▪ Provide feedback to nominating powers on desired board member profiles ▪ Develop a stakeholder policy and disclose an annual stakeholder report ▪ Institute a whistleblower policy and program ▪ Enhance disclosure of public interest commitments and advantages and disadvantages of Metro compared to private sector 	1	<p>HIGHEST BENEFIT AND HIGH CONTROL:</p> <ul style="list-style-type: none"> ▪ Disclose annual IFRS reports audited according to ISA ▪ Enhance CG disclosure ▪ Establish policies on conflict of interest and political contributions ▪ Increase board responsibility for: control; risk; ethics; compliance; anti-corruption; and external audit and disclosure thereof ▪ Annual evaluation of CG and board ▪ Establish an audit committee ▪ Mandatory training for all board members on best CG practice
	LOWER	4	<p>MODERATE BENEFIT LOW CONTROL:</p> <ul style="list-style-type: none"> ▪ Increase legal board size to permit more independent board members and more diversity 	3	<p>HIGHEST BENEFIT AND LOW CONTROL:</p> <ul style="list-style-type: none"> ▪ Board nominations processes should be transparent, merit-based and aim at diversity ▪ Nominate minimum number of independent board members ▪ Stabilize and professionalize board and protect from political tides ▪ Legal responsibilities of board should be enhanced and closer to best practice
	LOWER			HIGHEST	

Expected Benefit of Reform

Tocumen Corporate Governance Report

Background

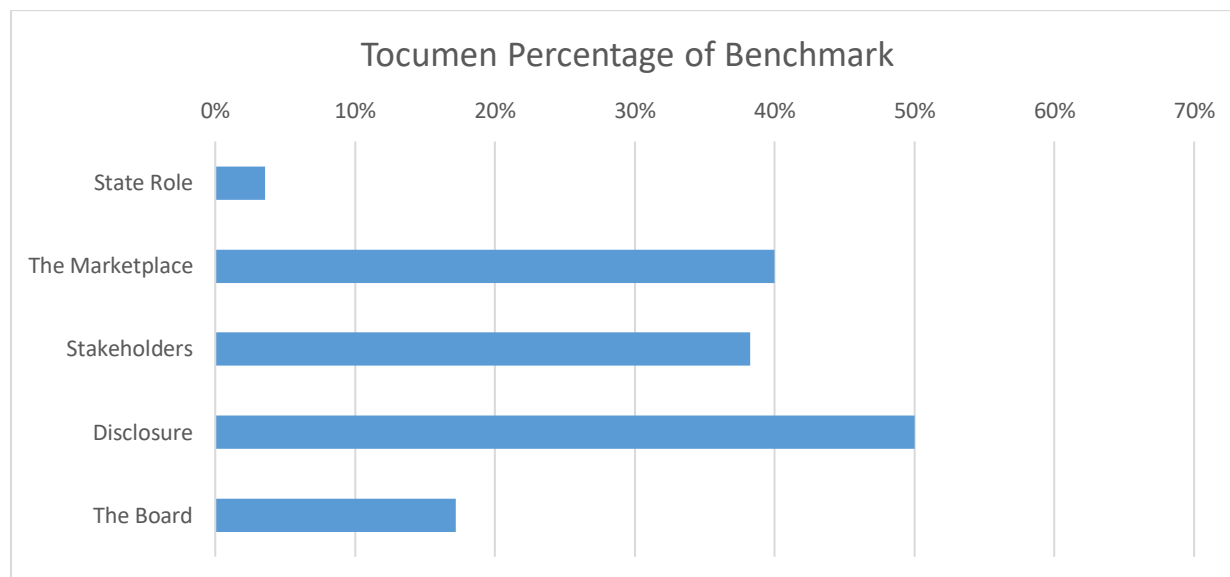
Tocumen Summary Data	
Legal structure: Statutory limited liability (SA)	Board size: 7
Establishing law: Law 23 of 2003	<p>A pie chart illustrating the composition of the board. The chart is divided into three segments: a blue segment representing 'Government' with 4 members, an orange segment representing 'Other constituency' with 3 members, and a very small grey segment representing 'Independent' with 0 members.</p>
Activity: Airport services	
Percentage state ownership: 100%	
Bond financing: Yes	
Financial reports: IFRS, 2014 unqualified. 2013 reports were restated in 2014.	
Auditor: Deloitte	Women: 1
Board Composition	
<i>Government</i>	
Dignitary (1) designated by Executive Body (Currently the Minister of Economy and Finance)	Dignitary (2) designated by Executive Body (Currently the Executive Secretary of Goals of the Presidency)
Dignitary (3) designated by Executive Body (Currently the General Director of the Civil Aviation Authority)	Dignitary (4) designated by Executive Body
<i>Civil Society</i>	
Association of Panamanian Airlines	Representative of airport concessions
Representative of airport workers	

Main corporate governance challenges

Tocumen's corporate governance appears comparatively good within the study group. Tocumen stands out from the other SOEs for its governance disclosure in its BVP filings. It is the only SOE that discloses a governance report in the form of answers to a BVP questionnaire as required by the securities regulator. In addition, it provides reasonably complete information on its board members as well as on the existence of board committees. It discloses information on an audit committee, its members and two independent board members. Tocumen's disclosure forms a strong basis on which to build and improve.

Anecdotal evidence suggests that the company tracks risks (at least informally). Therefore, there is some awareness of risk on the board and some risk assessment and management is taking place. One of the future challenges would be for Tocumen to formalize its risk assessment and management processes.

Performance by corporate governance category



Performance by corporate governance sub-indicator

<i>CG Category</i>	<i>Governance sub-indicator</i>	<i>Evaluation</i>
The state's role as an owner	• Undue interference by the state into SOE and SOE autonomy	?
	• Board nominations processes	✗
The marketplace	• No undue advantage or disadvantage versus private sector	=
	• Distinction and separation of state functions from SOE functions	=
Stakeholders and responsible business	• Stakeholders and responsible business conduct	=
	• Board responsibility for controls	✗
	• Use of SOE for political purposes	?
Transparency and disclosure	• Financial reporting	✓
	• Disclosure on public interest commitments	=
	• Governance	=
	• Risk	=
	• Related parties	=
	• Audit	✓
The responsibilities of the board	• Role and powers	=
	• Nominations	✗
	• Composition	✗
	• Independence	✗
	• Conflict of interest	✗
	• Structure and processes	=

Discussion and recommendations

The State's role as an owner

Undue interference by the state into SOE and SOE autonomy

Best practice suggests that the state not interfere unduly in the business and/or operational decisions of the SOE. It also suggests that the board be able to act autonomously, without political interference, and that it be ultimately responsible and accountable for SOE performance.

- ❓ Tocumen is given considerable autonomy under its establishing law. There is no evidence of direct political intervention in Tocumen's affairs. Despite the absence of evidence of undue interference, the preponderance of Tocumen's board is directly nominated by the Executive Body, which suggests that board deliberations and decisions making may be influenced by political powers.

Recommendation: No recommendation is made because undue interference or limitations of Tocumen's autonomy cannot be confirmed. Nevertheless, since board composition suggests a political influence over the board, the issue of board composition would appear to deserve attention. Recommendations on board composition are found below.

Board nomination processes

According to best practice, board members should be nominated through an open and transparent process that yields a diverse board composed of members chosen based on merit and who are able to exercise objective judgment on SOE affairs free from political influence.

- ❌ The board's composition is clearly set out in the law whereby Tocumen was established, although the process of nomination is not transparent. There is no indication that the board is either diverse or that board members are selected based on merit, or that they can exercise objective judgement free from political influence. Tocumen's board is dominated by government appointees (4) and interest groups (3). This approach to nominations makes the board directly beholden to political powers and vulnerable to changes in the government administration.

Recommendation: The board nominations process needs to be more transparent and result in less political board members. The goal should be to systematize a selection procedure that consistently yields a more professional and stable board. This may require changes to the law. The Presidency of the Republic holds the power over the nominations process and should focus on nominating board members whose backgrounds correspond to best practice.

No undue advantage or disadvantage versus private sector

Best practice suggests that the SOE not have any undue advantage or disadvantage with respect to other SOEs or the private sector. The SOE should not have any special legal or tax exemptions, and should obtain its financing according to market conditions.

- ☹ All the airports in Panama are nationalized and appear to be natural monopolies, so the question of unfair advantage compared to the private sector does not seem to be relevant. Furthermore, there is very little information available that would support taking a view on competitive neutrality. Tocumen can receive money from the state budget and benefits from various exemptions. The State has established a special investment pool for Tocumen. Tocumen must, at the same time, comply with regulation like any private sector company.

Recommendation: Tocumen should disclose in a single report information on the degree to which it adheres to the concept of competitive neutrality with the private sector. This could be part of the annual report, or be included within the context of an annual report on corporate governance.

Distinction and separation of State functions from SOE functions

According to best practice, there is a clear separation between the State, the SOE and regulatory functions. Public procurement should be competitive, non-discriminatory and transparent.

- ☹ There is insufficient information to assess the degree to which regulatory, oversight and operational functions of the SOE are separated. As noted above, the board's composition raises concerns regarding such separation. Tocumen must comply with public sector procurement laws which seek to ensure competitive, non-discriminatory and transparent procurement. However, concerns have been raised in the press regarding Tocumen's procurement practices as well as the manner in which it has awarded airport concessions.

Recommendation: Tocumen may wish to examine if regulatory and pricing decisions are made by the same individuals who make operational decisions and those individuals who have responsibility for setting state policies. These three functions should be clearly separated as they can have conflicting goals and lead to decision making that is not in the interest of the SOE. Regarding procurement and concessions, Tocumen should require the board to provide public assurances regarding the systems of control that are in place and that they function to ensure that the process is fair and transparent.

Stakeholders and responsible business conduct

Best practice suggests that the SOE recognize and respect stakeholder rights, and develop and disclose a stakeholder policy. Large SOEs should issue an annual stakeholder report on stakeholder relations. In addition, stakeholders should be provided with relevant information on a timely basis. In addition, SOEs should observe high standards of responsible business conduct and disclose compliance mechanisms.

- ☹ Tocumen has not developed a stakeholder rights policy. Rather, the Internal Regulations (Reglamento Interno) restate requirements under labor law. General standards of business conduct are specified in the ethics code promulgated under Executive Decree 246. Tocumen also has an ethics code for sub-contractors as well as a code on business conduct. It also conducts stakeholder disclosure in the form of practical updates for airport users. In addition, Tocumen has a special stakeholder's committee that is designed to provide stakeholder feedback to the enterprise and board. On the other hand, Tocumen does not produce a consolidated stakeholder report as envisaged under the OECD Guidelines.

Recommendation: Stakeholder relations and responsible business conduct policies are largely embodied in the law. It is urged that there be a better disclosure of stakeholder and business social responsibility policies in an annual stakeholder report.

Board responsibility for controls

According to best practice, the board is expected to develop, implement, and monitor internal control, ethics, compliance, and anti-corruption programs. The SOE should have standards of responsible business conduct and disclose mechanisms for ensuring their implementation. Best practice suggests that SOEs establish whistleblowing policies and procedures.

- ☹ Tocumen's Code of Ethics clearly states that ethics is a board responsibility. This Code is excellent, however, press reports suggest that there may have been lapses. There is an executive-level ethics committee, but no board-level committee. As a consequence, the degree to which the board actively oversees ethics is uncertain. There is no disclosure that confirms the board's role in the other previously specified responsibility areas. As with other SOEs, there is a general state policy that obliges employees to report acts that are contrary to law. However, Tocumen's disclosure does not show that it has an organized whistleblower program.

Recommendation: The board needs to take responsibility for the development, implementation and monitoring of internal controls, ethics, compliance and anti-corruption programs. The board's responsibility for the control environment should be disclosed as should its actions in support of corporate controls. Tocumen may wish to consider hiring an independent service provider to manage its whistleblower program.

Use of the SOE for political purposes

Best practice requires that the SOE not make political campaign contributions or finance political activities, or run charities or provide social services that are outside of its main area of activity.

- ❓ Tocumen's ethics code clearly states that the enterprise should not finance political parties or make political contributions. Actual practice could not be verified, nor is there any disclosure regarding systems that might be in place that would provide assurances to this effect. In principle, financing of political activities should not be possible since Tocumen's budget, which is examined by the General Comptroller's Office, does not include any line items for those activities.

Recommendation: Tocumen should disclose the extent to which systems are in place that ensure that the enterprise does not contribute to political or party financing. This disclosure should emanate from the board.

Transparency and disclosure

Financial reporting

Best practice recommends that SOEs produce annual financial reports in line with International Financial Reporting Standards (IFRS). A directors' report should be part of the annual financial report

- ✔ Tocumen issues financial reports prepared in accordance with IFRS. These reports are audited by Deloitte, a reputable independent auditor. There was a recent restatement of its accounts upon Tocumen's change from KPMG to Deloitte.

Recommendation: Financial reports fulfill the requirements of IFRS. However, certain elements that are typically included in an annual report, specifically, a statement by the board, a synthetic overview of the past year's results, and a discussion of strategy are missing. Tocumen complies well with the minimum requirements, but could raise the quality of its annual reports.

Disclosure on public interest commitments

Best practice is that SOE reports include information on areas of significant concern to the state and the general public, and provide statements on activities carried out in the public interest including financial and operating results associated with the achievement of public policy objectives. SOEs should also disclose financial assistance, guarantees, and any other commitments made by them or to them by the state.

- ⊖ The financial reports give some indication of the fulfillment and financial ramifications of certain public interest commitments. There is reasonable information provided in the annual report, although it could be presented in a more accessible fashion. However, such disclosure does not contain a discussion of these commitments as envisaged by the OECD Guidelines. Disclosure is not consolidated, nor does it contain a high-level discussion of policy goals, the means to achieve these goals, or a consolidated overview of the financial conditions under which Tocumen complies with its public commitments.

Recommendation: It would be useful to have an aggregate report on the public interest commitments of Tocumen, its progress and its agreements with the State in support of achieving such commitments.

Corporate governance

A best practice is that SOEs report on their corporate governance. Disclosures should at a minimum include the identity of board members, their qualifications, other posts held, the selection process, and the degree of board diversity. Information should be sufficient to assess board members' contribution to the SOE, competence, potential conflicts of interest and independence.

- ☹ The identities of the board members with information on their experience and past and present professional relations are available in the 2014 Annual Report and may be found in the BVP's website as part of the filings required for Tocumen's bond offering. As part of that same document, there is a completed questionnaire on corporate governance that provides significant information on Tocumen's governance practices. Tocumen is the only SOE in the study to make such disclosure, although it was only available on the BVP's website and not on that of the SOE itself. There are still gaps in terms of disclosure of the board's responsibilities for systems of control as well as in the disclosure of policies such as conflict of interest and related party transactions.

Recommendation: Tocumen can improve its corporate governance disclosure by ensuring that it be expanded and repeated annually. The information available on the BVP website should also be available on Tocumen's website. Tocumen should devote a special section of its website to governance and include, among other things, an annual governance report, policies on conflict of interest policies and related party transactions, board nomination policy, risk management and so on. The SMV corporate governance questionnaire should be updated. A detailed list of common governance disclosures is included in the annex.

Risk

Best practice suggests that SOEs disclose material foreseeable risk factors and remedial measures, and the systems they use to identify, manage, control and report on risks.

- ☹ Risk factors are discussed in the 2014 Annual Report. The annual report states that risk oversight is the responsibility of the board, but there is no disclosure from the board of its responsibility for risk oversight or any remedial measures. Anecdotal evidence suggests that the Tocumen board is aware of risks and tracks them, but there are no formal risk assessment and management processes at the board level, even though these do exist at management level.

Recommendation: The Tocumen board should acknowledge its responsibility for risk oversight, ensure that proper systems are in place and describe its risk oversight activities. A discussion of risks and systems to manage them should be included in every annual financial report.

Related parties

Best practice requires disclosure of material transactions with the State and other related entities. International Accounting Standard 24 requires disclosure of material related party transactions.

- ☹ Related party transactions are disclosed in Tocumen's IFRS statements. The Ethics Code contains a section on conflicts of interest and the requirement to avoid them. Furthermore, Tocumen's establishing law puts some limitations on related parties. Nevertheless, Tocumen does not have a discrete policy on conflicts of interest or related party transactions separate from what is found in law, nor is any information disclosed on systems for enforcement of such policies. Press reports

indicate that there is public concern with respect to some of Tocumen's transactions. Such feelings, whether right or wrong, should motivate some response.

Recommendation: The Tocumen board should develop and oversee the implementation of a conflict of interest and related party transaction policy and report annually on their effectiveness. Such disclosure could occur either in the context of the annual report or in a separate statement on corporate governance.

Audit

Best practice requires that SOE annual financial reports be subject to audit by an independent external (non-state) auditor. The audit should be conducted in accordance with International Standards of Audit (ISA). The board has the responsibility for overseeing the auditor and the audit process and assuring that the external auditor is independent.

- ✔ Tocumen's financial reports are audited by Deloitte using ISA. The board has the responsibility for contracting the independent auditor. However, there is no disclosure of the board's responsibility, its policy with respect to auditors or the actions that the board undertakes to ensure the external auditor's independence.

Recommendation: The board should disclose information on its policies and activities that support the independence of the external auditor. Such disclosure could take place either in the annual financial report or in an annual report on corporate governance.

The responsibilities of the board

Role and powers

Best practice suggests that the board have a clear mandate and ultimate responsibility for SOE performance. SOE boards should not merely be conduits for instructions from political powers. Nor should their main role be to ensure compliance with political orders. The board should understand its legal obligation to act in the best interest of the SOE. The board should have the power to set strategy, supervise management, and hire and fire the CEO. The board should also be able to decide (subject to limitations set by the State) on CEO compensation, and ensure that top executive remuneration is tied to the achievement of objectives.

- ☹ Tocumen is a statutory limited liability company subject to company law with limitations specified under the establishing law. The roles and responsibilities of board members are clearly set out. However, it is difficult to ascertain whether these translate into real board autonomy and an empowered board. For example, it appears that the power to nominate and remove the CEO remains in the hands of the Executive Body. So, despite the fact that the board has significant powers, there can be real concern that the board's close association with political powers is not conducive to a truly autonomous or independent-minded institution.

Recommendation: The powers of the board are stated in Tocumen's establishing law. Absent legislative reform, altering these powers is outside of Tocumen's control. It may, however, be possible for marginal changes to be made. The board should conduct a self-evaluation, compare itself to best practice and adopt whatever elements are feasible. Training for all existing and potential board members should become mandatory so that they become familiar with best practice standards.

Nominations

According to best practice, all board members should be nominated based on merit. The rules and procedures for nominations should be transparent and appointments should be based on professional criteria and a competitive selection process. Independent search experts may be used to enhance the process. In addition, the SOE should have some say in the selection process.

- ✘ The power to nominate board members is set down in Tocumen's establishing law. Four of Tocumen's 7 board members are selected by the Executive Body. An additional two represent the airlines and concessions and one represents organized labor. As with the other SOEs in this study, the nominations process is not transparent, nor is there any indication that merit is the essential criterion for selection. In addition, there is no indication that there is a competitive search process nor that search consultants have ever been employed to find the best candidates for board appointments.

Recommendation: At present, the choice of board members is largely at the discretion of the Presidency of the Republic and the Executive Body. Both should develop a written policy

describing the appointment criteria and make efforts to select individuals who enhance diversity, provide independence, and offer other needed skills. Interest groups should also develop and disclose nominations policies that are aimed at selecting board members based on merit. Rules should also be developed to prevent the complete change of board members as a result of election cycles. A proposal might be to maintain a certain percentage or number of board members irrespective of changes in government administration. Another proposal would be to stagger board terms (i.e., have them end at different times).

Composition

The board should be diverse and have competencies useful to the SOE. It should have some private sector experience and an appropriate gender mix. Board members should be free from political links and should not represent interest groups. Board members linked to the Executive Body should not serve on the board and the number of civil servants should be kept small.

- ✘ The identity of board members is disclosed in the 2014 Annual Report on the BVP website (this information is not disclosed on Tocumen's own website). Tocumen has the strongest corporate governance disclosure among the study group. It is clear from the disclosed information on board members that a good mix of competencies and backgrounds are present. One of the board members is female. The board is composed largely of board members appointed by the Presidency and board members who head important constituencies (which contrasts with best practice).

Recommendation: It is suggested that the Presidency of the Republic and Tocumen's other interest groups nominate board members exclusively based on the criterion of merit and ensure that the composition of the board is optimized.

Independence

Best practice in terms of the board composition promotes objective, unpoliticized decision making in the interest of the SOE. A minimum number of independent board members should be required and the roles of Chairman and CEO should be separated.

- ✘ None of Tocumen's board members can demonstrably be shown to be independent. In its Annual Report disclosed to the BVP, Tocumen describes two board members as independent. One represents airport concessions and the other represents the airlines. Neither would be considered independent under common definitions of independence because of their direct economic interest in the activities supervised by the board. A positive point is that Tocumen, like the other SOEs surveyed, separates the roles of Chairman and CEO.

Recommendation: Tocumen should appoint truly independent members to its board. Their status as independent board members should be disclosed as should the definition of independence used in determining their status.

Conflict of interest

Boards operating according to best practice should have policies and mechanisms in place to manage conflicts of interest. All board members should disclose potential conflicts of interest to the board in written form. In addition, board member interests should all be clearly disclosed on the enterprise website. Systems of control need to ensure observance of the conflict of interest policy.

- ✘ Despite the fact that Tocumen describes the interests of board members in the 2014 Annual Report, it does not disclose sufficient information on its website to assess the potential for conflict of interest existing in its board. There is no disclosure of a requirement that board members disclose potential conflicts publicly or to the board. Nor is there any indication that there is a board-level conflict of interest policy (different from what appears in the public procurement law of Panama) or that the board has any mechanism to control potential conflicts of interest.

Recommendation: The Tocumen board should establish a conflict of interest policy that goes beyond the requirements set by law. This policy should be disclosed on Tocumen's website, along with the mechanisms for its implementation.

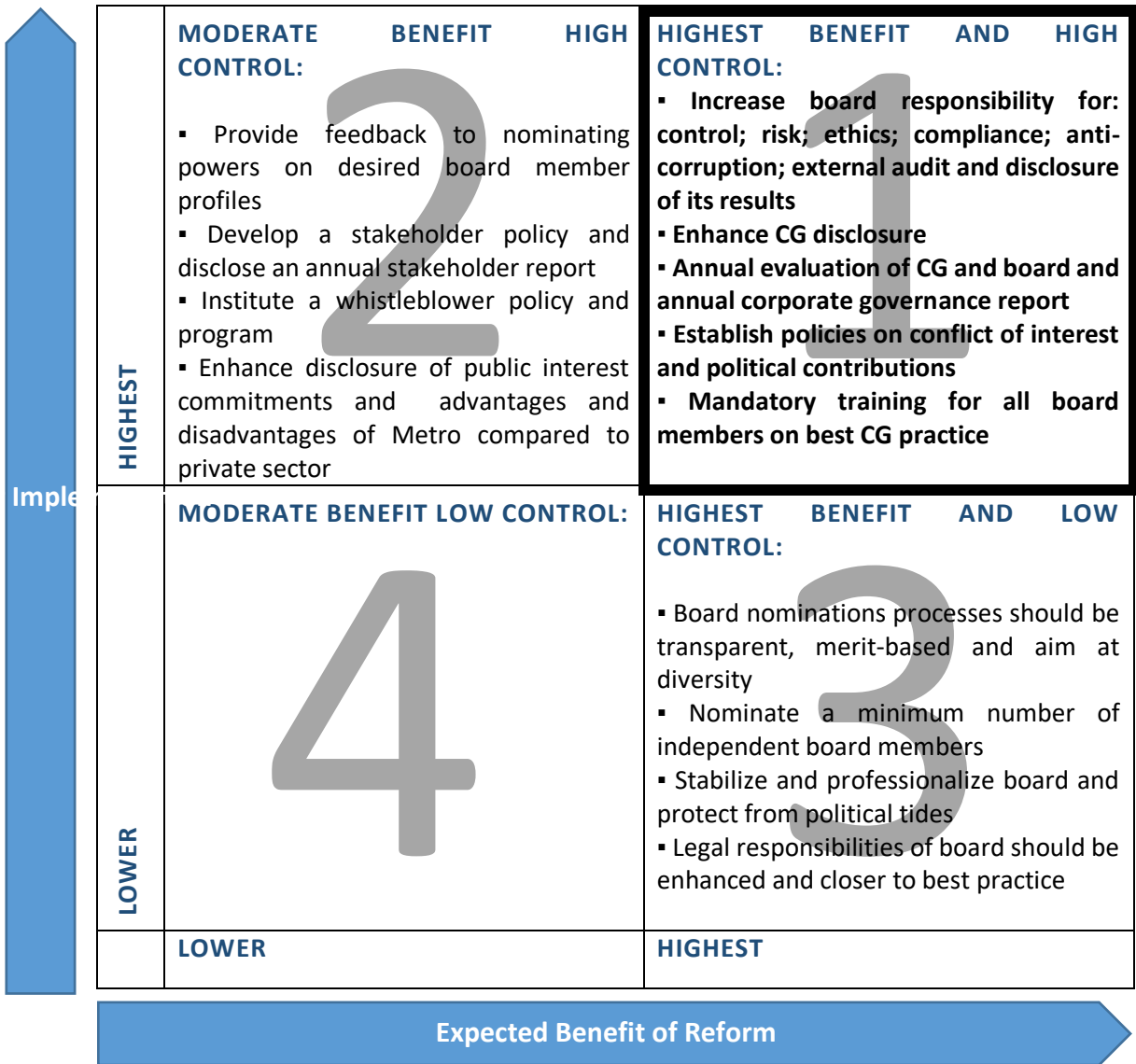
Structure and processes

Best practice suggests that the board consider establishing committees. The committee that is widely considered essential is the audit committee. The latter oversees a large number of issues related to the reporting and control environment. It may also be useful to establish remuneration and nominations committees. At the same time, board sizes should be kept reasonably small. The board should conduct an annual self-evaluation and develop a remedial action plan. All SOEs should have an internal audit function that has a direct reporting relationship to the independent members of the board.

- ☹ According to publicly available information, Tocumen has an audit committee. Despite disclosure that it has existed since at least 2014, there are questions regarding the degree to which it operates and fulfills best practice expectations. The Tocumen board is appropriately sized at 7 members. It also has an internal auditor who reports directly to the board, which corresponds well with best practice. There is no disclosure that confirms that the Tocumen board conducts annual evaluations of its own governance.

Recommendation: Tocumen's audit committee needs to assure itself that it fulfills the responsibilities of a best practice audit committee. Ideally, it should be an audit committee staffed by independent board members with experience in financial reporting, knowledge of audit and the enterprise control environment. The board should conduct an evaluation of its own governance processes, as well as devise an annual plan to better approximate itself to best practice.

Corporate governance action plan prioritization



Annexes

Methodology

The study group

There is a total of 15 SOEs in Panama. A subset of 5 of was selected for the conduct of this study. The enterprises were selected because of their central role in the Panamanian economy. What the SOEs have in common is that they come from heavily regulated sectors that are in a phase of expansion requiring significant investments. Each is involved in large development projects that bring with them the potential for inefficiency and misuse of public funds. Also, each operates in a highly visible industry that touches on the everyday lives of people. They are also potential flashpoints for public discontent.

The benchmark

The benchmark was developed using positions expressed in the OECD Guidelines for the Governance of State-owned Enterprises. These Guidelines had to be adapted for use as a benchmark. The main reason is because the OECD Guidelines are addressed to governments while the purpose of this study is to examine SOE practices and not government practices. As a consequence, the section from the Guidelines entitled “Rationales for state ownership” was not included in the benchmark. In addition, the section entitled “Equitable treatment of investors” was not included because all of the SOEs in this study are wholly state-owned and thus have no other investors. Two other sections of the OECD Guidelines also speak mainly to the State: a) “the State’s role as an owner”; and b) “the Marketplace”. Nevertheless, some of the recommendations in these two sections are included in the benchmark because they are important indirect indicators of the quality of SOE governance. One hundred indicators were developed from the OECD Guidelines against which to measure corporate governance practices. The level of compliance with individual indicators was converted into a numerical score.

Data sources

The study is based principally on publicly available information. Publicly available information includes the enterprise’s website, information on the SMV and BVP websites and press reports. The advantage of using publicly available information is: a) access to information is relatively easy; and b) the information represents what the general public could reasonably expect to have at its disposal. Nevertheless, the disadvantage is that publicly available information may not provide a full or accurate view of the enterprise. For this reason, each SOE was contacted in order to ensure that the findings were properly understood and that the information on the enterprise was not being misrepresented.

Limitations

There is a series of limitations some of which are more or less important. The most important one is that judgement is involved. Some data are concrete such as the presence or absence of financial statements prepared according to IFRS. Other data require considerable interpretation, for example, the degree to which board oversight of controls is present.

The study is based mainly on publicly available information. In principle, it is possible for a well-governed enterprise to score low only because its good practices are invisible to the public. Furthermore, the scoring is based to a major extent on what the law and enterprise rules and documentation require. What happens in practice may be quite different.

Excessive attention should not be paid to small differences in numerical performance. Numerical scorings cannot be casually used to assess the quality of governance, risk, or the likelihood of good or bad financial performance. They only reflect the number of good governance practices with which the SOE complies. As such, they are perfectly suited to develop remedial plans to close gaps with accepted standards of good practice.

The OECD Guidelines describe practice from a group of the most economically and socially developed countries. SOEs from these countries typically operate in very different contexts and the gaps between best practice and practices in non-OECD countries can be quite large. Finally, due caution should be exercised when emulating practices from other countries with different business, legal and political traditions and where institutional structures are in different stages of development. A simple transposition of practices is no guaranty for success. Extensive local adaptation may be required.

Essential corporate governance disclosures

Basic information on the enterprise

- ❖ An annual corporate governance report
- ❖ Corporate charter
- ❖ By-laws
- ❖ Summary profiles of board members focusing on relevant experience
- ❖ Full information on the interests of board members and top executives in order to assess potential conflicts of interest. Political affiliations must also be disclosed
- ❖ Board and committee charters
- ❖ Board relationship with internal auditor

Financial information

- ❖ Current and prior years audited financial statements and annual reports including:
 - Letter from the board
 - MD&A (Management's Discussion and Analysis)
 - Independent auditor's report
 - Full notes
- ❖ Board responsibility for developing, implementing and monitoring the control environment including internal audit, compliance and risk management
- ❖ Unaudited quarterly financial statements
- ❖ Enhanced related-party transaction disclosure (going beyond International Accounting Standard 24)

Policies

- ❖ Conflict of interest policy
- ❖ Code of ethics
- ❖ Related-party transaction policy
- ❖ Whistleblower policy and whistleblower contact data
- ❖ Nominations policy for board members
- ❖ Remuneration and incentive compensation policy for board members and top executives
- ❖ Basic governance practices (may be part of annual report)
- ❖ Systems of risk management

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