OECD Review of the Corporate Governance of State-Owned Enterprises

UKRAINE
OECD Review of the Corporate Governance of State-Owned Enterprises

UKRAINE
Foreword

This review evaluates the corporate governance framework of the Ukrainian state-owned sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (“SOE Guidelines”). It was requested by Ukraine’s Ministry for the Development of Economy, Trade and Agriculture under a project supported financially by the Norwegian Ministry of Foreign Affairs. The work is implemented in the context of the Memorandum of Understanding for Strengthening Co-operation between the OECD and the Government of Ukraine.

Following Ukraine’s request to adhere to the SOE Guidelines in March 2020 and endorsement by Prime Minister Shmyhal, the OECD started the review process of Ukraine against the SOE Guidelines in June 2020. The process has entailed collecting information from the Ukrainian authorities, carrying out supplementary research, and holding (virtual) fact-finding missions. During the fact-finding missions, the assessment team met with representatives from relevant government agencies, governing bodies and management of SOEs, and civil society. The assessment team included the Secretariat, Working Party bureau members from Sweden and Latvia, representatives from the EU delegation and the Norwegian Ministry of Foreign Affairs, and local corporate governance and legal experts.

Following an initial fact-finding mission and information gathering, an interim version of this report was presented for the consideration of the Working Party on State Ownership and Privatisation Practices meeting in October 2020. At that occasion, the Working Party identified and communicated additional information it would need to reach an opinion with regard to Ukraine’s implementation of the SOE Guidelines. Following the submission of additional material by the Ukrainian authorities, the OECD Secretariat undertook a second fact-finding mission to Ukraine in January 2021. During its meeting in March 2021, the Working Party discussed and approved the final version of this report, which has been updated based on the information made available to the Secretariat as of end-April 2021.

At Ukraine’s request, during the review process the OECD also commented on a draft corporate governance law (so-called ex-6428) that is currently being developed. The draft law looks to amend legislation bearing on SOE corporate governance to streamline applicable laws and clarify corporate governance practices in SOEs. Comments were prepared by the OECD Secretariat, in consultation with the assessment team and the EBRD, and were shared with the Ukrainian authorities in November 2020. The updated draft law remains to be submitted to the parliament and the OECD has not been consulted on further revisions.
Acknowledgements

This review reflects significant contributions from a number of participants. Special thanks are attributed to the Norwegian government for their funding and project support, including Ambassador H.E. Erik Svedahl, Petter Nore, Ellen Stie, Aleksandra Wacko and Kerstin Wahlberg.

The OECD would like to thank the representatives of Ukrainian ministries and government agencies for their co-operation and support during fact-finding missions and information gathering during the review process. Their availability to meet with the OECD assessment team, complete the questionnaire, comment on drafts and provide additional information for the development of this report is greatly appreciated. The OECD would like to extend its gratitude to the Ministry for the Development of Economy, Trade and Agriculture, including Deputy Minister Svitlana Panaiotidi, Nadia Kobyliai, Oleksandr Maksymov, Nataliia Turchyna and Olena Baldukhova; the Ministry of Finance, including Olena Zubchenko, Oleksandra Kupriychuk, Oksana Paraskeva, Natalia Strakhova, Dmytro Oliynyk and Anna Lipska; and the Secretariat of the Cabinet of Ministers, including Oleksandr Melnychenko, Oleksii Voloshyn, Kateryna Penkova, Kateryna Shamanska, Oleksandr Kurylo, Volodymyr Kalenskyi and Dmytro Shevchuk.

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Special thanks are due to the representatives from the state-owned enterprises that were interviewed during fact-finding missions, including Andriy Haidutski and Oleksandr Holodnytsk with the Ukrainian Sea Ports Authority; Dmytro Bogdan with Ukrzaliznytsia; Roman Bondar, Taras Ivanysyny and Oleg Yakovenko with Ukroboronprom; Vitalii Bielikov and Mariia Shvirst with Ukrposhta; and supervisory and management board members of PrivatBank and Ukreximbank. Thanks are also due to the representatives of enterprises that submitted information regarding their practices, including Ukrenergo, Polina Zagnitko and Olga Kucheruk of Naftogaz, GTSO, Ukrhydroenergo, Energoatom, Boryspil Airport, UkSATSE, Agrarian Fund,
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<td>AMCU</td>
<td>Anti-Monopoly Committee of Ukraine</td>
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<tr>
<td>RBC</td>
<td>Responsible business conduct</td>
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<tr>
<td>CEO</td>
<td>Chief executive officer</td>
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<tr>
<td>CGAP</td>
<td>Corporate governance action plan</td>
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<tr>
<td>CMU</td>
<td>Cabinet of Ministers of Ukraine</td>
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<tr>
<td>DSO</td>
<td>Distribution system operator</td>
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<tr>
<td>EBITDA</td>
<td>Earnings before interest, taxes, depreciation and amortization</td>
</tr>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<tr>
<td>ENTSO-E</td>
<td>European Network of Transmission System Operator</td>
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<tr>
<td>ESU</td>
<td>Energy Strategy of Ukraine</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>EUR</td>
<td>Euro</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
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<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>GNI</td>
<td>Gross national income</td>
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<td>GTSO</td>
<td>Gas Transmission System Operator of Ukraine, LLC</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IPS</td>
<td>Integrated power system</td>
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<tr>
<td>JSC</td>
<td>Joint-stock company</td>
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<tr>
<td>LLC</td>
<td>Limited liability company</td>
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<tr>
<td>LPG</td>
<td>Liquefied petroleum gas</td>
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<td>MDETA</td>
<td>Ministry for the Development of Economy, Trade and Agriculture</td>
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<td>MGU</td>
<td>Main Gas Pipelines of Ukraine</td>
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<td>MOE</td>
<td>Municipally-owned enterprise</td>
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<td>NABU</td>
<td>National Anti-Corruption Bureau of Ukraine</td>
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<td>NAPC</td>
<td>National Agency for Prevention of Corruption</td>
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<td>NBU</td>
<td>National Bank of Ukraine</td>
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<td>NCCIR</td>
<td>National Commission for State Regulation of Communications and Information</td>
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<td>NCSSM</td>
<td>National Commission on Securities and Stock Market</td>
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<tr>
<td>NEURC</td>
<td>National Energy and Utilities Regulatory Commission</td>
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<td>NWF</td>
<td>National Wealth Fund</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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ACRONYMS AND ABBREVIATIONS

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<td>PSO</td>
<td>Public service obligation</td>
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<tr>
<td>ROA</td>
<td>Return on assets</td>
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<td>ROE</td>
<td>Return on equity</td>
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<td>SFGC</td>
<td>State Food and Grain Corporation</td>
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<td>SOE</td>
<td>State-owned enterprise</td>
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<td>SPFU</td>
<td>State Property Fund of Ukraine</td>
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<td>TSO</td>
<td>Transmission system operator</td>
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<td>UAH</td>
<td>Ukrainian Hryvnia</td>
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<td>UkSATSE</td>
<td>Ukrainian State Air Traffic Services Enterprise</td>
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<tr>
<td>USD</td>
<td>United States Dollar</td>
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<tr>
<td>USPA</td>
<td>Ukrainian Sea Ports Authority</td>
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Part I. SOE landscape in Ukraine
Chapter 1. Economic and political context

Ukraine is one of the largest countries in continental Europe, with approximately 42 million inhabitants. In 2019, the country’s current GDP amounted to USD 153.8 billion, with 3.2% annual growth and 7.9% inflation (World Bank, 2020[1]). As it neighbours the Russian Federation (Russia), Central Europe and the Black Sea, it has been strategically located for transiting oil and gas between Russia and the European Union (EU). Ukraine is also one of the world’s largest grain and sunflower oil exporters, and holds mercury, titanium, and iron ore deposits, along with coal reserves. However, its dependence on the primary sector of the economy has rendered it vulnerable to global prices and external shocks.

Table 1.1. Selected economic indicators for Ukraine

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<td>GDP, current (in billion USD)</td>
<td>91.0</td>
<td>93.4</td>
<td>112.2</td>
<td>130.9</td>
<td>153.8</td>
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<tr>
<td>GPD per capita, current prices (USD)</td>
<td>2,124.7</td>
<td>2,187.7</td>
<td>2,640.7</td>
<td>3,096.8</td>
<td>3,659.0</td>
</tr>
<tr>
<td>Real GDP growth (annual %)</td>
<td>-9.7%</td>
<td>2.2%</td>
<td>2.5%</td>
<td>3.4%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Inflation rate, average consumer prices (annual % change)</td>
<td>48.7%</td>
<td>13.9%</td>
<td>14.4%</td>
<td>10.95%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Unemployment rate (% of total labour force)</td>
<td>9.1%</td>
<td>9.4%</td>
<td>9.5%</td>
<td>8.8%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Public debt (% of GDP)</td>
<td>79.4</td>
<td>81.0</td>
<td>71.8</td>
<td>60.9</td>
<td>50.3</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>1.7%</td>
<td>-1.4%</td>
<td>-2.1%</td>
<td>-3.3%</td>
<td>-0.86%</td>
</tr>
<tr>
<td>Per capita GNI (in USD, constant)</td>
<td>2,837.1</td>
<td>2,946.4</td>
<td>3,056.4</td>
<td>3,185.5</td>
<td>3,326.1</td>
</tr>
<tr>
<td>Poverty ratio at national poverty lines (% of total population)</td>
<td>6.4</td>
<td>3.8</td>
<td>2.4</td>
<td>1.3</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Source: (World Bank, 2020[2]) (Ministry of Finance, 2020[3]).

Following its transformation from a centrally planned to a market economy in the 1990s, Ukraine witnessed severe political, economic and security challenges. While the country achieved modest recovery after the global financial crisis of 2007-2008, the Euromaidan revolution in 2014, followed by Russia’s illegal occupation of Crimea and the eruption of armed conflict with Russian-backed separatists in the East of the country further exacerbated its economic conditions. However, with a change in government and structural reforms, Ukraine’s economy stabilised and the country started witnessing GDP growth, while inflation, poverty and unemployment gradually declined (see Table 1.1). Moreover, its commitments with international partners and the establishment of the EU-Ukraine Association Agreement and the Deep and Comprehensive Free Trade Area (DCFTA) enabled Ukraine to underpin its reform processes. Despite improvements, the Covid-19 induced economic crisis in 2020

1 It is worth noting that in December 2019, the government of Ukraine released the results of a pilot digital population census, showing that 37.1 million people lived in government-controlled territories (AIN, 2020[316]). According to the State Statistics Service of Ukraine, there are 41.8 million inhabitants.

2 The figures may differ based on the reporting agency. According to the State Statistics Service, inflation in 2019 ended at 4.1%.
negatively impacted the country’s conditions, resulting in GDP decline and currency devaluation, as well as growth in government borrowing (OECD, 2020[3]).

1.1. Government

Ukraine adopted its constitution in 1996 and established a parliamentary-presidential system of government in 2014. The President is the head of state elected by popular vote for a five-year term that can be renewed once. The Prime Minister is the head of government appointed by the parliament (Verkhovna Rada) on the President’s proposal, which, in turn, is based on the proposal of a parliamentary coalition. The Prime Minister is responsible for forming the government and heading the Cabinet of Ministers (CMU), which is the highest executive body in Ukraine. The CMU consists of Prime and Deputy Prime Ministers (including the First Deputy Prime Minister), as well as Ministers proposed by the Prime Minister (though Minister of Defence and Minister of Foreign Affairs are proposed by the President) and appointed by the parliament. The CMU is accountable to the President and the parliament, and its activities are guided by presidential decrees and parliamentary resolutions, along with laws and other regulations. The Verkhovna Rada is the country’s highest legislative body, consisting of 450 members elected by direct popular vote.3

The current president Volodymyr Zelensky, representing the Servant of the People party, was elected in 2019, defeating the incumbent Petro Poroshenko. Following the snap parliamentary elections in July 2019, the majority of the seats in the Verkhovna Rada were allocated to the members of his party. In addition, since 2019 the government and the ministries have experienced restructuring. Notably, the Ministry of Economic Development and Trade and the Ministry of Agriculture merged in 2019, and became the Ministry for the Development of Economy, Trade and Agriculture (MDETA). Similarly, the Ministry of Digital Transformation and the Ministry of Strategic Industries were formed in 2019 and 2020, respectively, and the Ministry of Energy was reorganised twice within a year. Moreover, during the first year of Zelensky’s presidency, Oleksiy Honcharuk’s Cabinet was replaced with the appointment of Denys Shmyhal as Prime Minister in March 2020.4 However, it is worth noting that many more line Ministers have changed during the same period, resulting in vacant positions and the appointment of acting Ministers.5

While Ukraine is a unitary republic, it is divided into twenty-four provinces (known as oblasts) and one autonomous republic, and two cities (Kyiv and Sevastopol) exercise a special administrative status. Within these regions, local administrations may

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3 Half of the parliament members are elected according to a single-member district system, while the other half is elected according to the proportional system (“closed” party lists). In the current convocation of the Verkhovna Rada, 423 members were elected, including 225 members elected according to the proportional system and 198 members elected according to the single-member district system. The remaining 27 single-member seats remain unfilled, as elections could not be held in these districts located in the uncontrolled territories of Ukraine. However, starting from next elections, all seats will be allocated based on a proportional system with “open” party lists (Verkhovna Rada, 2019[321]).

4 Since 2014, the government of Ukraine has changed five times, along with most of the composition of the Cabinet of Ministers.

5 For instance, the Minister of Energy under the Honcharuk government changed and the position has been left vacant for almost a year, with four acting Ministers overseeing the Ministry since March 2020. In February 2021, the Verkhovna Rada adopted a law to put a cap on the term of office for acting Ministers. The law forbids any acting Minister to fulfil duties for more than 30 days if the post has remained vacant for over 60 days (Unian, 2021[336]).
exercise certain powers, such as implementing regulations and regional programmes, preparing and reporting on regional and local budgets, and performing ownership functions over municipally-owned enterprises. With the launch of the decentralisation reform in 2014, the central government has sought to delegate powers to local government, such as providing greater control over budgetary affairs, to help deal with challenges and improve local infrastructure and waste management. To optimise the provision of administrative services, the central government has also established amalgamated regions (known as hromadas) that deal with local issues related to education, healthcare, infrastructure and administrative services (Verkhovna Rada, 1996[4]) (Verkhovna Rada, 2003[3]) (OECD, 2018[6]).

1.2. Legal and judicial system

Ukraine’s legal system is based on civil law (Romano-Germanic legal family). The system is code-based and has a well-structured hierarchy of normative acts, starting with the Constitution and various legal acts (including laws, orders, decrees, decisions, instructions, etc.) with different titles and legal force depending on the law-making subject and issuing state body. As a result of its relatively recent transition towards market economy, Ukraine does not have a mature legal system yet comparable to the legal systems of most European countries. As legislation remained undeveloped and contained many gaps, there were challenges in providing an adequate underpinning for complex transactions. While new laws have been introduced and amendments have been made to company, property, bankruptcy, securities, taxation, banking and foreign investment laws to promote consistency, their enforcement remains weak (Biryukov and Kryvonos, 2017[7]).

Ukraine’s judicial system is based on the principles of separate territorial and subject matter jurisdiction, and consists of three levels of judicial review. Separate courts exist for civil, criminal, administrative and commercial cases. Civil cases usually involve disputes related to land, family and labour, and may be brought to inter-district general courts and appealed at a regional level. The same general and appellate courts have jurisdiction over criminal cases. Commercial courts settle disputes mostly between legal entities, which are resolved by regional (first-instance) and inter-regional (appellate) commercial courts. Administrative courts decide on claims brought against various government agencies. However, the effectiveness of the courts in resolving legal disputes independently has been put into question. For example, recent allegations have been made by Ukraine’s National Anti-Corruption Bureau and anti-corruption watchdogs that the head of the Kyiv Administrative Court takes “decisions in the interest of political elites and business circles, as well as in their own interest, interfering in any state processes” (Financial Times, 2020[8]).

The Supreme Court is the highest entity in Ukraine’s judicial system, and consists of civil, administrative, commercial, and criminal cassation courts, as well as the Grand Chamber. In most cases, it hears cassation appeals against judgments of appellate courts. Judicial appointments are made through a presidential decree, following the proposal of the High Council of Justice (Verkhovna Rada, 2016[9]). Ukraine has also established a Constitutional Court, which is responsible for interpreting Ukraine’s Constitution and deciding on the conformity of laws and other acts by adopting decisions, providing opinions, delivering rulings and issuing orders, as needed. The

6 https://decentralization.gov.ua/en/gromadas
Court is composed of eighteen judges (the President, the Rada and the Congress of Judges each appoint six judges) and operates under a system consisting of the Grand Chamber, two Senates, six Boards and Standing Commissions (CCU, n.d.[19]). In recent years, the Constitutional Court has received criticism over its decisions, including a ruling in October 2020 that undermined the asset declaration system, which was one of the key pillars of Ukraine’s anti-corruption infrastructure (Sukhov, 2021[11]).

1.3. Public prosecution and anti-corruption bodies

Ukraine has established special entities to deal with corruption and public prosecution. Over the years, the country has faced corruption-related challenges and the presence of vested interests, particularly within the SOE sector (OECD, 2018[12]). In 2019, its ranking in Transparency International’s Corruption Perceptions Index was 126th out of 198 countries monitored (Transparency International, 2019[13]). During the onset of Ukraine’s independence, the prosecutor’s office was formed for public prosecution in court and for the management of pre-trial investigation. However, due to high levels of corruption, a number of special anti-corruption bodies were also established. Notably, the National Anti-Corruption Bureau of Ukraine (NABU) was formed in 2015, and it is responsible for investigating corruption-related crimes committed by Ukrainian officials (though its independent status is being challenged in Constitutional Court). A Specialised Anti-Corruption Prosecutor’s Office (SAPO) was also established in 2015 as an independent structural sub-division of public prosecution, and it supervises NABU. Moreover, in 2019 Ukraine established the High Anti-Corruption Court to handle corruption-related cases in the country, which to date has handed down 17 verdicts (Economist, 2020[14]).

Along with these institutions, in 2018 the Cabinet of Ministers established the State Bureau of Investigation (SBI) to combat and investigate crimes committed by high-ranking officials. Moreover, the National Agency for the Prevention of Corruption (NAPC) became operational in 2016 to develop and implement anti-corruption policy, while creating an environment conducive to the prevention of corruption.

1.4. Economic development

While achieving a slight recovery following the 2007-2008 global financial crisis, Ukraine has faced on-going economic challenges. During 2013-2015, its GDP contracted sharply as the country witnessed Euromaidan protests, temporary occupation of Crimea and the Donbass, and a slowdown in trade (OECD, 2018[6]). With the establishment of a new government and the launch of reforms, Ukraine experienced a modest economic recovery, with its GDP growth reaching 3.4% and 3.2% in 2018 and 2019, respectively (Figure 1.1). However, compared to other emerging markets (in which GDP increased by approximately 4.5% during the same

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7 In August 2020, the Constitutional Court ruled that the constitution does not give the president the power to establish or select the head of NABU, and that certain provisions of the Law of Ukraine "On the National Anti-Corruption Bureau of Ukraine" were not in line with the Constitution of Ukraine. NABU has stated that this Constitutional Court judgement “is an attempt to block the fight against political corruption and stop cleansing of the judiciary in the state.” Until the Verkhovna Rada of Ukraine adopts amends the legislation, the current institutional framework and nominations will remain in place. 
period), Ukraine fell slightly behind (IMF, 2020[15]). The country’s growth has been mainly underpinned by an increase in private consumption and wages, as well as a strong renewal of consumer credit growth and remittances (with the latter increasing significantly since 2015, after Ukraine signed the Association Agreement) (Figure 1.2). Despite volatility in its FDI inflows, an increase in fixed investments, fuelled by residential construction, contributed to supporting recovery. Further elements, including flexible exchange rate and energy tariff reforms, played an important role in promoting growth, while improved efficiency of expenditures in the public sector helped reduce the country’s fiscal deficit (OECD, EC, EBRD and ETF, 2020[16]).

In addition to structural reforms, the recovery resulted partly from access to the European markets and a reduction in EU trade barriers following the establishment of the EU-Ukraine Association Agreement and the Deep and Comprehensive Free Trade Area (DCFTA), which came into force in 2017. Moreover, Ukraine has received strong support from international partners, which has underpinned its economic development. In 2018, the IMF approved a 14-month USD 3.9 billion Stand-By Arrangement (SBA), while the EU provided EUR 4.4 billion macroeconomic financial assistance and the World Bank provided EUR 349 million loan under its policy-based guarantee (OECD, EC, EBRD and ETF, 2020[16]).

Figure 1.1. GDP (constant), % change

As in many countries, the Covid-19 pandemic has derailed Ukraine’s economic recovery. Notably, its GDP has fluctuated more compared to its neighbouring countries, and it is forecast to contract by 7.2% in 2020, with a 3% growth forecast in 2021 (OECD, 2020[18]). The country’s current account balance is expected to remain negative, its net lending and borrowing ratio as a share of GDP is expected to fall by 4% in 2020, and its currency (hryvnia) has experienced significant volatility (IMF, 2020[17]). During the onset of the pandemic, Ukraine recorded a 48% rise in unemployment compared to the previous year, while new vacancies fell by 60%. Paired with large foreign debt repayments, limited social security benefits and low domestic savings, the impact of Covid-19 contributed to pessimism across many sectors of the economy (OECD, 2020[19]).
Ukraine adopted measures to ease the negative socioeconomic impact of the pandemic. Along with introducing tax exemptions and postponing filing requirements, the government suspended interest payments for taxpayers and social security contributors, and expanded programmes for affordable bank loans. The state-owned PrivatBank put in place a “credit holiday” for small and medium-sized enterprises. Moreover, the National Bank of Ukraine (NBU) continued to intervene in the foreign exchange market to mitigate excessive fluctuation in the foreign exchange rate, and reduced interest rates to 8%, which was subsequently lowered to 6% (OECD, 2020[3]).

Along with domestic measures, Ukraine has received strong support from the international community to weather the challenges imposed by the pandemic. In June 2020, the IMF approved a USD 5 billion stand-by arrangement (SBA) for 18 months with an immediate disbursement of USD 2.1 billion. The SBA seeks to provide balance of payments and budget support, help advance key structural reforms, and ensure a return to growth over the coming months. It also contains provisions to improve Ukraine’s corporate governance framework for state-owned enterprises and state-owned banks, and bring it in line with the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines) (IMF, 2020[19]). The IMF mission in February 2021, however, concluded that Ukraine needed to demonstrate more progress on some of its reforms before another instalment of the SBA could be disbursed (Reuters, 2021[20]).

Other international partners have provided additional support to Ukraine. Notably, the EU signed a Memorandum of Understanding on macro-financial assistance worth up to EUR 1.2 billion, which also includes conditionality related to SOE governance, and the World Bank approved an Economic Recovery Development Policy Loan worth USD 350 million. Moreover, in 2020 the EBRD invested between EUR 750-850 million in Ukraine, while the parties signed a Memorandum of Understanding to improve corporate governance in Ukrainian state-owned enterprises (SOEs) (European Commission, 2020[21]) (CMU, 2020[22]) (Kyiv Post, 2020[23]).
1.5. Business environment trends

Following the Euromaidan revolution, the Ukrainian government sought to improve the country’s business environment. Structural reforms, in part, were introduced to meet the obligations under the EU-Ukraine Association Agreement and the DCFTA, as well as conditionalities put forth by other international partners. Some of these reforms included deregulation and improvements within the judicial sector and tax administration, and the promotion of an anti-corruption agenda. Other key reform areas covered public procurement, decentralisation, tax policies, and improvements in institutional framework, including the establishment of a Business Ombudsman Council. Further policies also contributed to reforming the SOEs through the improvement of corporate governance practices, while also relaunching a privatisation programme with a focus on smaller assets (OECD, EC, EBRD and ETF, 2020[16]). Moreover, in 2020 Ukraine introduced land market and banking sector reforms.

Ukraine has also witnessed improvement in its business climate. Notably, in World Bank’s Doing Business 2020, it ranked 64th out of 190 economies, scoring 19 points higher than in 2016 (World Bank, 2020[24]). The improvements were mostly seen in issuing construction permits and in protecting the rights of minority shareholders. However, Ukraine’s position has remained relatively low in the World Economic Forum’s Global Competitiveness Index, ranking 85th out of 141 economies (World Economic Forum, 2019[25]). Limited improvement in its scoring, in part, has been attributed to on-going challenges in developing the country’s institutions, financial system and innovation capacity.

1.6. Banking sector

Banking remains the primary activity in Ukraine’s financial sector, holding approximately 80% of the assets. Most of the banking services are traditional, including deposits, money transfers, foreign exchange, loans and guarantees. High-risk products are usually not provided or remain forbidden (Moneyval, 2017[26]). During the early 2000s, Ukraine’s banking sector experienced strong credit expansion and rapid growth, though it was strained during the 2007-2008 global financial crisis. Despite a brief period of stability, political and economic challenges in 2014 resulted in currency devaluation, high inflation and recession. In addition, on-going challenges, including imprudent lending by both state-owned and private banks, led to the rise in non-performing loans from 19% in 2014 to 55% in 2017. While representing a dominant position in most segments of banking services, the share of state-owned banks in non-performing loans reached 62%. Moreover, these banks benefitted from state support, receiving USD 10 billion for recapitalisation over two decades (Boytsun and Yablonovskyy, 2017[27]).

Since 2014, the banking sector experienced massive restructuring, which contributed to a sharp reduction in the ratio of banking assets to GDP and the number of operating banks (Figure 1.3). To preserve financial stability, PrivatBank – which in 2016 was the largest private bank in Ukraine – was nationalised after being declared insolvent by the National Bank of Ukraine (NBU) due to crisis-related factors, and an “imprudent

Following the nationalisation of PrivatBank, the market share of the state-owned banks increased from 34% to 56% (Boytsun and Yablonovskyy, 2017[27]). It is worth noting that according to the Ministry of Finance, in 2020 the state-owned banks reduced their non-performing loans in their portfolio to 57.4% (Ministry of Finance, 2021[34]).
lending policy pursued by the bank”. Currently, state-owned banks constitute 54% of the total assets within the banking system (Ministry of Finance, 2020[28]). The NBU also promoted debt restructuring and introduced new standards for banking regulations in line with the EU directives (OECD, 2020[29]) (BBC, 2016[30]). In 2019, NBU held a scheduled round of stress tests of Ukraine’s largest banks, which noted that in a baseline scenario, 11 out of the 29 banks evaluated would need capital to meet minimum capital adequacy requirements, increasing to 18 banks in an “adverse scenario” (NBU, 2019[31]). Observers attribute fragility in the banking sector related, *inter alia*, to (i) massive unresolved portfolio of non-performing loans; (ii) high probability of borrower default; and (iii) inability for lenders to recover funds after borrower bankruptcy or foreclosure (Repko, 2020[32]).

With regard to anti-money laundering measures, the Council of Europe’s Moneyval assessment (in 2017 and 2019) identified Ukraine to be at high risk for corruption and illegal economic activity. Though efforts have been made by NBU to address these risks, the Ukrainian financial system being bank-centric remains vulnerable to money laundering passing through a network of non-bank financial intermediaries. Until July 2020, the non-banking financial sector remained largely unregulated. However, Ukraine has been implementing the Financial Sector Strategy 2015-2020, as well as a new strategy approved until 2025. The country has also introduced corporate governance reforms for the state-owned banks, monitored by the National Bank of Ukraine.

**Figure 1.3. Number of banks and their share of assets to GDP in Ukraine**

![Graph showing number of banks and their share of assets to GDP in Ukraine](image)

Source: Author’s compilation is based on the figures provided by the Ministry of Finance of Ukraine (Ministry of Finance, 2020[33]).

### 1.7. Capital markets

Ukraine’s capital markets are underdeveloped. In 2018, the country’s market capitalisation was USD 4.4 billion, or approximately 3.4% of GDP (comparably, the

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10 In July 2020, the NBU became the regulator of the market for nonbank financial services of the financial sector, which comprises insurance companies, leasing companies, factoring companies, credit unions, pawnshops, and other financial institutions.

same year market capitalisation in Poland was USD 160.5 billion, or 27.3% of GDP) (World Bank, 2020[11]). Initially, Ukraine developed ten stock exchange platforms regulated by the National Commission on Securities and Stock Market (NCSSM), the National Bank of Ukraine (NBU) and the Cabinet of Ministers (CMU). Currently, five platforms are left, of which four remain active (Table 1.2), as Ukrainian Interbank Currency Exchange is mainly involved in foreign exchange (NCSSM, 2020[33]; NCSSM, n.d.[34]). Capital markets have struggled to develop in Ukraine and have benefitted largely from foreign capital, thus remaining vulnerable to flight risks. During the 2007-2008 global financial crisis, the liquidity on the Ukrainian market was halved (Zotsenko, 2014[35]).

Further challenges have included a lack of uniformity due to the fragmentation of the stock market and the conduct of operations outside the organised market, thus rendering the regulatory authorities unable to guarantee security to investors. Moreover, a perception of poor corporate governance, limited disclosure, and a lack of protections for minority shareholders, along with potential market manipulations and the presence of vested interests, have contributed to discouraging the development of capital markets. In remediying these issues, the NCSSM has sought to improve legal and regulatory frameworks by introducing draft laws to develop capital markets and to protect investors’ rights (NBU, 2018[36]). Further elements have included the development of legal and regulatory frameworks for derivatives to assist with risk management and price discovery, and the development of an updated Corporate Governance Code in 2020 (Usov, 2020[37]). In addition, in June 2020, the Ukrainian parliament introduced a law on investment facilitation and the introduction of new financial instruments, aimed at re-launching the national stock market and transforming it into a capital market. It also provides for the development of corporate governance systems for participants in the securities market (Verkhovna Rada, 2020[38]). However, on-going challenges in the capital markets can have significant implications for both state and private companies, including the ability to raise capital and attract investments.

Table 1.2. Trade volumes by platforms and instruments in 2019 (UAH million)

<table>
<thead>
<tr>
<th>Platform</th>
<th>Shares (excluding CIF)</th>
<th>O/F-shares</th>
<th>Foreign shares</th>
<th>Corp. bonds</th>
<th>Foreign corp. bonds</th>
<th>Foreign private bonds</th>
<th>Ukrainian priv. bonds</th>
<th>Local bonds</th>
<th>Investment certificates</th>
<th>Option certificates</th>
<th>Derivatives</th>
<th>Government derivatives</th>
<th>Total trade volume</th>
<th>Market share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perspektiva</td>
<td>0.9</td>
<td>0</td>
<td>0</td>
<td>554.5</td>
<td>0</td>
<td>0</td>
<td>185,602.7</td>
<td>0</td>
<td>0.01</td>
<td>196.1</td>
<td>0</td>
<td>9.1</td>
<td>186,363.2</td>
<td>61.1%</td>
</tr>
<tr>
<td>PFTS</td>
<td>251.3</td>
<td>2.8</td>
<td>22.3</td>
<td>5,447.4</td>
<td>27.2</td>
<td>44.2</td>
<td>106,240.4</td>
<td>305.6</td>
<td>331.7</td>
<td>0</td>
<td>0</td>
<td>114,672.7</td>
<td>37.6%</td>
<td></td>
</tr>
<tr>
<td>Ukrainian Exchange</td>
<td>82.7</td>
<td>0.2</td>
<td>3.4</td>
<td>2,697.8</td>
<td>0</td>
<td>0</td>
<td>1,056.0</td>
<td>0</td>
<td>0.1</td>
<td>0</td>
<td>0</td>
<td>3,840.2</td>
<td>1.3%</td>
<td></td>
</tr>
<tr>
<td>Ukrainian Stock Exchange</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>4.4</td>
<td>4.4</td>
<td>0</td>
<td>&gt;0.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>334.8</td>
<td>3.0</td>
<td>25.7</td>
<td>8,699.7</td>
<td>27.2</td>
<td>44.2</td>
<td>294,899.1</td>
<td>331.8</td>
<td>196.1</td>
<td>4.4</td>
<td>9.1</td>
<td>304,880.5</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Author’s compilation is based on National Securities and Stock Market Commission Annual Report and supporting document presenting macroeconomic indicators. Source: (NCSSM, 2020[33])
Chapter 2. Overview of Ukrainian SOEs

Following the dissolution of the Soviet Union in 1991, Ukrainian leadership sought to develop a market economy and, within this framework, promoted a policy to privatise state-owned assets. In 1992, a law on privatisation was adopted, which provided an opportunity for employees to purchase shares within state enterprises on preferential terms (later on, a voucher programme was introduced to further ease the privatisation process). The State Property Fund of Ukraine (SPFU) was established to privatise state-owned assets and to manage state-owned entities under its oversight, including companies, non-corporatised infrastructure and real estate. The country briefly established the Ministry of Privatisation as a responsible entity for policymaking, though it was soon abolished and some of its functions were transferred to the SPFU (Boytsun, 2019[39]).

The process of managing and privatising state-owned assets, however, was ill-designed, and raised issues in policymaking. For one, during the 1990s more than 60,000 SOEs were sold at artificially low prices and were concentrated within the hands of former executives. The receipts from privatisation amounted to approximately 3% of GDP in 2000, compared to an average of 9% in other transition economies (OECD, 2019[40]) (Boytsun, 2019[39]). For another, the line ministries raised issue with the State Property Fund’s involvement in the management and the privatisation of state assets, for which the ministries perceived themselves to be responsible. Moreover, due to the sale of SOEs in opaque transactions, the privatisation policy experienced a decline in popular support, which waned steadily since 1992 (Boytsun, 2019[39]). As a result of this historical reality, the central government retained control over a large and, by some measures, unwieldy portfolio of SOEs, as elaborated in the sections below.

2.1. Number and types of state-owned enterprises

Compared with most countries, Ukraine has a significantly large SOE portfolio, with 3,293 SOEs reported at the central level of government (Figure 2.1). Out of these entities, 1,535 were operational and 1,063 were profitable, with an overall profit of UAH 52.1 billion in 2019, albeit with a lower ROE and ROA compared to private companies (see Table 2.2). The remaining entities are either inactive or in the

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12 The figure is based on the government’s official monitoring data as of 01.01.2020, and it does not include 168 entities located in Crimea. Moreover, according to other estimates and platforms, including ProZvit – a newly launched government portal which aggregates financial and ownership data for Ukrainian SOEs – there are over 3,500 SOEs. The platform, however, is being updated and may not contain full information.

13 In 2018, out of 1,640 operational SOEs, Ukraine reported a net profit of UAH 31.2 billion, based on the information provided to the assessment team by Ukrainian authorities. According to the YouControl data, ROE was 2% and ROA was less than 0.1% in SOEs, though figures provided by Ukrainian officials were higher (see Annex A) (YouControl, 2020[85]).
process of being liquidated. In addition, a number of state-owned companies are located in Crimea and the Donbass, for which no information was made available.\textsuperscript{14}

Considering the large size of Ukraine’s SOE sector and various state registries that record the state enterprise portfolio, the exact number of SOEs is subject to debate (more detailed data and methodological issues are addressed in Annex A). Moreover, these figures exclude the municipally-owned enterprises (estimated to be around 14,000), as discussed in further detail in Section 8 of this report.

**Figure 2.1. Overview of state-owned enterprise distribution by country**

Ukraine has a fully decentralised ownership model, with over 80 central executive bodies, ministries and state agencies exercising SOE ownership rights. Among the line ministries, some of the largest SOE portfolios belong to the Ministry for the Development of Economy, Trade and Agriculture (MDETA), the Ministry of Energy, the Ministry of Justice, and the Ministry of Defence. The Cabinet of Ministers holds some of the key SOEs, including Naftogaz Group (hydrocarbons company) and Ukrzaliznytsia (national railway), though ownership functions are often delegated to the line ministries.

Additionally, a number of agencies and institutions perform ownership functions. For example, the State Forest Resource Agency and the State Property Fund, the country’s privatisation agency, hold some of the largest SOE portfolios (see Annex A). Other examples with smaller shares include the National Academy of Sciences and the State Service on Geodesy, Cartography and Cadastre, though entities under their ownership are typically non-commercial (such as scientific and research centres). Some of Ukraine’s major SOE groups and holding companies (such as Naftogaz) exercise ownership rights to a degree over their subsidiaries and affiliated companies.

\textsuperscript{14} Of the overall portfolio, 1,365 did not carry out financial and economic activities (with 277 located in the Donbass) and 561 entities did not provide any information (168 are located in Crimea and 62 are located in the Donbass).
When measured by equity value, the CMU and the Ministry of Energy are responsible for the largest share of the SOE portfolios. This is primarily accounted for by the large energy SOEs that fall under their ownership.\textsuperscript{15} The Ministry of Finance became an ownership entity of Ukrenergo (electricity transmission system operator) and the Main Gas Pipelines of Ukraine (a special purpose company that owns Ukraine’s gas transmission system operator) in 2018 and 2019, respectively, thus increasing its portfolio based on equity value (CMU, 2018\textsuperscript{[43]} (CMU, 2019\textsuperscript{[44]}). It is also worth noting that as the Ministry of Energy has experienced a number of restructurings, the SOEs under its control may have changed. Other line ministries that have significant SOE portfolios include the Ministry of Infrastructure and MDETA, though their share of equity value remains smaller. However, the government announced plans to change ownership entities among some of the key energy SOEs in 2021 (as further elaborated in the review), which may impact this assessment (CMU, 2021\textsuperscript{45}).

\textbf{2.2. Sectoral distribution of SOEs}

In terms of their sectoral distribution by number, most SOEs are concentrated in agriculture, forestry and fisheries (covered under “primary sector” in the subsequent tables and figures, including Table 2.1, Figure 2.2 and Figure 2.3), and in professional, scientific and technical services (covered under “other activities” in the subsequent tables and figures), followed by manufacturing. While the exact figures may vary by reporting entity (as outlined in Annex A), the share of SOEs registered within these sectors remains three to seven times higher compared to other sectors, including mining and quarrying, ITC, construction and trade.\textsuperscript{16}

\begin{table}[h]
\centering
\begin{tabular}{|l|l|l|l|l|}
\hline
 & Number of SOEs & Number of employees & Equity value (thousand UAH) & Equity value (thousand USD) \\
\hline
Primary sector & 818 & 93,673 & 11,808,897 & 429,102 \\
Manufacturing & 729 & 86,599 & 10,414,625 & 378,438 \\
Finance & 32 & 353 & 12,348,187 & 448,699 \\
Telecoms & 128 & 12,000 & 1,005,874 & 36,551 \\
Electricity and gas & 42 & 71,342 & 201,368,730 & 7,317,178 \\
Transportation & 113 & 296,229 & 267,009,549 & 9,702,382 \\
Other utilities & 28 & 5,460 & 1,396,848 & 50,758 \\
Real estate & 50 & 927 & 602,793 & 21,904 \\
Other activities & 1,353 & 157,001 & 423,014,211 & 15,396,461 \\
Total & 3,293 & 723,584 & 903,340,173 & 32,850,166 \\
\hline
\end{tabular}
\caption{Sectoral distribution of centrally-owned SOEs by employment and value}
\end{table}

\textsuperscript{15} The CMU is the ownership entity of Naftogaz, with an equity value of UAH 398.7 billion and an income of UAH 204.9 billion, generating approx. 27.8% of the total income received by operating SOEs according to figures provided by the Ukrainian authorities.

\textsuperscript{16} According to the questionnaire responses, out of 3,293 SOEs, there are over 900 entities in professional, scientific and technical activities, 700 in agriculture, forestry and fisheries, and 650 in manufacturing. Comparably, transport, trade, ITC, construction and mining have between 100-200 entities within each sector. Others, including arts, sports and entertainment, education, and administrative, have fewer than 100 entities each.
Note: Calculations are based on 3,293 enterprises provided in the questionnaire, though there may be discrepancies as outlined under Annex A. Data was submitted based on NACE Rev 2 and was re-formatted to fit the OECD SOE sector reporting standards. “Primary sector” includes data on mining and quarrying, and agriculture, forestry and fisheries. Construction has been included under “manufacturing”. “Other activities” cover public administration, temporary accommodation and catering, education, healthcare and social assistance, professional, scientific and technical activities, wholesale and retail trade, and administrative services. Conversion from UAH to USD is based on 1 USD = UAH 27.52 (August 31, 2020).

Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

While SOEs in professional, agricultural and manufacturing activities represent a significant share of the portfolio in terms of sheer number, the latter two are less significant in terms of their employment and equity value. There are nearly 900 SOEs and 71,000 individuals engaged in professional activities, while representing UAH 401.9 billion in equity value (included under “other activities” in Table 2.1 and subsequent figures). Though the SOEs operating within the energy sector are less numerous, those engaged in the electricity and gas sub-sectors represent UAH 201.4 billion in equity value. However, the SOEs involved in the primary sector have faced significant losses and remain heavily indebted, with companies operating in the mining and quarrying sector having a negative equity value (up to UAH 19.9 billion) as of 2019.

Another key sector is transportation, warehousing and postal services (covered under “transportation” in subsequent figures), with nearly 300,000 employees and an equity value of UAH 267 billion. Other activities, including real estate, finance, and telecoms, represent a smaller share in employment and equity value (with significant losses in telecommunications).

Figure 2.2. Sectoral distribution of centrally-owned SOEs by number of enterprises (2019)

Note: Author’s compilation is based on 3,293 enterprises provided through the questionnaire. “Other activities” include professional, scientific and technical activities, with 896 SOEs. It also includes wholesale and retail trade, administrative activities, public administration, arts and recreation, catering, healthcare and social assistance and education, all of which represent a significantly smaller number of entities and employees.

Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])
2.3. Employment

According to MDETA, SOEs represent 11.9% of total employment in Ukraine, which is higher compared to some of the OECD countries with the largest SOE sectors based on the percentage of total (non-agriculture) employment (Figure 2.4) (MDETA, 2020[46]). However, considering a large MOE sector and potential underreporting, it is likely that the overall employment in the sector is higher. The figures may also vary depending on the calculation methodology.\(^\text{17}\) Ukraine’s top SOE employers are in the energy and transportation sectors, along with professional, scientific and technical activities, and administrative services (covered under “other activities” in Figure 2.5). Additional key sectors for SOE employment include manufacturing, information and technologies, and utilities, with a limited share in finance and insurance, real estate, and trade.

\(^{17}\) IMF/EBRD (2019) estimated the share of SOE employment at 13% (for 2016), while according to the EBRD, the figure was closer to 16% (MDETA, 2019[120]; EBRD, 2020[123]). In determining the overall size of employment in the SOE sector, the State Statistics Service of Ukraine considers SOE employees (723,584) as a share of individuals that are payroll employees (amounting to 6.3 million). However, it is worth noting that there are approximately 16.6 million individuals employed in Ukraine.
Figure 2.4. SOE share in national employment in OECD countries

Note: Author’s compilation is based on the 2015 figures available through the data collection exercise carried out under the Size and Sectoral Distribution of State-Owned Enterprises (2017), reflecting non-agriculture employment. Source: (CMU, 2020[42]; OECD, 2017[41]; SSSU, 2020[47])

Figure 2.5. Share of SOE employment in Ukraine by sector

Note: Author’s compilation is based on the data provided through the questionnaire responses and the State Statistics Service (total employment) database. “Primary sector” in this figure excludes agriculture, forestry and fisheries, and reflects only mining and quarrying. Source: (CMU, 2020[42]; SSSU, 2020[47])

Transport, warehousing, postal and courier activities together are responsible for 41% of the employment within the SOE sector (see Figure 2.3). This is largely because Ukrzaliznytsia, the national railway company, employs more than 250,000 individuals. Ukroposhta, the national postal service and public service provider (including pension distribution), is another key employer, with a staff of approximately 70,000. Other major employers include energy and manufacturing SOEs, followed by professional and administrative services, utilities and social services.
2.4. Operational performance of SOEs

According to a previous assessment by the government of Ukraine, the top-100 largest SOEs in Ukraine held over 90% of assets within the overall portfolio and generated most of the revenue.\(^\text{18}\) Energy SOEs (mainly in oil, gas and electricity) have remained some of the most profitable, with Naftogaz driving a large share of the revenue (MDETA, 2019\(^{[33]}\)). However, SOEs in the overall portfolio generate substantially lower rates of return on equity compared to their private counterparts, thus posing a challenge for the Ukrainian economy. They also exhibit lower return on assets, profit margins, liquidity ratios, and asset turnover, and have higher indebtedness (Table 2.2). While their (low) rates of return have been stable over the past three years, their liquidity ratios have tended to further decrease on average, and their average debt-to-equity ratio has continued to grow (Table 2.3).\(^\text{19}\)

Moreover, according to an assessment by the IMF and the EBRD, Ukrainian SOEs generate significantly less revenue per employee than in private companies, representing one of the least efficient SOE sectors among Central and Eastern European economies. SOE monthly wages for employees may at times be higher compared to the private sector, which can impose additional burden on SOE profitability and the bottom line (IMF & EBRD, 2019\(^{[49]}\)). However, the gap between the salaries may also be attributed to a large shadow economy and informal sector (up to 21.6% in 2018), allowing private companies to minimise tax contributions (OECD, 2020\(^{[29]}\)).\(^\text{20}\)

Table 2.2. Key financial ratios (median) for 2019 for enterprises with different type of ownership

<table>
<thead>
<tr>
<th>Ownership Type</th>
<th>Return on Equity</th>
<th>Return on Assets</th>
<th>Profit Margin</th>
<th>Current Ratio</th>
<th>Quick Ratio</th>
<th>Debt-to-Equity Ratio</th>
<th>Asset Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned enterprises</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>1.05</td>
<td>0.51</td>
<td>0.40</td>
<td>0.97</td>
</tr>
<tr>
<td>Municipally-owned enterprises</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.81</td>
<td>1.02</td>
<td>0.05</td>
<td>0.93</td>
</tr>
<tr>
<td>Private companies</td>
<td>8%</td>
<td>1%</td>
<td>2%</td>
<td>1.28</td>
<td>0.83</td>
<td>0.18</td>
<td>1.10</td>
</tr>
</tbody>
</table>

Note: SOEs were distinguished based on the register provided by the CMU. MOEs were defined based on their legal form: Companies registered as a “communal enterprise” were selected, although some of MOEs may be registered as JSCs or LLCs. Ratios were computed based on raw data for each observation and median figures were used to limit sensitivity to outliers. The data includes median figures for all private companies available through YouControl. Moreover, figures may differ based on the government’s database, unified monitoring of the efficiency of management of state-owned objects, which are outlined in Annex A.

Source: Author’s compilation is based on YouControl data for 2019.

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\(^\text{18}\) According to the Ukrainian authorities, top-100 SOEs generated UAH 44.4 billion profit in 2017 (2.94% ROA and 4.86% ROE) and 32.1 billion in 2016 (2.23% ROA and 3.46% ROE) (MDETA, 2018\(^{[33]}\)). Discrepancies in financial ratios calculated by the OECD and Ukrainian authorities are outlined in Annex A.

\(^\text{19}\) OECD assessment is based on the YouControl database (YouControl, 2020\(^{[49]}\)). Ukrainian authorities also shared their assessment based on the calculations using an internal database, though the assessment team was not provided with access. The figures shared by the authorities are outlined in Annex A.

\(^\text{20}\) According to the Ukrainian authorities, average monthly salary at public sector enterprises (SOEs) in 2019 was UAH 12,819 (excluding the average monthly salary of JSC Naftogaz of Ukraine). Comparably, the SSSU stated that the average monthly salary in Ukraine in 2019 was UAH 9,970 (SSSU, n.d.\(^{[32]}\)).

\(^\text{21}\) The share of informal employment in total employment includes those informally employed in enterprises, contributing family members, and persons who worked according to verbal agreement or had no social guarantees.
On a sectoral level, SOEs in mining and quarrying, and telecommunications have reflected negative equity values, though some of the least efficient SOEs may also be found in manufacturing, construction, water supply and waste management. A further example of inefficiency may be observed in alcohol production, which, until recently, had a state monopoly. Out of twenty-one SOEs engaged in production, only eight were profitable and eleven were in bankruptcy. Despite these figures, the price of alcohol in Ukraine was over 40% higher compared to the prices in the EU and other neighbouring countries (Talakh, 2020[50]).

<table>
<thead>
<tr>
<th>Year</th>
<th>Return on equity</th>
<th>Return on assets</th>
<th>Profit margin</th>
<th>Current ratio</th>
<th>Quick ratio</th>
<th>Debt-to-equity ratio</th>
<th>Asset turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>1.10</td>
<td>0.58</td>
<td>0.34</td>
<td>0.95</td>
</tr>
<tr>
<td>2018</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>1.07</td>
<td>0.56</td>
<td>0.38</td>
<td>1.01</td>
</tr>
<tr>
<td>2019</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>1.05</td>
<td>0.51</td>
<td>0.40</td>
<td>0.97</td>
</tr>
</tbody>
</table>

Note: Figures may differ based on the government’s database, unified monitoring of the efficiency of management of state-owned objects, which are outlined in Annex A.

Source: Author’s compilation is based on YouControl data for 2019.

Potential reasons for the inferior performance of SOEs may include corruption, undue political intervention in SOEs operations, uneven playing field resulting from public service obligations (PSOs), and poor management. Numerous cases of corruption in SOEs are reported in the media and in the regular reports of the National Anti-Corruption Bureau of Ukraine (NABU), as elaborated in the subsequent sections. In addition, PSOs are explicitly or implicitly imposed on SOEs in the electricity and gas markets, rail transportation, and postal services, and their fulfilment is often cross-subsidised by the inflows from their profitable areas of business. (Specific cases of corruption and PSOs may be found in the description of top-10 Ukrainian SOEs in Section 3, with broader policy challenges outlined in Section 4). Moreover, Ukraine has only recently begun to implement corporate governance reforms in economically important SOEs with the introduction of independent boards of directors and competitive selection of CEOs. Other elements include weak corporate governance and a lack of internal controls, and uncompetitive remuneration compared to practices in private companies. Poor shareholder oversight due to weak institutional capacity also contributes to challenges in SOE performance.

It is also worth noting that inferior performance of SOEs compared to private companies have generally resulted in the former’s poor access to capital. Based on the questionnaire response from the Ukrainian authorities, most important creditors of Ukrainian SOEs are international financial institutions (EBRD, IFC, EIB, and the World Bank) and Ukrainian state-owned banks. A trade credit from one SOE to another can also be an important source of funding depending on the industry.

At the time of writing, information regarding financial performance of Ukrainian SOEs in 2020 was unavailable. However, economic downturn due to Covid-19 has no doubt had a significant impact on some of the key SOEs, particularly those operating in energy and transport sectors. Due to the pandemic, there was a restructuring of technological processes and production facilities in oil and gas companies in the country. Although production was not directly impacted, decline in hydrocarbons prices globally was reflected in Ukraine, with Naftogaz reporting a net loss for the first
time since 2016, amounting to approximately UAH 19 billion (Naftogaz Group, 2021[52]). In addition, enterprises under the Ministry of Energy have reported a net loss of over UAH 4 billion for 2020 (Boytsun et al., 2021[53]).

Along with the energy sector, travel restrictions resulted in losses for SOEs operating in the transport sector. Rail freight significantly decreased during the first months of the pandemic, while a ban on international travel led to airlines suspending their operations. Ukrzaliznytsia has suffered significant challenges, with net losses in 2020 amounting to USD 426 million. Compared to 2019, income generated from both passenger and freight transportation fell by 58% and 22%, respectively. Further difficulties have resulted from currency volatility, as well as increased payments for social benefits and early retirement to avoid hazardous working conditions (Antoniuk, 2021[54]). To mitigate challenges, certain measures targeting SOEs were adopted, including the postponement of dividend payments in some cases and provision of state aid, particularly to compensate employees (CMU, 2020[55]) (KAS, 2020[56]). In addition, international partners have provided additional support measures to certain Ukrainian SOEs (particularly Boryspil Airport) to help weather the impact of the pandemic (EIB, 2021[57]).
Chapter 3. Description of the top-10 Ukrainian SOEs

As part of promoting SOE sector reforms, in December 2019 the Ukrainian government adopted a protocol decision to improve corporate governance practices in its top-10 economically important SOEs with the stated intention to align practices with the SOE Guidelines (hereafter referred to as “top-10”). In July 2020, the list was further extended to include five additional SOEs (Table 3.1) (hereafter referred to as “top-15”).\(^{22}\) Considering the size of Ukraine’s SOE portfolio, the subsequent section will limit its focus on a description of the top-10 SOEs according to the sector of operation, namely energy, transportation and infrastructure, defence and agriculture. For each enterprise, an overview of activities, financial performance, and corporate governance practices is provided. The remaining enterprises identified under the top-15 are covered in Annex B. The challenges identified in their corporate governance reforms are also reflective of those perceived for the broader portfolio.

Table 3.1. Top-15 SOEs by value and employment (2019)

<table>
<thead>
<tr>
<th>Top-15</th>
<th>Legal form</th>
<th>Sector</th>
<th>Equity value (in thousand UAH)</th>
<th>Employment 1</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Naftogaz of Ukraine</td>
<td>Joint-stock company</td>
<td>Energy</td>
<td>385,173,670</td>
<td>71,844 (Parent company= 666)</td>
<td>CMU (delegation to MDETA)</td>
</tr>
<tr>
<td>Ukrzaliznytsia</td>
<td>Joint-stock company</td>
<td>Transport</td>
<td>211,816,203</td>
<td>255,013</td>
<td>CMU (delegation to Ministry of Infrastructure)</td>
</tr>
<tr>
<td>Energoatom</td>
<td>State unitary enterprise</td>
<td>Energy</td>
<td>134,122,148</td>
<td>33,951</td>
<td>CMU (transferred from Ministry of Energy in 2021)</td>
</tr>
<tr>
<td>Ukrenergo</td>
<td>Joint-stock company</td>
<td>Energy</td>
<td>37,433,157</td>
<td>8,011</td>
<td>Ministry of Finance (to be transferred to the Ministry of Energy)</td>
</tr>
<tr>
<td>Ukhydroenergo</td>
<td>Joint-stock company</td>
<td>Energy</td>
<td>25,855,325</td>
<td>3,064</td>
<td>CMU (transferred from Ministry of Energy in 2021)</td>
</tr>
<tr>
<td>State Food and Grain Corporation</td>
<td>Joint-stock company</td>
<td>Other</td>
<td>(9,510,004)</td>
<td>4,534</td>
<td>MDETA</td>
</tr>
<tr>
<td>Ukrainian Sea Ports Authority</td>
<td>State unitary enterprise</td>
<td>Transport</td>
<td>20,134,528</td>
<td>7,261</td>
<td>Ministry of Infrastructure</td>
</tr>
<tr>
<td>Ukroposhta</td>
<td>Joint-stock company</td>
<td>Transport (postal service)</td>
<td>2,764,344</td>
<td>64,655</td>
<td>Ministry of Infrastructure</td>
</tr>
</tbody>
</table>

\(^{22}\) Based on a Protocol Decision No. 26 issued in December 2019, the government sought to improve corporate governance practices in 10 SOEs, including Naftogaz, Ukrzaliznytsia, State Food and Grain Corporation, Ukhydroenergo, Ukrenergo, Ukroboronprom, Ukroposhta, Energoatom, Sea Ports Authority, and Boryspil Airport (MDETA, n.d.[150]). In July 2020, the government issued a Protocol Decision No. 62 and added five SOEs to the list, including the Gas Transmission System Operator of Ukraine (GTSO), the Agrarian Fund, the Automobile Roads of Ukraine, the Air Traffic Control and Polygraph Combine Ukraina.
38 | DESCRIPTION OF THE TOP-10 UKRAINIAN SOEs

<table>
<thead>
<tr>
<th>Description of the Top 10 Ukrainian SOEs</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Boryspil International Airport</td>
<td>State unitary enterprise</td>
<td>Transport</td>
<td>12,381,377</td>
<td>4,434</td>
</tr>
<tr>
<td>Ukroboronprom</td>
<td>State “concern” Other (defence)</td>
<td>29,596,926</td>
<td>67,780</td>
<td>CMU</td>
</tr>
<tr>
<td>Polygraph Combine Ukrainia</td>
<td>State unitary enterprise</td>
<td>Other</td>
<td>1,604,299</td>
<td>996</td>
</tr>
<tr>
<td>UkSATSE Air Traffic Services</td>
<td>State unitary enterprise</td>
<td>Transport</td>
<td>5,348,166</td>
<td>4,300</td>
</tr>
<tr>
<td>Gas Transmission System Operator</td>
<td>Limited liability company</td>
<td>Energy</td>
<td>(newly established, function unbundled from Naftogaz)</td>
<td>(newly established, function unbundled from Naftogaz)</td>
</tr>
<tr>
<td>Automobile Roads of Ukraine</td>
<td>Joint-stock company</td>
<td>Transport</td>
<td>2,359,248</td>
<td>16,444</td>
</tr>
<tr>
<td>Agrarian Fund</td>
<td>Joint-stock company</td>
<td>Other</td>
<td>2,030,219</td>
<td>252</td>
</tr>
</tbody>
</table>

Note:
1 Employment figures for top-15 SOEs may be underreported, as, in some cases, information was reported only for the parent company. Naftogaz employment figures reflect the status as of 2018.
2 It is worth noting that CMU does not have corporate governance units responsible for entities under its authority. Certain ownership functions are delegated to other bodies, such as MDETA for Naftogaz and the Ministry of Infrastructure to Ukrzaliznytsia, based on the CMU Procedures (though this may be revoked at any time). However, CMU remains the ownership entity and exercises shareholder powers, including reorganisation, board member and CEO appointments, and overseeing transactions. Moreover, certain delegated functions can be conflicting – for instance, Ministry of Infrastructure exercises regulatory and policymaking functions, along with ownership functions in Ukrzaliznytsia.
Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42]) (CMU, 2018[58]).

3.1. Energy sector

3.1.1. Naftogaz of Ukraine

Overview

Naftogaz is a vertically integrated company operating in the hydrocarbons sector. It is engaged in a full cycle of operations in gas and oil field exploration and development, production and exploratory drilling, gas and oil transport and storage, and supply of natural gas and liquefied petroleum gas (LPG) to consumers. Aside from commercial operations, the company plays an important social role, as it supplies natural gas designated for households, institutions funded through the state budget, and utilities at prices set by the state under the public service obligation (PSO) (Naftogaz Group, n.d.[59]).

The company has maintained separate analytical accounting of activities subject to the PSO so that it may fairly determine the compensation the company should claim to cover its losses. At the same time, the CMU must identify sources of funding and the procedure to compensate natural gas market participants subject to PSO, though no such methodology or compensation mechanism has been developed. In December 2020, after a prolonged discussion that required adopting a separate law, Naftogaz received a PSO compensation worth approximately UAH 32.2 billion.

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23 The PSO is set by the CMU and was imposed on Naftogaz from October 2015 until August 2020. However, Naftogaz has continued to supply natural gas to heating companies at regulated tariffs.
Financial performance

In 2019, Naftogaz was the largest Ukrainian SOE by the value of assets and revenues. During the past six years, its performance has improved substantially, which can largely be attributed to its improved corporate governance framework (Table 3.2). According to Naftogaz Group, in 2019 its cash flow from operating activities amounted to UAH 110 billion, which contributed to boosting its liquidity ratios. Nearly half of this sum (post-tax) amounted to the award following its litigation against Gazprom in the Stockholm Court of Arbitration (USD 2.9 billion gross) (Naftogaz Group, 2020[60]). In addition, in 2019 Naftogaz issued Eurobonds worth USD 835 million and EUR 600 million, which increased its debt-to-equity ratio from 0.24 in 2018 to 0.33 in 2019 (Naftogaz Group, 2020[61]). Naftogaz also remains Ukraine’s largest contributor to the government budget through taxes and dividends, accounting for nearly 16% of the state budget revenue in 2019 (Naftogaz Group, 2020[62]).

While Naftogaz was previously involved in gas transmission through its subsidiary, this function has been unbundled and, as of 2020, it is performed by the Gas Transmission System Operator under the ownership of MGU (as further described in Annex B). As a significant portion of Naftogaz’s revenue was generated through transmission activities, unbundling may impact its financial position moving forward. In 2020, Naftogaz reported a net loss of UAH 19 billion partly due to Covid-19, which contributed to a drop in demand and price fluctuation. Other challenges have included public service obligations that have forced Naftogaz to sell natural gas at 30% below market price, as well as significant debts (up to USD 1.5 billion) owed by regional gas supply companies (Query, 2021[63]) (Naftogaz Group, 2021[52]).

Table 3.2. Key financial indicators of Naftogaz

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>74,412,085</td>
<td>112,761,671</td>
<td>161,382,827</td>
<td>187,927,433</td>
<td>204,938,122</td>
<td>178,349,399</td>
</tr>
<tr>
<td>EBITDA</td>
<td>-37,712,286</td>
<td>6,985,420</td>
<td>34,873,740</td>
<td>56,684,830</td>
<td>22,049,674</td>
<td>74,971,410</td>
</tr>
<tr>
<td>Net financial result</td>
<td>-85,044,610</td>
<td>-25,096,084</td>
<td>26,526,989</td>
<td>39,330,153</td>
<td>13,613,258</td>
<td>50,658,211</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>13,264,495</td>
<td>29,497,614</td>
<td>20,751,932</td>
</tr>
<tr>
<td>Total assets</td>
<td>221,804,726</td>
<td>456,954,432</td>
<td>599,792,463</td>
<td>638,946,642</td>
<td>495,025,674</td>
<td>511,240,860</td>
</tr>
<tr>
<td>Total payables</td>
<td>93,812,180</td>
<td>109,204,715</td>
<td>130,568,865</td>
<td>175,466,700</td>
<td>78,675,050</td>
<td>91,854,237</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>26,611,562</td>
<td>34,826,207</td>
<td>22,971,585</td>
<td>14,117,317</td>
<td>10,707,317</td>
<td>46,680,035</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-39.2</td>
<td>-5.6</td>
<td>4.7</td>
<td>6.4</td>
<td>2.4</td>
<td>10.1</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-76.1</td>
<td>-7.3</td>
<td>6.1</td>
<td>8.9</td>
<td>3.3</td>
<td>12.9</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

Naftogaz is a joint-stock company organised as a company group. As of 2016, the CMU has been its ownership entity. The group brings together companies operating

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24 Hereinafter, the liquidity and debt-to-equity ratios are authors’ calculation based on YouControl data.
either as subsidiary “daughter” companies, wholly-owned business companies, and partially-owned business companies, distinguished as follows:

- Subsidiary “daughter” companies are established by Naftogaz and are not classified as business companies (“corporations”). Naftogaz is the sole owner of these subsidiaries.
- Wholly-owned business companies are joint-stock or limited liability companies incorporated by Naftogaz and/or in which Naftogaz holds 100% of shares. This category includes three large companies: Ukrgasvydobuvannya (gas extraction), and Ukrtransnafta (oil transportation pipelines). Wholly-owned business companies have a greater degree of autonomy and are not subject to the same level of subordination to the parent company as the subsidiary “daughter” companies.
- Partially-owned business companies have been partly privatised. Naftogaz owns shares in 44 such entities. In six of these companies, including Ukrautogas (engaged in oil extraction and petroleum retail), Naftogaz is a majority shareholder. The remaining 38 are local gas distribution and gasification companies in which Naftogaz is a minority shareholder (in most cases, 25% plus one share), and the effective control over these entities remains with vested interests.

In addition, the subsidiaries of Naftogaz have their own subsidiary companies operating within sectors beyond hydrocarbons, such as agriculture, food processing, health services, real estate and hospitality. Naftogaz also has “representative offices”, or branches, in eight different locations. These offices have their own legal personality but are not significant in terms of their business operations (OECD, 2019).

Over the last six years, Naftogaz has sought to implement corporate governance reforms. The company developed a Corporate Governance Action Plan (CGAP) together with the EBRD, which was benchmarked against the OECD SOE Guidelines and undertaken to meet EBRD loan conditionality (Naftogaz Group, 2019). Adopted by the CMU in 2015, the CGAP envisaged the development and approval of amendments to laws regulating SOE governance, and bringing practices closer to the G20/OECD Principles of Corporate Governance and the OECD SOE Guidelines. In addition, the first-ever independent supervisory board in a Ukrainian SOE was appointed in Naftogaz in 2016 consisting of five individuals, including three independent members and two state representatives. In 2017, one state representative and all independent board members resigned, with the latter expressing a number of complaints with regard to the state’s role as an owner and corporate governance deficiencies (this fact was also perceived as a sign of board independence) (OECD, 2019).

According to Naftogaz’s current charter, the supervisory board must consist of seven members, including an independent majority (implying, based on the law, that the rest of the positions should be filled by state representatives), and the company had five board members, with one independent and one state representative missing. The company had also established a management board (collegiate executive body) consisting of five members, including the CEO. The CEO was previously appointed in 2014 directly by the CMU and re-appointed (with the approval of the supervisory board) in 2020 without a competitive selection procedure (Economic Truth, 2020).

25 These are small entities, including Ukrautogas, Gas of Ukraine, Zakordonnaftogaz, Vuglesyntezgaz Ukraine, Naftogaz-Energoservice, Nauknaftogaz, Naftogazobslugovuvannya, Naftogazbezpeka, and Budivelnyk.
However, on April 28, 2021, the CMU terminated the powers of supervisory board members and the CEO, citing unsatisfactory performance due to significant losses faced by Naftogaz in 2020. The supervisory board members were reappointed on April 30 to continue performing their functions. However, before their reappointment, on April 29 a former acting Minister of Energy was appointed as the CEO of Naftogaz (CMU, 2021[67]). In response to these developments, all board members of Naftogaz submitted written notices to terminate their powers effective May 14, 2021 (Naftogaz Group, 2021[68]). These developments have resulted in concerns among the members of the international community, including international financial organisations and G7 Ambassadors as to Ukraine’s commitment to implement internationally accepted corporate governance practices.26

3.1.2. Ukrenergo

Overview

The National Power Company Ukrenergo is a natural monopoly that acts as a transmission system operator in Ukraine’s electricity sector. It exercises operational and technological control over the Integrated Power System of Ukraine (IPS) and transmits electricity via trunk power grids from generation to distribution networks. Other functions include acting as a commercial metering administrator and settlement administrator of the Ukrainian electricity market, while coordinating transmission system operations and managing cross-border electricity flows with neighbouring countries (OECD, 2020[69]).

Ukrenergo was established in 1998 following a merger of two SOEs, namely the National Dispatching Centre of Ukraine and the electricity company Ukrelektroperedacha. Ukrenergo is currently undergoing a significant transformation to meet the requirements under the Electricity Market Law adopted in 2017, which called for the establishment of an independent and certified transmission system operator (TSO) integrated into the ENTSO-E (OECD, 2020[69]).

Financial performance

In 2019, Ukrenergo was the fifth largest SOE by asset value and revenues, and had approximately 8,000 employees. It has exhibited a substantial increase in asset value (Table 3.3) and has switched to IFRS accounting (Ukrenergo, 2020[70]). Ukrenergo’s revenues also grew substantially in 2019, which mainly resulted from increased tariffs approved by NEURC, Ukraine’s energy regulator. Since it is natural monopoly, fluctuations in the company’s profitability are based more on the tariff policy set by regulation, rather than on changing market conditions.

However, a substantial part of the collected tariffs (UAH 7.8 billion in 2019) were used to fulfil the PSO to cover the “green tariff” for energy from renewables. (Similarly to

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26 Notably, the EU, EBRD, EIB, World Bank and IFC expressed concerned following the dismissal of Naftogaz’s leadership and called for renewed commitments to reform (EBRD, 2021[349]). G7 Ambassadors also reacted to the decision of the CMU, outlining that effective management of SOEs, “free from political interference, is crucial for competitiveness, prosperity, and Ukraine fulfilling its international commitments” (G7AmbReformUA, 2021[350]).

27 According to its website, Ukrenergo ensures real-time balancing of electricity production and consumption and capacity in the power system; operation and development of trunk and interstate power grids; parallel operation of the power system of Ukraine with the power systems of neighbouring countries; and technical possibility of electricity exports/imports to four countries of the European Union and neighbouring countries.
Naftogaz, Ukrenergo uses separate accounting to reflect PSO-related revenues and expenses. In July 2020, Ukrenergo’s debt to the Guaranteed Buyer, which settles payments on the electricity market for the green tariff, surpassed UAH 20 billion (CMU, 2020[42]). In 2020, the CMU decided to provide up to UAH 11.3 billion to Ukrenergo in guarantees to help repay debts to green energy producers and the possibility of increasing transmission tariffs has been considered. While in February 2021 Ukrenergo was able to pay the Guaranteed Buyer UAH 900 million, settling debts and ensuring sustainability of the market will require broader policy considerations (Unian, 2021[71]).

28 However, Ukrenergo has also witnessed a net loss of UAH 27.5 billion in 2020 (compared to net profits in previous years), which has been blamed largely on the low tariffs established by the energy regulator (Boytsun et al., 2021[72]).

Table 3.3. Key financial indicators of Ukrenergo

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>3,097,168</td>
<td>5,433,493</td>
<td>7,173,623</td>
<td>8,263,856</td>
<td>5,992,663</td>
<td>26,326,366</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,306,196</td>
<td>3,731,382</td>
<td>5,098,774</td>
<td>5,382,181</td>
<td>3,001,142</td>
<td>4,026,484</td>
</tr>
<tr>
<td>Net financial result</td>
<td>-1,198,528</td>
<td>820,396</td>
<td>3,012,096</td>
<td>1,172,371</td>
<td>2,558,941</td>
<td>1,864,095</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>0</td>
<td>0</td>
<td>892,434</td>
<td>0</td>
<td>498,041</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>12,918,261</td>
<td>19,872,392</td>
<td>24,909,619</td>
<td>27,283,884</td>
<td>28,287,846</td>
<td>64,413,972</td>
</tr>
<tr>
<td>Equity</td>
<td>5,740,957</td>
<td>6,429,737</td>
<td>8,134,307</td>
<td>9,564,283</td>
<td>10,600,796</td>
<td>37,433,157</td>
</tr>
<tr>
<td>Total payables</td>
<td>6,214,513</td>
<td>12,471,539</td>
<td>15,761,987</td>
<td>16,903,687</td>
<td>16,290,408</td>
<td>20,302,555</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>4,655,091</td>
<td>9,575,555</td>
<td>0</td>
<td>13,490,271</td>
<td>13,456,733</td>
<td>4,766,657</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-10.1</td>
<td>5.0</td>
<td>13.5</td>
<td>6.7</td>
<td>9.3</td>
<td>4.0</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-18.9</td>
<td>13.5</td>
<td>41.4</td>
<td>19.7</td>
<td>26.9</td>
<td>7.7</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities.
Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

Initially, Ukrenergo was held under the Ministry of Energy, along with other energy companies, including Energoatom and Ukrhydroenergo. However, due to the existing conflicts of interest and the unbundling requirements under the EU’s Third Energy Package, in 2018 Ukrenergo was transferred under the ownership of the Ministry of Finance.29 Following its transfer, the Ministry of Finance approved an action plan for Ukrenergo’s corporatisation in line with the European Energy Community standards, as well as the valuation of its assets and liabilities, and the establishment of internal audit. In 2021, it was announced that Ukrenergo would be transferred back to the Ministry of Energy, despite potential conflicts of interests (CMU, 2021[45]).30

28 Guaranteed Buyer is a state enterprise that was created in 2019 with the launch of the new electricity market. Some of its duties include providing services to ensure the availability of electricity for household consumers and purchasing electricity at a feed-in (“green”) tariff.
29 EU’s Third Energy Package foresees independence of electricity transmission from production with the aim of effectively separating monopoly activities from competitive activities and ensuring equal treatment of all customers.
30 The transfer is planned to take place within the context of SOEs, including Energoatom and Ukrhydroenergo, being moved from the ownership of the Ministry of Energy to the CMU. Moreover, transferring Ukrenergo back to the Ministry of Energy may introduce conflicts due to the latter performing both ownership and policymaking functions. This, in turn, may contribute to challenges in achieving certification as a transmission system operator based on the EU’s Third Energy Package and joining the ENTSO-E, which is one of Ukrenergo’s goals.
Ukrenergo is now a private joint-stock company with 100% shares owned by the state. The company does not have any subsidiaries, though its network includes eight regional sub-divisions and three separate technical sub-divisions that are full-fledged daughter companies in terms of management, but have no separate legal status. These sub-divisions have their own CEOs and senior management, but are administratively subordinate to Ukrenergo’s management (OECD, 2020[69]).

As part of corporate governance reforms launched in Ukraine, a supervisory board was established in Ukrenergo in 2018. Ukrenergo’s charter states that the company must have a seven-member supervisory board, including four independent members and three state representatives. The current board is de facto composed of five members, including four independents, with two positions of state representatives yet to be filled.

According to Ukrenergo’s charter, its management board should consist of three to five members. The current management board is composed of five members, including the CEO appointed in 2020. Of these five members, one performs functions as an acting management board member (i.e., on a temporary basis).

### 3.1.3. Energoatom

**Overview**

Established in 1996, Energoatom is a state enterprise that generates about 55% of Ukraine’s electricity from nuclear power. It operates four nuclear power plants in Ukraine and 15 nuclear power units, with a total installed capacity of 13.8 gigawatts. The four nuclear power plants include Zaporizhzhya, Rivne, Yuzhnoukrayinsk, and Khmelnytsky. Energoatom also has separate sub-divisions (which are its business units, rather than separate legal entities) and a Representative Office in Brussels.

As using nuclear electricity to balance intraday peaks is challenging due to technical reasons, Energoatom produces baseload electricity, thus reaching a large number of consumers. While Ukraine sought to liberate electricity prices by launching a new market in 2019, the government imposed a public service obligation (PSO) on Energoatom, according to which nearly 90% of its electricity was sold at a below market price for regulated consumers (including households). This PSO created uncompensated financial and operating liabilities for the company, as the fixed price has been unable to cover its operating costs, including dispatching (operational and technological), management services, and excise tax (Energoatom, 2020[73]). The PSO rate, however, was later reduced, and the company was able to supply 50% of the electricity at a regulated price (CMU, 2020[74]).

The design of the electricity auctions (large size of the trading lots) of Energoatom in some cases favours large buyers, resulting in lower competition and lower revenues.

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31 Prior to the appointment of the current (permanent) CEO, Ukrenergo had an acting CEO for five years.
32 The figure, however, may reach 70% in autumn and winter. The company’s main responsibility is safe electricity production, with some of its tasks including the construction and refurbishment of generating capacities, and the export of spent fuel. It also sets up infrastructure for irradiated nuclear fuel management and protection for nuclear energy facilities, and conducts personnel trainings (Verkhovna Rada, 1995[317]).
33 These sub-divisions include AtomRemontService, AtomEnergoMash, AtomKomplekt, AtomProjectEngineering, Emergency Technical Centre, Energoatom Trading, Donuzlavskas Wind Power Station, Warehouse, AtomPrylad, Automation and Mechanical Engineering and Administrative Department.
34 In addition, electricity provided by Energoatom is priced lower compared to other sources in Ukraine, partly due to the PSO, though production and maintenance costs are higher.
for the SOE. By way of example, Energoatom held an auction for night-time (off-peak) electricity in November 2020. Although eight companies participated, 85% of the electricity was sold to D Trading and United Energy (both affiliated with politically connected firms with vested interests) at a price of UAH 650 per MWh. This price implies a record 42% discount relative to the spot market price, with the usual discounts normally not exceeding 10%. The other participants to the auction bought electricity at UAH 800-943 per MWh (Shkolyarenko, 2020[75]).

Financial performance

In 2019, Energoatom was Ukraine’s third largest SOE based on its asset value and revenues, and the fifth largest employer among the top-15 SOEs. In the past two years, its net revenue, EBITDA, net financial result, and other financial indicators have improved. Although the company has a relatively high profit margin (7.7% in 2019), its ROA is low and its liquidity tends to decrease over time, which poses a risk to its long-term viability (Table 3.4).35 The company has also been facing increasing payables, partly due to the challenges in settling debts within the electricity market and public service obligations (OECD, 2019[76]). In addition, considering the exchange rate fluctuations and reduction of its marketable output due to the impact of Covid-19, Energoatom witnessed a net loss of UAH 4.8 billion in 2020, while starting to experience recovery during the first quarter of 2021 (Boytsun et al., 2021[72]) (Boytsun et al., 2021[77]).

Table 3.4. Key financial indicators of Energoatom

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>23,237,672</td>
<td>32,903,883</td>
<td>36,067,864</td>
<td>38,487,690</td>
<td>44,055,259</td>
<td>48,846,595</td>
</tr>
<tr>
<td>EBITDA</td>
<td>6,518,324</td>
<td>14,009,685</td>
<td>11,475,470</td>
<td>9,530,713</td>
<td>18,219,392</td>
<td>15,222,716</td>
</tr>
<tr>
<td>Net financial result</td>
<td>-6,494,416</td>
<td>1,168,184</td>
<td>187,126</td>
<td>-1,321,755</td>
<td>4,631,828</td>
<td>3,773,641</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>0</td>
<td>0</td>
<td>669,840</td>
<td>457,100</td>
<td>331,342</td>
<td>4,920,428</td>
</tr>
<tr>
<td>Total assets</td>
<td>199,513,670</td>
<td>202,266,531</td>
<td>206,279,899</td>
<td>210,186,435</td>
<td>215,562,903</td>
<td>218,867,050</td>
</tr>
<tr>
<td>Equity</td>
<td>154,744,064</td>
<td>155,610,710</td>
<td>159,616,296</td>
<td>158,420,443</td>
<td>130,175,217</td>
<td>134,122,148</td>
</tr>
<tr>
<td>Total payables</td>
<td>35,891,279</td>
<td>18,977,001</td>
<td>20,978,019</td>
<td>27,163,502</td>
<td>35,981,977</td>
<td>40,361,986</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>27,054,141</td>
<td>2,004,017</td>
<td>0</td>
<td>3,595,502</td>
<td>10,854,498</td>
<td>12,757,843</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-3.2</td>
<td>0.6</td>
<td>0.1</td>
<td>-0.6</td>
<td>2.2</td>
<td>1.7</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-4.0</td>
<td>0.8</td>
<td>0.1</td>
<td>-0.8</td>
<td>3.6</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities.
Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[43])

Corporate governance

Energoatom is a state unitary enterprise, which was historically held under the Ministry of Energy but – further to a Decree of the President36 – has been recently moved under direct control of the CMU (CMU, 2021[45]). The company is reportedly

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35 Authors’ calculations based on YouControl data. Available upon request.
36 See Decree of the President of Ukraine ‘On urgent measures to stabilise the situation in the energy sector and further develop nuclear energy’ No. 406/2020 dated September 22, 2020.
undergoing reform and the Decree reiterates the goal of converting it into a joint-stock company. However, as of January 2021, Energoatom was still not corporatised and no further information regarding the status of such plans have been communicated.  

Energoatom’s charter envisages the following governing bodies: supervisory board, management board (until a supervisory board is established), and President (CEO). No supervisory board has been established in Energoatom to date. This contradicts the legal requirements, under which a supervisory board with a majority of independent members must be established in such SOE. A selection process for independent supervisory board members of Energoatom was announced in October 2020.

According to Energoatom’s charter, members of its management board should be appointed and dismissed by its ownership entity. However, no management board appears to have been established at Energoatom, based on the information on Energoatom’s website and other publicly available sources. Instead, the executive body of Energoatom consists of a single person, the President (CEO). The current acting (i.e., temporary) CEO was appointed in March 2020. Energoatom’s top management also includes an acting First Vice President and two Vice Presidents.

### 3.1.4. Ukrhydroenergo

**Overview**

Ukrhydroenergo is Ukraine’s largest hydro-generating company. It was established in 2004 following the reorganisation and merger of Dniprohydroenergo and Dnisterhydroenergo, two state-owned hydro companies. Ukrhydroenergo has ten stations on the Dnipro and Dniester rivers, and 103 hydraulic units (Ukrhydroenergo, n.d.[78]). According to its annual report, some of the main goals of Ukrhydroenergo include safe generation of electricity and operation of the hydro power plants. It should also ensure high emergency preparedness and high quality repairs, as well as safe working conditions and improvements to ensure operating efficiency (Ukrhydroenergo, 2020[79]).

The launch of the electricity market in Ukraine in 2019 enabled Ukrhydroenergo to start selling part of its electricity directly to consumers through auctions, though, similarly to Energoatom, 35% of the produced electricity was subject to PSO. Later, the rate was slightly lowered (to 30%) in parallel with the changes introduced within Energoatom’s fixed rate (CMU, 2020[80]).

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37 Decree of the President of Ukraine “On urgent measure to reform and strengthen the state” No. 837/2019 dated November 8, 2019 instructed the Cabinet of Ministers of Ukraine to undertake measures by December 31, 2020 to ensure the corporatisation of Energoatom. This implied developing a relevant draft law and submitting it to the Verkhovna Rada of Ukraine. However, it is worth noting that the plans to corporatise Energoatom have been discussed since at least April 2012, but they have never been implemented.

38 See Sections 6, 11 and 16 of this Review regarding the requirements to establish supervisory boards.

39 The company includes ten stations on the Dnipro and Dnister rivers: Kyiv Hydroelectric Power Plant (HPP), Kyiv Pumped Power Plant, Kanivska HPP, Kremenchuk HPP, Serednedniprovska HPP, Dniprovska HPP-1, Dniprovska HPP-2, Kakivska HPP, Dniester HPP, and Dnieper Pumped Power Plant. Kanivska Pumped Hydroelectric Energy Storage and Kakivska HPP-2 are being prepared for construction. There are 103 hydraulic units across the company’s stations (Ukrhydroenergo, n.d.[78]).
Financial performance

Ukrhydroenergo was Ukraine’s sixth largest SOE by asset value and seventh by revenue in 2019, with approximately 3,000 employees. The company has demonstrated positive and relatively stable financial performance during last six years, including a positive net revenue, EBITDA, and net financial result, as well as ROA and ROE (Table 3.5). In 2019, the company’s profitability indicators decreased year-on-year due to added costs incurred with the launch of the new electricity market and growing debts within the sector. However, its non-current assets grew due to an increase in capital work and a simultaneous decrease in long-term receivables. At the same time, its current assets witnessed growth due to an increase in receivables for goods, works and services, and advance payments (Ukrhydroenergo, 2020[79]).

Table 3.5. Key financial indicators of Ukrhydroenergo

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>2,582,327</td>
<td>4,469,210</td>
<td>5,907,813</td>
<td>5,716,400</td>
<td>7,960,791</td>
<td>8,262,350</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,623,224</td>
<td>2,687,818</td>
<td>3,977,905</td>
<td>2,832,783</td>
<td>5,181,155</td>
<td>4,109,158</td>
</tr>
<tr>
<td>Net financial result</td>
<td>475,966</td>
<td>1,090,543</td>
<td>2,209,718</td>
<td>1,465,533</td>
<td>3,668,256</td>
<td>3,222,610</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>393,908</td>
<td>142,790</td>
<td>327,163</td>
<td>662,915</td>
<td>439,660</td>
<td>1,100,477</td>
</tr>
<tr>
<td>Total assets</td>
<td>21,256,623</td>
<td>23,198,860</td>
<td>25,071,912</td>
<td>26,767,074</td>
<td>30,042,233</td>
<td>33,795,633</td>
</tr>
<tr>
<td>Equity</td>
<td>17,124,215</td>
<td>18,071,437</td>
<td>19,950,091</td>
<td>20,739,191</td>
<td>23,783,018</td>
<td>25,855,325</td>
</tr>
<tr>
<td>Total payables</td>
<td>3,957,300</td>
<td>4,328,831</td>
<td>4,391,997</td>
<td>5,323,909</td>
<td>5,368,813</td>
<td>7,281,555</td>
</tr>
<tr>
<td>ROA, %</td>
<td>2.3</td>
<td>4.9</td>
<td>9.2</td>
<td>5.7</td>
<td>12.9</td>
<td>10.1</td>
</tr>
<tr>
<td>ROE, %</td>
<td>2.8</td>
<td>6.2</td>
<td>11.6</td>
<td>7.2</td>
<td>16.5</td>
<td>13.0</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities.
Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

Ukrhydroenergo is a joint-stock company under the ownership of the Ministry of Energy. Although Ukrhydroenergo was originally corporatised into a public joint-stock company in 2004 (following the merger of Dniprohydroenergo and Dnisterhydroenergo), it was converted into a private joint-stock company in 2017. In 2021, it was announced that the company had been transferred to CMU (CMU, 2021[45]).

In 2019, Ukrhydroenergo established a supervisory board with an independent majority (Ukrhydroenergo, n.d.[78]). Its charter requires the supervisory board to consist of seven members, with at least four independent members (implying that the rest are state representatives). Today, the board consists of five members (including four independent), and two state representatives remain to be appointed.

The executive body of Ukrhydroenergo consists of a single person, the General Director (CEO). The current CEO was originally appointed in 2011. According to Ukrhydroenergo’s 2017 annual disclosure statement, the CEO was re-appointed in 2017 with a five-year contract expiring in June 2022. In July 2019, the supervisory board decided to extend the powers of the CEO until July 2024, although the contract

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was still valid for more than two years. Ukrhydroenergo’s top management also includes four deputy CEOs who are not part of the executive body.

3.2. Transport, infrastructure and postal services

3.2.1. Ukrzaliznytsia

Overview

Ukrzaliznytsia is Ukraine’s railway operator, and a national freight and passenger carrier. It is a natural monopoly in performing certain functions, including the operation of rail tracks. The company also has a monopoly in locomotives traction and passenger transportation, though there are plans for market liberalisation. Overall, Ukrzaliznytsia is responsible for over 80% of cargo transportation by all types of transport and over 30% of passenger traffic (excluding urban electric transport). In terms of freight transport volumes, the company ranks fourth in Eurasia, following the railways of China, Russia, and India (Ukrzaliznytsia, 2019[81]).

The long-term challenge for the company is the absence of an approved transformation strategy, which would address unbundling various segments of its operations. Currently, the losses from passenger transportation are cross-subsidised by cargo transportation revenues. However, there are additional inconsistencies within cargo tariff calculations. For example, some of the company’s supervisory board members have indicated that transporting both full and empty iron ore freight cars is cheaper than full and empty grain cars. Unifying these tariffs could potentially enable Ukrzaliznytsia to generate an additional UAH 4.4 billion in revenues (Leschenko, 2020[82]). In the meantime, the company has faced additional challenges, particularly related to upgrading its worn-out equipment (Ukrzaliznytsia, 2020[83]).

The annual report on the implementation of the Association Agreement between Ukraine and the EU notes the financial situation of Ukrzaliznytsia remains challenging. The report also stressed that a number of key documents in the field of transport, including for market opening, had not yet been adopted in Ukraine (European Commission, 2020[84]). The draft law on railway is considered a critical step for reforming Ukrzaliznytsia.

Financial performance

Ukrzaliznytsia was the country’s second largest SOE by turnover and asset value in 2019 (Ukrzaliznytsia, 2019[81]). It is also one of the largest employers, with its staff amounting to 255,000 individuals in January 2020. Despite improved financial performance, as noted, 2020 is expected to be challenging due to the impact of the Covid-19 on passenger transportation (CMU, 2020[42]). As Table 3.6 shows, Ukrzaliznytsia’s net revenue and net financial result have grown steadily over the past five years, although its EBITDA has fluctuated. Its ROA and ROE turned marginally positive in 2015, but have remained low. Moreover, data analysis based on YouControl revealed that the company has relatively low liquidity ratios, with a current ratio of 0.67 and a quick ratio of 0.37 (YouControl, 2020[85]).

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40 Reported figures on the number of employees may slightly differ. According to the questionnaire responses from the CMU, Ukrzaliznytsia employed more than 255,000 individuals in 2019.
Considering the impacts of the pandemic, Ukrzaliznytsia suffered losses in 2020, amounting to nearly UAH 12 billion. Its financial result was impacted by decrease in revenues from freight and passenger transportation compared to 2019 levels, as well as fluctuations in exchange rate (Boytsun et al., 2021[72]). With limited support from the state, the company was, until recently, considering to issue Eurobonds in 2021, while potentially borrowing from international financial institutions and state-owned banks (Antoniuk, 2021[54]). Following CMU’s decision in 2021, 30% of the profit generated in 2019 was used to pay out dividends to the state budget, and the remainder 70% was used to cover losses for the previous years (Boytsun et al., 2021[87]).

Based on Ukrzaliznytsia’s financial plan, it expects UAH 3.6 billion in profits in 2021. Total revenues are expected to reach UAH 93 billion, with UAH 24.7 billion expected to be allocated to the state budget and state target funds (Boytsun et al., 2021[77]). The company’s capital investments in 2021 are expected to reach UAH 27.2 billion, which are nearly three times the amount allocated in 2020. Over half of the amount is expected to come from the company’s own funds and 31% from the investors, with another 14% to be received from the state budget (Ukrzaliznytsia, 2020[86]).

Table 3.6. Key financial indicators of Ukrzaliznytsia

<table>
<thead>
<tr>
<th>Ukrzaliznytsia (in thousand UAH)</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>5,591,580</td>
<td>67,559,929</td>
<td>73,938,151</td>
<td>83,402,407</td>
<td>90,352,319</td>
</tr>
<tr>
<td>EBITDA</td>
<td>18,619,138</td>
<td>20,079,013</td>
<td>20,060,042</td>
<td>16,023,509</td>
<td>17,326,379</td>
</tr>
<tr>
<td>Net financial result</td>
<td>120,300</td>
<td>320,017</td>
<td>114,549</td>
<td>203,854</td>
<td>2,988,247</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget(^{41})</td>
<td>794/165,686</td>
<td>6,513</td>
<td>33,158.7/133</td>
<td>103,101.3</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>396,307,109</td>
<td>381,395,237</td>
<td>264,444,663</td>
<td>265,508,467</td>
<td>269,009,924</td>
</tr>
<tr>
<td>Equity</td>
<td>346,377,749</td>
<td>328,199,832</td>
<td>210,776,978</td>
<td>210,117,926</td>
<td>211,816,203</td>
</tr>
<tr>
<td>Total payables</td>
<td>47,064,984</td>
<td>48,499,554</td>
<td>48,390,042</td>
<td>49,005,052</td>
<td>50,949,340</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>25,756,294</td>
<td>28,973,702</td>
<td>27,715,713</td>
<td>21,288,959</td>
<td>25,290,678</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-5.6</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
<td>1.1</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-7.3</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Note: As the company was incorporated in 2014, the figures were available from 2015. In addition, there may be discrepancies between figures reported by the Ukrainian authorities and Ukrzaliznytsia. In particular, in 2015 and 2016, Ukrzaliznytsia witnessed a net loss of 16,781,920,000 and 7,322,041,000, respectively according to its audited statements, while revenues amounted to 60,125,598 and 66,50,164, respectively. However, information provided by the company and the Ukrainian authorities coincides for the subsequent years.

Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

Ukrzaliznytsia was corporatised in 2014 (and registered as a JSC in 2015) as a legal successor of the State Administration of Railway Transport of Ukraine. Prior to corporatisation, its predecessor performed combined functions of railway carrier and railway administrator, with six regional SOEs (Kuzyo, Zatvornytska and

\(^{41}\) Dividends are paid by corporatised entities, while the profit share payable to the state budget is paid by non-corporatised (or state unitary) entities.
While the CMU is the sole shareholder of the company, certain ownership functions (including preparing decisions for the shareholder’s meeting) are delegated to the Ministry of Infrastructure (Ministry of Infrastructure, 2019). While performing corporate governance functions, the Ministry of Infrastructure also performs regulatory and policy making functions within the Ukrainian railway sector.

Along with introducing SOE reforms, the corporatisation of Ukrzaliznytsia was partly spurred by Ukraine’s obligation to meet the requirements under the EU-Ukraine Association Agreement. According to its commitments, Ukraine must bring the organisation and regulation of railway transport in compliance with the respective EU directives by 2023, including the liberalisation of access to market and infrastructure, the separation of track operations and railway infrastructure, and the collection of infrastructure usage charges. In practice, this means that some of Ukrzaliznytsia’s current functions, including railway transport infrastructure operation and railway transportation, should be unbundled (Kuzyo, Zatvornytska and Yablonovsky, 2019).

A supervisory board was established in Ukrzaliznytsia in 2018, consisting of seven members and four independent directors. The management board (a collegiate executive body) of Ukrzaliznytsia consists of six members, including the CEO. Of these six, three perform their functions on a temporary basis (i.e. as acting management board members). The CEO appointed in August 2020 was fired in March 2021 over allegations for supporting vested interests, and, at the time of writing, an acting CEO had already been appointed (Semko, 2021). However, in April 2021, a temporary commission of inquiry of Verkhovna Rada called on the CMU to dismiss Ukrzaliznytsia’s management board (including the acting CEO) and supervisory board members, due to unsatisfactory performance (Economic Truth, 2021).

### 3.2.2. Boryspil International Airport

#### Overview

Boryspil International Airport is the largest airport of Ukraine, providing over 67% of the country’s passenger air traffic and accommodating over 10 million passengers annually (Boryspil, n.d.). Some of its key functions are to ensure aviation and flight safety, as well as timely satisfaction of economic and public needs for passenger and cargo transport. In addition, it should ensure maintenance and servicing of aircraft used on domestic, interstate and international routes, as well as providing services for ensuring take-off and landing, fuelling, security, aircraft parking, and registration, among others. In 2019, the CMU approved the Concept of Development of the Boryspil International Airport until 2045, with some of the key priorities being infrastructure development and introduction of modern services. The concept would provide for investments of up to EU 3.4 billion and an increase in passenger traffic to 54 million passengers annually (Boryspil, 2015) (Interfax Ukraine, 2019). The company has been investigated by NABU for corruption schemes, including illegal

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42 Since 2015, Ukrzaliznytsia has provided passenger and freight transportation services, consisting of 28 branches, 6 regional branches, and 2 representative offices.

43 The lack of separation of the ownership function and the regulatory function is relevant for all the infrastructure SOEs among the top 15, since Ukraine has no independent transport regulator. Specifically, this is relevant for Ukrzaliznytsia, Ukrposhta, Boryspil International Airport, USPA, and UkSATSE.
lease of property, with damages worth over UAH 16.5 million (further challenges in the SOE sector are outlined under Section 4.5) (NABU, 2020[95]).

**Financial performance**

In 2019, Boryspil Airport was the ninth largest SOE by asset value and twelfth largest (within the list of top-15 SOEs) by revenue, while employing approximately 4,400 individuals. It has shown relatively high profitability, as reflected by its ROA and ROE (Table 3.7). In 2019, Boryspil exhibited a substantial increase in assets and liabilities, which can be attributed to growing capital investment (e.g., the airport opened a new multilevel parking in 2019).

**Table 3.7. Key financial indicators of Boryspil Airport**

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>1,577,343</td>
<td>2,515,943</td>
<td>3,352,792</td>
<td>3,870,048</td>
<td>4,279,226</td>
<td>4,476,477</td>
</tr>
<tr>
<td>EBITDA</td>
<td>997,233</td>
<td>1,947,252</td>
<td>2,442,332</td>
<td>2,706,731</td>
<td>2,845,203</td>
<td>2,436,203</td>
</tr>
<tr>
<td>Net financial result</td>
<td>-126,818</td>
<td>696,460</td>
<td>1,385,931</td>
<td>1,731,420</td>
<td>1,857,920</td>
<td>1,532,861</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>0</td>
<td>179,375</td>
<td>804,256</td>
<td>1,250,591</td>
<td>974,636</td>
<td>1,099,510</td>
</tr>
<tr>
<td>Total assets</td>
<td>9,494,755</td>
<td>9,032,760</td>
<td>9,135,734</td>
<td>8,959,924</td>
<td>9,890,581</td>
<td>16,439,345</td>
</tr>
<tr>
<td>Equity</td>
<td>5,167,945</td>
<td>5,499,863</td>
<td>5,801,300</td>
<td>6,212,029</td>
<td>7,163,908</td>
<td>12,381,337</td>
</tr>
<tr>
<td>Total payables</td>
<td>3,888,194</td>
<td>3,532,897</td>
<td>2,937,440</td>
<td>2,371,162</td>
<td>2,367,945</td>
<td>2,715,950</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>2,769,564</td>
<td>2,544,546</td>
<td>2,082,684</td>
<td>1,401,897</td>
<td>1,646,839</td>
<td>2,096,915</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-3.3</td>
<td>7.5</td>
<td>15.3</td>
<td>19.1</td>
<td>19.7</td>
<td>12.5</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-2.4</td>
<td>13.1</td>
<td>24.5</td>
<td>28.8</td>
<td>27.8</td>
<td>17.1</td>
</tr>
</tbody>
</table>

*Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])*

**Corporate governance**

Boryspil International Airport remains a state unitary enterprise under the ownership of the Ministry of Infrastructure, which also exercises regulatory functions. Notably, the Ministry sets airport fees, which constitutes roughly 60% of the airport’s revenues (Ministry of Transport of Ukraine, 2008[96]).

Similarly to other larger Ukrainian SOEs, Boryspil Airport established a supervisory board in 2019 consisting of five members (including three independent directors). The executive body of Boryspil Airport consists of a single person, the General Director (CEO). The SOE has a temporary (acting) CEO who was appointed in November 2020 following the resignation of the previous (permanent) CEO who became the Head of the State Customs Service of Ukraine.

### 3.2.3. Ukrainian Sea Ports Authority (USPA)

**Overview**

The Ukrainian Sea Ports Authority (USPA) is a state enterprise founded in 2013 as a result of the maritime industry reform in Ukraine. The reform was launched to manage state property in the seaports and to use it efficiently, attract investments in the port infrastructure and promote stable business performance. USPA also has other tasks,
such as maintaining passport depths in the water area of the seaports and ensuring safety of navigation (USPA, n.d.[97]).

Based on its Strategic Development Plan, USPA fulfils a number of developmental and regulatory functions. The plan aims at transforming USPA into a modern, efficient and competitive port development company, and contains objectives that include corporatisation, increasing profitability, and encouraging private sector involvement in the port infrastructure. It also seeks to improve public relations and help promote Ukraine’s economic development (including creation of new jobs) (USPA, 2020[98]).

The enterprise has also been involved in several corruption investigation cases led by NABU. For example, in 2018 NABU and SAPO gave notices of suspicion to eight individuals suspected of embezzling UAH 247 million of public funds in USPA (NABU, 2018[99]). In a most recent case, the NABU detectives gave notices of suspicion to five persons allegedly involved in causing USPA up to UAH 21.4 million in damages (NABU, 2020[100]).

Financial performance

USPA was the seventh largest SOE by asset value and ninth largest by revenue in 2019, with approximately 7,200 employees (Table 3.8). The revenue of the company was relatively stable in the past six years, while profit decreased in 2019 due to increased operating costs.44

Table 3.8. Key financial indicators of the Ukrainian Sea Ports Authority (USPA)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>4,002,291</td>
<td>6,810,663</td>
<td>7,297,604</td>
<td>7,633,560</td>
<td>6,747,880</td>
<td>7,020,799</td>
</tr>
<tr>
<td>EBITDA</td>
<td>2,661,624</td>
<td>5,167,818</td>
<td>4,574,424</td>
<td>4,695,811</td>
<td>3,811,127</td>
<td>2,718,308</td>
</tr>
<tr>
<td>Net financial result</td>
<td>1,511,052</td>
<td>3,847,292</td>
<td>3,854,369</td>
<td>3,605,587</td>
<td>2,754,984</td>
<td>1,631,058</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>554,102</td>
<td>1,092,831</td>
<td>2,314,539</td>
<td>2,737,674</td>
<td>1,839,011</td>
<td>1,564,946</td>
</tr>
<tr>
<td>Total assets</td>
<td>17,481,171</td>
<td>20,639,467</td>
<td>20,682,619</td>
<td>21,517,831</td>
<td>22,028,495</td>
<td>22,123,572</td>
</tr>
<tr>
<td>Equity</td>
<td>16,129,884</td>
<td>18,684,177</td>
<td>19,286,691</td>
<td>19,879,489</td>
<td>20,770,154</td>
<td>20,134,528</td>
</tr>
<tr>
<td>Total payables</td>
<td>1,351,287</td>
<td>1,790,709</td>
<td>1,253,521</td>
<td>1,476,407</td>
<td>1,072,934</td>
<td>819,674</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>1,070,061</td>
<td>1,041,281</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>41,668</td>
</tr>
<tr>
<td>ROA, %</td>
<td>8.9</td>
<td>20.2</td>
<td>18.7</td>
<td>17.1</td>
<td>12.7</td>
<td>7.3</td>
</tr>
<tr>
<td>ROE, %</td>
<td>9.6</td>
<td>22.1</td>
<td>20.3</td>
<td>18.4</td>
<td>13.6</td>
<td>8.1</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

USPA’s is under the ownership of the Ministry of Infrastructure and unites Ukrainian seaports and other infrastructure objects. It has a head office in Kyiv and a representative office in Odessa, two branches that are not separate legal entities (Delta-Lotsman and Dredging Fleet), and 13 branches in the seaports of Ukraine (with directors of these branches appointed by the Ministry of Infrastructure on the proposal

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44 https://prozvit.com.ua/SOE/28832/
of USPA’s CEO). Moreover, while USPA is responsible for maintenance and use of state-owned port infrastructure (notably berths), these state unitary enterprises – although called seaports – operate as stevedores.

USPA’s supervisory board, established in 2019, has five members. According to the company’s charter, the board should consist of seven members, including four independents. However, only two out of the effective five board members are independent, while the other three are state representatives. The executive body of the USPA consists of an acting CEO appointed in 2020. USPA’s top management also includes three deputy CEOs who are not part of the executive body.

### 3.2.4. Ukrposhta

**Overview**

The Ukrainian state postal service was established in 1947 and it was reorganised into Ukrainian Postal Association in 1994. The company was converted into a state unitary enterprise in 2011 and finally corporatised in 2017. Ukrposhta is a member of the Universal Postal Union and its activities include providing postal services, though the company also delivers pensions and social payments to individuals, and provides financial services (such as accepting payments for utilities and transferring money).

Along with commercial activities, Ukrposhta fulfils public service obligations, as regulated tariffs apply to universal postal services, payment and delivery of pensions, and subscriptions. Tariffs are regulated by the Ministry of Infrastructure and the National Commission for State Regulation of Communications and Information (NCCIR). Due to a lengthy process for approving tariffs, Ukrposhta may face shortfalls in revenues in providing some of its services in competitive markets. Like most of the top-15 SOEs, the company’s dividends are also set ex-post from the previous year and differ based on the needs of the government (as further elaborated under Section 4.3 regarding the applicability of dividends within the SOE sector). This policy may not allow for clear planning and investment in the renewal and modernisation of Ukrposhta’s fixed assets, which would help promote its sustainable development and competitiveness.

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45 The company has a head office in Kyiv, a representative office in Odessa, two branches that are not separate legal entities (Delta-Lotsman and Dredging Fleet), and 13 branches in the seaports of Ukraine (USPA, 2020[98]).
46 The composition of the board is such because two independent members have resigned and have not been replaced, and such practice is generally not in line with legal requirements, according to which majority of the board members must be independent (see Sections 6, 11 and 16 of this Review). However, technically, this may not be a violation of the Ukrainian law. The law requires SOE to establish a supervisory board with an independent majority, which the USPA has done by adopting this requirement in its charter. The law also requires that the supervisory board meetings should be quorate in order to be able to make decisions, and USPA complies with that requirement as well, as it has more than four members required for that. However, the law does not seem to require for an SOE to maintain an independent majority on its supervisory board at all times.
47 Although originally it was registered as a public joint-stock company, in 2018 it was converted into a private joint-stock company. This, in part is because in November 2017, legislative changes were adopted, which clarified that public joint stock companies were those that had shares publicly offered. All other joint-stock companies were deemed private (Verkhovna Rada, 2017[119]).
48 It also distributes periodicals and sells merchandise, along with performing other services.
49 It is worth noting that challenges related to dividend policy are not unique to Ukrposhta and apply to most of the SOEs, as elaborated in the subsequent sections of this report.
More recently, the company has sought to expand its financial services. The parliament has passed a law in first reading that would enable Ukrposhta to offer banking services, including opening and maintaining postal accounts, conducting banking transactions, issuing and servicing payment cards, and attracting funds from individuals and legal entities (Ukrposhta, 2018[101]).

Financial performance

Ukrposhta was the tenth largest SOE by asset value and eighth largest by revenue in 2019, while remaining one of the country’s largest employers with approximately 64,650 employees. In 2016, Ukrposhta, exhibited an upsurge in equity, which resulted in a growth of total assets. According to the SOE’s financial report, this appears to be due to the revaluation of fixed assets (Ukrposhta, 2017[102]). Note that it was the first time that an internationally recognised audit firm audited Ukrposhta (for 2015-2016).

In 2017, Ukrposhta’s equity decreased, likely due to the revaluation during its corporatisation.50

In 2019, the company reversed its negative profitability trend and demonstrated a substantial profit after three consecutive years of growing losses (Table 3.9), which may be attributed, inter alia, to key corporate governance reforms.51 The same year, it also witnessed a substantial increase in long-term liabilities, resulting from growing investment. In 2020, Ukrposhta’s revenues amounted to UAH 9.2 billion, though its profits remained low (UAH 184.5 million), part of which has been attributed to low tariffs and public service obligations (Boytsun et al., 2021[103]).

Table 3.9. Key financial indicators of Ukrposhta

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>3,697,306</td>
<td>3,902,454</td>
<td>4,483,659</td>
<td>5,500,971</td>
<td>6,811,740</td>
<td>8,064,764</td>
</tr>
<tr>
<td>EBITDA</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>-188,804</td>
<td>-346,140</td>
<td>929,224</td>
</tr>
<tr>
<td>Net financial result</td>
<td>40,826</td>
<td>40,826</td>
<td>-161,470</td>
<td>-192,351</td>
<td>-504,490</td>
<td>496,419</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>9,631</td>
<td>13,668</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total assets</td>
<td>5,003,445</td>
<td>4,286,734</td>
<td>10,593,290</td>
<td>7,829,891</td>
<td>6,100,174</td>
<td>8,077,341</td>
</tr>
<tr>
<td>Equity</td>
<td>2,190,316</td>
<td>2,247,188</td>
<td>7,165,412</td>
<td>2,941,287</td>
<td>2,294,269</td>
<td>2,764,344</td>
</tr>
<tr>
<td>Total payables</td>
<td>2,840,698</td>
<td>1,909,881</td>
<td>2,212,926</td>
<td>4,460,560</td>
<td>2,974,791</td>
<td>4,308,177</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>152,264</td>
<td>192,198</td>
<td>150,251</td>
<td>27,250</td>
<td>72,328</td>
<td>253,647</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-0.1</td>
<td>0.9</td>
<td>-2.2</td>
<td>-2.8</td>
<td>-7.3</td>
<td>7.0</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-0.2</td>
<td>1.8</td>
<td>-3.4</td>
<td>-6.6</td>
<td>-19.8</td>
<td>19.7</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities.
Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

50 It may be that Ukrposhta made inventory and consolidated all assets in 2016 based on their book value, and then revalued them based on their market value.

51 The company was initially corporatised and the board was subsequently established, which spurred its effort to be profitable, compete on a level playing field, and obtain a fair PSO compensation. In 2019, Ukrposhta received UAH 500 million compensation from the state budget for delivering pensions and financial aid. In 2020, the government increased the tariff for pension and financial aid deliveries (Yakovenko, 2020[330]) (Ukrposhta, n.d.[231]).
Corporate governance

Ukrposhta is a joint-stock company, with the Ministry of Infrastructure as its ownership entity. The company has a supervisory board, established in October 2018, in line with the 2016 corporate governance changes to the state property management law. According to Ukrposhta’s charter, its supervisory board must consist of seven members, including five independents. (The law requires majority of supervisory board members to be independent, and the usual practice is to appoint a minimally required number, which would be four independents in case of Ukposhta). This is also observed in practice, with Ukrposhta’s supervisory board effectively including five independent members and two state representatives.

The executive body of Ukrposhta consists of a single person, the General Director (CEO). The current CEO was re-appointed in 2018, with a three-year contract expiring in June 2021. Ukrposhta’s top management also includes eight deputy CEOs that are not part of the executive body.

3.3. Defence sector

3.3.1. Ukroboronprom

Overview

Ukroboronprom, which is registered as a “state concern”, was established in 2010 to manage enterprises in the military-industrial complex (Ukroboronprom, n.d.[104]). Currently, Ukroboronprom unites 118 enterprises in major defence sectors, covering armament, military equipment development, manufacturing, scientific research and exports.52 The company has over ten bureaus that are involved in equipment design, development and research. Out of its enterprises, 28 generate 98% of Ukroboronprom’s revenues (Economic Truth, 2021[105]). One of the largest members of Ukroboronprom is Antonov, and its main source of revenue is aircraft construction and cargo transportation by air. It also has maintenance and repair services for Antonov aircraft, and Antonov Airlines, which is a global competitor for air transportation of oversized cargos (Antonov, n.d.[106]).53

The 2012 OECD corporate governance review of Antonov pointed out a number of governance challenges, including the lack of a recognised board of directors, limited capacity to restructure the capital of Antonov by way of equity, and the ban of entry into joint ventures, which severely limited Antonov’s capacity to pursue strategic relationships with manufacturers and suppliers. The report concluded that improving the governance, transparency and ownership arrangements at Antonov would increase the attractiveness to private sector investors (OECD, 2012[107]).

Ukroboronprom’s other large enterprises include Kyiv Design Bureau Luch (production of anti-tank guided missiles, anti-tank missile systems, and naval guided

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52 According to the information received from the Ukrainian authorities, Ukroboronprom united 137 SOEs, though in 2021 some enterprises were transferred to the SPFU for privatisation. It is also worth noting that certain SOEs under Ukroboronprom’s oversight are located in non-controlled territories (Boytsun et al., 2021[87]).

53 The company’s subdivisions include a design bureau and project development departments, production facilities involved in constructing aircraft and a development base to conduct flight tests, train personnel (including flight crew and technical staff) and certify aircraft.
missile systems), Kharkiv Design Bureau of Mechanical Engineering named after A. A. Morozov (development of heavy tracked vehicles, serial production of armoured personnel carriers, and machines based on it), Kharkiv Armoured Tank Plant (repair and modernisation of armoured vehicles and production of autonomous power units), Research and Production Complex Iskra, and Zhytomyr Armoured Tank Plant (Economic Truth, 2021[108]). According to Ukroboronprom, in 2020, the share of private companies fulfilling the state defence order was 54%, which is double the share in 2015 (Economic Truth, 2021[109]).

In December 2020, the newly appointed CEO of Ukroboronprom signed an order to start the transformation of Ukroboronprom into separate holding companies. According to the CEO, the order was issued in anticipation of the parliament’s consideration of Draft Law No. 3822 on reforming state-owned defence enterprises (Bryl, 2020[110]) (Verkhovna Rada, 2020[111]).

Financial performance

Ukroboronprom was the fourth largest SOE by asset value and turnover in 2019. As Table 3.10 shows, the company’s financial performance has been positive and has demonstrated an increase in equity value, though it reflected a decline in profitability in 2019.

Table 3.10. Key financial indicators for Ukroboronprom

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>11,953,124</td>
<td>21,601,083</td>
<td>28,250,640</td>
<td>28,452,661</td>
<td>37,626,562</td>
<td>39,907,443</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,538,299</td>
<td>3,456,548</td>
<td>3,731,290</td>
<td>3,297,440</td>
<td>5,679,756</td>
<td>4,390,680</td>
</tr>
<tr>
<td>Net financial result</td>
<td>-550,428</td>
<td>169,093</td>
<td>1,507,462</td>
<td>2,312,676</td>
<td>3,664,408</td>
<td>1,687,950</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>8,353/144,742</td>
<td>3,112/317,826</td>
<td>15,171/552,288</td>
<td>47,336/507,746</td>
<td>34,712/1,111,296</td>
<td>12,965/940,970</td>
</tr>
<tr>
<td>Total assets</td>
<td>27,972,738</td>
<td>78,346,116</td>
<td>47,187,161</td>
<td>61,057,673</td>
<td>68,546,232</td>
<td>70,281,001</td>
</tr>
<tr>
<td>Equity</td>
<td>8,199,173</td>
<td>42,681,354</td>
<td>14,233,579</td>
<td>20,630,255</td>
<td>22,990,398</td>
<td>29,596,926</td>
</tr>
<tr>
<td>Total payables</td>
<td>7,668,125</td>
<td>34,259,249</td>
<td>29,990,173</td>
<td>35,658,305</td>
<td>39,738,575</td>
<td>34,968,716</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>485,282</td>
<td>990,815</td>
<td>1,213,554</td>
<td>1,431,999</td>
<td>1,347,691</td>
<td>2,283,428</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-2.1</td>
<td>0.3</td>
<td>3.3</td>
<td>4.3</td>
<td>5.7</td>
<td>2.4</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-6.5</td>
<td>0.6</td>
<td>10.7</td>
<td>13.5</td>
<td>16.8</td>
<td>6.0</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities.
Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

The legal form of Ukroboronprom is a “concern”, meaning that it acts as an association of defence SOEs overseen from a corporate centre. The corporate centre does not

54 Based on the largest orders received by the Ukroboronprom’s enterprises in 2020: Luch, UAH 3.3 billion; Kharkiv Design Bureau of Mechanical Engineering named after A.A. Morozov, UAH 1.2 billion; Kharkiv Armoured Tank Plant, UAH 1.2 billion; Iskra, UAH 0.9 billion; and Zhytomyr Armoured Tank Plant, UAH 0.7 billion.

55 According to the CMU data, Ukroboronprom’s asset value was UAH 70 billion and the number of staff was 68,000 in 2019 for all members of the concern. According to YouControl, the asset value only for Ukroboronprom (as a separate legal entity/corporate centre) was UAH 540 million and the number of staff was 225 in 2019. However, audited consolidated statements for the companies of the Concern are not yet available.
own these SOEs, and, in this sense, it is not a holding company – or a company, for that matter.\textsuperscript{56} These SOEs are legally owned by the state with Ukroboronprom performing an oversight function and receiving a management fee (Boytsun et al., 2020\textsuperscript{[112]}).

The management functions over Ukroboronprom are performed by the CMU, though its official ownership entity is not formally designated (Boytsun et al., 2020\textsuperscript{[113]}). Moreover, corporate governance framework of Ukroboronprom significantly differs from that of other SOEs, as outlined in the subsequent sections. However, following the establishment of the Ministry of Strategic Industries, a new ownership policy and framework is being considered for defence SOEs.

Ukroboronprom’s governance bodies include the supervisory board, the council of directors, and the general director. The Ukrainian law (also reflected in Ukroboronprom’s charter) requires for there to be five supervisory board members, three of whom are to be appointed by President and two by the CMU without a competitive or merit-based procedure. Moreover, the supervisory board members cannot be remunerated by law, and they have no contracts with Ukroboronprom. Today, the board effectively consists of three members, with two members appointed by the CMU and one by the President. The council of directors of Ukroboronprom includes the CEOs (“directors”) of the SOEs under the oversight of Ukroboronprom, which should be acting as a collegiate governance body. In practice, however, this body has never met.

Ukroboronprom’s general director (CEO) is appointed directly by the President on the proposal of the CMU and has very broad powers in appointing the heads of companies under the oversight of Ukroboronprom. However, the general director may not interfere with the operational autonomy of these companies (Boytsun et al., 2020\textsuperscript{[113]}). The current CEO was appointed in December 2020. Ukroboronprom’s top management also includes the first deputy CEO and three deputy CEOs who are not part of the executive body.

Considering its unique structure, there have been attempts to reform Ukroboronprom. Notably, in January 2021, the Verkhovna Rada adopted a draft law (No. 3822) in first reading aimed at transforming Ukroboronprom and converting it into a joint-stock company, and its affiliated SOEs into joint-stock or limited liability companies.\textsuperscript{57} The draft law also seeks to introduce changes in its corporate governance, such as appointing independent supervisory board members and allowing for their remuneration. In its current wording, the proposed law appears to have significant deficiencies. Specifically, the current draft: (a) cements the conflicting roles of the state as owner, policymaker, and regulator, which opens room for undue political intervention (including by the line ministry); (b) does not guarantee the independence of the supervisory board from the owner and policymaker; and (c) allows for easy replacement of management and, under the proposed corporate governance set-up,

\textsuperscript{56} “Concern” is a statutory union of enterprises and other entities, based on their financial dependence on one or a group of members of the union, with the centralisation of the functions of scientific, technical and industrial development, investment, financial, foreign economic and other activities. The members of the concern delegate their powers, including the right to represent their interests in relations with the authorities, other enterprises and organisations. Concern members cannot be members of another concern simultaneously.

\textsuperscript{57} The draft law was registered in the Verkhovna Rada on July 9, 2020 and was approved in the first reading on January 29, 2021.
makes the transfer of assets during the transformation, as currently proposed, a major risk.

3.4. Agriculture sector

3.4.1. State Food and Grain Corporation (SFGC)

Overview

The State Food and Grain Corporation of Ukraine (SFGC) is a vertically integrated company in the agriculture sector. It is a national grain market operator of Ukraine and a leader in the area of cereals storage, processing, transhipment, and exports. SFGC was established in 2010 as a successor of the state company Khlib Ukrainy (Bread of Ukraine) (SFGC, n.d.).

Some of SFGC’s main functions include receiving, storing and shipping grains, meeting relevant quality standards, and purchasing and exporting cereals and relevant products. The company is also responsible for producing a wide range of flour, cereals, flakes and additives, and shipping grains and oilseeds. More broadly, it implements international and inter-governmental agreements regarding the supply of agricultural products. Currently, SFGC is meeting roughly 10% of domestic flour and cereal demand, and owns about 10% of certified storage capacities, while its port terminals provide up to 6% of the average annual volumes of Ukrainian grain export shipping.

NABU has investigated former company officials for alleged corruption. In 2019, the company’s former CEO was detained in Lithuania as a suspect in a criminal proceeding involving over USD 60 million in damages to the company (NABU, 2019).

Financial performance

In 2019, SFGC was Ukraine’s eighth largest SOE by asset value and sixth largest by revenues, though the company has continued to accumulate losses (Table 3.11). The main reason for SFGC’s negative financial performance may be attributed to the alleged misuse of the USD 3 billion loan obtained from Chinese Export-Import Bank’s in 2012 (Oganov and Sydoruk, 2020). The loan was to be used to purchase Chinese crop protection products, seeds and agricultural equipment, and to facilitate Ukrainian grain exports to China. While USD 1.5 billion had been disbursed, SFGC’s accounts stated that less than USD 387 million was received. As the loan is state guaranteed, Ukraine’s state budget will be liable for over USD 1 billion under the loan agreement. In 2020, the company witnessed a net loss of UAH 5.8 billion, which is significantly larger compared to previous years (Boytsun et al., 2021).
Table 3.11. Key financial indicators of State Food and Grain Corporation of Ukraine (SFGC)

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>(in thousand UAH)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net revenue</td>
<td></td>
<td>7,053,958</td>
<td>12,418,410</td>
<td>13,098,028</td>
<td>10,415,414</td>
<td>10,578,436</td>
<td>14,104,879</td>
</tr>
<tr>
<td>EBITDA</td>
<td></td>
<td>1,172,511</td>
<td>43,677</td>
<td>954,830</td>
<td>297,761</td>
<td>182,760</td>
<td>-2,336,365</td>
</tr>
<tr>
<td>Net financial result</td>
<td></td>
<td>-1,364,912</td>
<td>-3,029,460</td>
<td>-770,642</td>
<td>-1,518,487</td>
<td>-1,469,849</td>
<td>-1,920,430</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total assets</td>
<td></td>
<td>24,296,265</td>
<td>33,033,755</td>
<td>37,976,780</td>
<td>37,782,552</td>
<td>31,691,955</td>
<td>20,841,685</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td>-397,759</td>
<td>-4,311,207</td>
<td>-4,197,447</td>
<td>-5,732,260</td>
<td>-7,244,160</td>
<td>-9,510,004</td>
</tr>
<tr>
<td>Total payables</td>
<td></td>
<td>24,694,024</td>
<td>37,344,962</td>
<td>42,174,227</td>
<td>43,475,494</td>
<td>38,895,723</td>
<td>29,748,061</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td></td>
<td>23,652,834</td>
<td>36,001,018</td>
<td>40,786,298</td>
<td>39,995,793</td>
<td>33,225,917</td>
<td>24,842,364</td>
</tr>
<tr>
<td>ROA, %</td>
<td></td>
<td>-7.2</td>
<td>-10.8</td>
<td>-2.2</td>
<td>-4.0</td>
<td>-4.2</td>
<td>-7.3</td>
</tr>
<tr>
<td>ROE, %*</td>
<td></td>
<td>NM</td>
<td>NM</td>
<td>NM</td>
<td>NM</td>
<td>NM</td>
<td>NM</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Considering that both net financial result and equity are negative, ROE is not meaningful (NM) in this case. According to the Civil Code of Ukraine (Articles 144 and 155), if the equity value in JSCs and LLCs is less than the authorised capital for two years, then the company must announce a reduction of its authorised capital and register relevant changes in the charter. If the value of equity becomes less than the minimum amount of authorised capital, the company should be liquidated. Authorised capital should be reduced only after all of the creditors are notified, in which case they may have the right to demand early liquidation of the company and request compensation for damages.

Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

SFGC is a joint-stock company and MDETA is its sole shareholder (SFGC, n.d.[114]). Its charter states that an independent supervisory board should be established, though if no such board is established relevant functions should be performed by the general meeting of shareholders (that is, by MDETA) (SFGC, 2020[117]). To date, no independent supervisory board has been established in SFGC.

According to the SFGC’s charter, its management board (a collegiate executive body) must consist of five members. The current management board is composed of four members, including an acting (temporary) CEO appointed in 2020. Of these four members, three perform their duties as acting members of the management board. In April 2020, SFGC’s former CEO resigned, citing differences in opinion with the state as a shareholder regarding the “corporate governance strategy and the protection of the corporation from political interests” (Krasenets, 2020[118]).
Chapter 4. Legal and regulatory environment

Considering the size of Ukraine’s SOE portfolio, the existence of multiple SOE legal forms, their involvement in various sectors of the economy and the specificity of the applicable framework, this section outlines a landscape of legal and regulatory environment in which the SOEs operate. Along with identifying laws framing their corporate governance practices, it provides an overview of applicable policies, covering dividends, state aid and support measures, public service obligations, asset ownership, financial reporting and procurement practices, among others. The section also outlines some of the key regulatory and anti-corruption institutions with which the SOEs engage.

4.1. Legal forms of Ukrainian SOEs

Ukrainian legislation does not provide a unified definition of an SOE, and the concept may vary based on different laws and regulations, as well as the share of state ownership. The Commercial Code of Ukraine comes closest, as it broadly refers to commercial entities operating in the public sector of the economy and on the basis of the share of state ownership, while leaving room for other special regimes (such as non-commercial SOEs). This may also encompass entities in which the state owns more than 50% of authorised capital or has a decisive influence over their economic activities (CMU, 2020[42]) (Verkhovna Rada, 2003[5]). SOEs are typically found in the various legal forms (outlined in Figure 4.1 and detailed in Section 11 and Annex C) with the vast majority (86%) operating in the form of “state unitary enterprise”, operating either as a state-owned commercial entity or a budget supported entity (as further elaborated in Section 11).

A smaller share of the portfolio includes entities corporatised according to the Law on Joint Stock Companies (JSC Law). While JSC ownership types differ, legislative changes adopted in November 2017 established that public joint-stock companies were those that had shares publicly offered and all other joint-stock companies were deemed private (Verkhovna Rada, 2017[119]). As a result, a large number of SOEs...
(including Naftogaz, Ukrenergo and Ukrzaliznytsia) became private JSCs, and relevant provisions and carve outs in the law may apply. In addition, various legal forms exist at the municipal level, with communal enterprise being the main legal form.

The Ukrainian legislation also contains the notions of state property objects that are of strategic importance for the economy and security of the state (Resolution No. 83 2015-n). These include approximately 300 SOEs, such as Naftogaz, Ukrenergo and Ukrzaliznytsia, as well as energy distribution companies and state-owned banks, among others. Some SOEs may also be considered as being “economically important” if their asset value (according to the latest financial statement) exceeds UAH 2 billion or net profit exceeds UAH 1.5 billion (as outlined in CMU Resolutions No. 142, 143 and 777). Considering their status, these entities are subject to further regulations and corporate governance norms that differ from those applicable to the rest of the portfolio (CMU, 2015[120]).

While Ukraine repealed the law banning the privatisation of SOEs, most of these strategic SOEs could not be privatised due to other regulatory requirements. However, in August 2020, the government considered re-introducing the ban on privatising SOEs, which would apply to approximately 600 entities. In September 2020, a draft law No. 4020 was introduced to approve the list of objects excluded from privatisation, including state-owned joint-stock companies and unitary enterprises, cultural and sports facilities, and over 300 SOEs operating in the forestry sector (Verkhovna Rada, 2020[121]). The draft law was adopted by the parliament in the first reading in March 2021. In the meantime, the government is also developing a separate list of SOEs that may be privatised, and they are being transferred to the SPFU for privatisation on a rolling basis.

60 According to the Ukrainian authorities, the law banning privatisation needs to be introduced in order to comply with the requirements under the constitution. It should also provide state ownership of minimum 50%+1 shares of corporatised SOEs. However, the Constitution authorises the parliament to authorise the list of SOEs that may not be privatised, which does not mean that list must be introduced – rather, it outlines that the parliament has the right to do so.
The existence of multiple SOE legal forms and categories has resulted in a lack of uniformity and consistency in corporate governance practices and the applicability of laws, which are discussed in detail under Part II (Section 11).

4.2. Main laws and regulations bearing on corporate governance

The primary sources of corporate governance legislation in Ukraine applicable to SOEs include:

- Law on Management of Objects of State Property
- Law on Joint-Stock Companies
- Other applicable orders, decrees and regulations
- Law on Banks and Banking
- Law on Management of Objects of State Property in the Defence-Industrial Complex

4.2.1. Overview of main laws and regulations

The two main laws that regulate corporate governance practices in SOEs are the Law on Management of Objects of State Property (2006) (and subsequent revisions) and the Law on Joint-Stock Companies (2008) (and subsequent revisions). In addition, there are specific laws that apply to SOEs operating in certain sectors (notably in banking and defence), as well as secondary legislation (including CMU resolutions and Presidential decrees) that may define and elaborate on corporate governance practices in state-owned entities. There are additional sectoral laws (including on
railways, gas market and electricity, among others), which, in practice, would also impact corporate governance practices in SOEs operating within their respective sectors.

**Law on Management of Objects of State Property**

The Law on Management of Objects of State Property (SOE Law) defines the concept of managing state property. It allocates responsibilities and ownership arrangements among the Cabinet of Ministers (CMU), line ministries and other authorised bodies regarding property owned or managed (including leased property) by the state. While providing a general framework for SOE corporate governance, the Law on Management of Objects of State Property focuses more on state unitary enterprises. It defines the roles of ownership entities, details the responsibilities of the supervisory board members and provides for the establishment of internal audit, among other elements. For most SOEs, corporate governance practices are less formalised – for instance, the ownership entity selects the nomination committee members responsible for appointing CEOs and board members, and, in some cases, directly appoints the candidates. However, other legislation and practices may apply based on the company’s sector of operation and legal form, provisions under the company’s charter, and if an SOE is considered to be economically important (as further elaborated in subsequent sections, particularly Sections 6, 11 and 16, and Annex D) (Verkhovna Rada, 2006)

**Law on Joint Stock Companies**

The Law on Joint Stock Companies (JSC Law) is applicable to companies existing as joint-stock companies (JSCs) – which make up 6% of the total centrally-owned SOE portfolio. The law provides a broad framework for establishing, operating and terminating JSCs, along with determining their legal status, as well as the rights and obligations of shareholders, and establishing a supervisory board and an internal audit function. It has specific elements addressed to SOEs. Other elements include procedures for issuing shares and securities, developing a charter, and paying dividends, as well as for corporate reorganisation. While there is no specific law on state-owned JSCs, converting SOEs into JSCs provides for the applicability of the JSC law, which can help improve their corporate governance. For example, SOE corporatisation would allow for their management through a system of bodies, including a general meeting of shareholders, supervisory board and the executive body. Moreover, certain practices, including the appointment of supervisory board committees (including on audit, remuneration and appointment) and establishment of internal audit, are more formalised under the JSC law. Reporting and disclosure requirements are also more strictly enforced in practice among SOEs existing as JSCs, which fall under the oversight of the National Commission on Securities and Stock Market (NCSSM) (see Section 15) (Verkhovna Rada, 2008).

However, it is worth noting that the provisions under the JSC law may conflict with other legislation applicable to SOEs. For example, while the JSC law requires only one-third (and at least two) of the supervisory board members to be independent, the Law on Management of Objects of State Property requires more than half of the supervisory board members to be independent. Different views exist regarding which

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61 Although the framework for appointing supervisory board member committees exists under the CMU Resolution No. 142 in state unitary enterprises, committee functions are well defined under the JSC law. See Section 16.8.
law should prevail in this case. According to one view, amendments to the JSC Law are more recent and, therefore, should prevail. Another view is that the Law on Management of Objects of State Property is a law specific to SOEs and should prevail on this basis. Taking the former view may lead to potentially reducing the share of independent supervisory board members in state-owned JSCs. In practice, however, corporatised SOEs existing as JSCs have (and their charters provide for) a majority of independent supervisory board members, as the entities were established according to the Law on Management of Objects of State Property. Other conflicting areas relate to the powers of the supervisory board members (which may remain limited in state-owned JSCs despite being corporatised) and CEO appointments, as well as the selection of an independent auditor. As elaborated in the subsequent sections, while the Law on Management of Objects of State Property and relevant CMU Resolutions often override other requirements. Conflicting provisions limit clarity and uniformity of the applicable corporate governance framework and practices among SOEs, and may work towards undermining good practices (Verkhovna Rada, 2008[123]).

Other applicable orders, decrees and regulations

In addition to laws, there are orders, decrees and regulations that further frame corporate governance practices in the SOE sector. Notably, specific provisions apply to the appointment of supervisory board members and CEOs in enterprises that are deemed economically important to the state, which differ from the practices in other SOEs (see Sections 6 and 11, and Annex D). The process of selecting board members is more formalised in such SOEs, as the selection and nomination process is run by the nomination committee, which is overseen by MDETA. The process, however, is fraught with numerous exceptions, including in some of the key SOEs, and the CMU is involved in approving the candidates selected as supervisory board members and CEOs.

Moreover, certain CMU resolutions often contain conflicting provisions and present ambiguities in corporate governance framework applicable to SOEs. For example, according to CMU resolutions, CEOs may be appointed and dismissed by ownership entities or the CMU, which contradicts with the JSC law that grant this power to the supervisory board.

Law on Banks and Banking, and Law on Managing Objects of State Property in Defence-Industrial Complex

Certain corporate governance practices (including supervisory board and CEO appointments) also differ depending on the SOE sector of operation. Notably, specific procedures and requirements in state-owned banks (except for Ukrgasbank) are outlined under the Law on Banks and Banking (as elaborated in Section 7), while state-owned defence companies (Ukroboronprom and associated companies) must meet the requirements under the Law on Managing Objects of State Property in

62 These enterprises are defined under the CMU Resolution No. 999 (dated November 10, 2010, as amended, and identified in the CMU Resolution No. 83, dated March 4, 2015.

63 The Law on Management of Objects of State Property is ambiguous in this regard. Although it states that supervisory boards can appoint and dismiss CEOs, it also contains provisions reserving this right to the CMU if the SOE is under its ownership. In practice, however, ownership entities are often involved in CEO appointments and dismissals, unless the charter clearly allocates this power to the supervisory boards.
Defence-Industrial Complex (as elaborated in Section 3.3) (Verkhovna Rada, 2000[124]) (Verkhovna Rada, 2011[125]).64

4.2.2. Additional steps towards improving corporate governance in SOEs

Ukraine has also sought to continue improving its corporate governance framework through the introduction of various strategies and principles. In 2014, the National Commission on Securities and Stock Market (NCSSM) adopted the Principles of Corporate Governance, and later, a Corporate Governance Code (revised in 2020) which is applicable to listed companies. For a majority of the SOEs that are not listed, the Code is not mandatory and may apply as guidance. The Code provides a framework for good practices in corporate governance, such as appointing independent supervisory board members and ensuring information disclosure (NCSSM, 2020[126] (NCSSM, 2014[127]). Compliance with the Corporate Governance Principles has been a listing requirement based on the “comply or explain” principle, in accordance with an NCSSM Regulation No. 1688. Notably, companies are to explain whether they are in compliance with the code, the reasons for any deviations, and how alternative practices can help achieve governance aims. Companies are also to conduct self-assessment against the chapters of the code, and the information should be available through their websites. In practice, however, there is no evidence that the guidelines are taken as a reference, or that they are subject to monitoring or enforcement by the securities regulator.65

In addition, in 2018 the National Bank of Ukraine (NBU) adopted the Methodological Recommendations on Organisation of Corporate Governance in Banks (CMU, 2020[42]). These recommendations are largely based on the Corporate Governance Principles for Banks approved by the Basel Committee on Banking Supervision. Among other elements, Ukraine’s framework includes recommendations related to the supervisory board (including board composition and committees), corporate secretary, board assessment, and the executive board. The recommendations are not mandatory, but the NBU has been actively using them as supervisory expectations to improve corporate governance in each bank (as per its Annual Bank Inspection Plan). Moreover, the NBU’s instructions often result from these inspections, which are mandatory for inspected banks to implement (though they may be challenged in court). For example, the inspections may result in an instruction to improve the bank’s supervisory board composition.

Along with relevant codes and principles, in 2015 the Cabinet of Ministers approved a strategy to improve SOE corporate governance practices. The strategy introduced broad objectives, such as implementing OECD recommendations and practices related to corporate governance and promoting transparency (CMU, 2015[128]). While the strategy remains in force and the action plan has been adopted, the status of its

64 It is worth noting that the share of state ownership in Ukrgasbank is 94.94% and Article 7 in the Law on Banks and Banking applies to banks in which the state owns 100% of the shares. As a result, Ukrgasbank falls under different regulations.
65 The requirement to comply with the corporate governance principles is mentioned under the rules on stock exchange (Resolution No. 1688), which may apply to listed joint stock companies. They are required to explain any non-compliance with these principles in their annual reports. Other joint-stock companies may adhere voluntarily (NCSSM, 2012[306]).
66 The 2019 plan covers 51 banks out of 77 total in Ukraine. Moreover, international and professional community expects the NBU’s recommendations to become mandatory once it is adopted into law.
monitoring and implementation is not made public, although the Government reports that it continues to use the action plan and monitor implementation. For example, the Ministry of Finance uses the action plan to monitor SOE financial and business activities, and assesses fiscal risks on the state budget based on the data from ownership entities.\(^\text{67}\)

In March 2021 the government approved the 2030 National Economic Strategy which identifies the need to (i) increase the institutional capacity of public authorities responsible for strategic reform of state and communal property management; (ii) to reduce the role of the state and local governments as owners of economic entities based on state and municipal property; and (iii) to improve the management of SOEs that remain in state and municipal ownership. (CMU, 2021\(^\text{129}\)) Moreover, the government renewed its commitment to December 2020 to approve an updated action plan to bring the corporate governance system in the large and economically-important SOEs in line with OECD corporate governance standards (Minutes of 16.12.2020 № 127). According to this Plan, measures to reform corporate governance, which began in December 2019 are to be completed in September 2021.

### 4.3. Additional laws and regulations applicable to SOEs

Along with laws and strategies related to corporate governance, SOEs are subject to additional regulations that shape their legal and operational frameworks. Some of these laws include (and are not limited to) the following:

- Commercial Code of Ukraine
- Civil Code of Ukraine
- Law on Privatisation of State and Municipal Property
- Law on Holding Companies in Ukraine
- Tax Code
- Bankruptcy Code
- Law on Prevention of Corruption
- Law on Accounting and Financial Reporting
- Law on Limited Liability and Additional Liability Companies
- Law on Audit and Auditing Activities

The Commercial Code and the Civil Code provide an overview of economic activities in Ukraine for individuals and legal entities. Notably, they provide a general framework for establishing enterprises, along with organising their structure, management, and economic and social activities, which have guided the subsequent legislation specific to SOEs (Verkhovna Rada, 2003\(^\text{53}\)).

The Law on Privatisation of State and Municipal Property, adopted in 2018, helped develop a framework for the privatisation of state and municipal property, including shares in JSCs and unified property complexes of state unitary enterprises (Verkhovna Rada, 2018\(^\text{130}\)). Furthermore, the Law on Holding Companies in Ukraine provides general principles for holding companies that are applicable to joint-stock

\(^{67}\) https://www.kmu.gov.ua/en/reformi/ekonomichne-zrostannya/prodazh-neefektivnogo-derzhavnogo-majna
companies where the state owns 100% of the shares, along with other state holding companies and corporate entities (Verkhovna Rada, 2006[131]).

It should also be noted that SOEs are generally subject to the same tax regime as privately-owned companies, as defined by various acts through the commercial, tax, and budget codes, as well as sector-specific laws, which may be applicable. In 2015, the country reformed taxation at national level, with substantial changes in corporate, VAT and excise taxes, along with resource rents and customs duties. 68 While this framework also applies to SOEs, certain entities may benefit from tax breaks, particularly those engaged in investment programmes (MDETA, 2015[132]) (OECD, 2019[76]).

More broadly, the SOE operations are governed by various regulations and resolutions that may differentiate their operations from private companies. These areas relate to dividend payments, state aid and support measures, public service obligations, bankruptcy procedures, public procurement practices, asset ownership and financial reporting and disclosure, as outlined below.69

4.3.1. Dividends

SOEs in Ukraine are subject to paying dividends into the state budget.70 The Law on Management of Objects of State Property establishes a minimum dividend pay-out ratio of no less than 30% of net profit that applies to business entities in which the state owns a share. This includes not only majority-owned SOEs, but also companies in which the state owns a minority stake or in which it owns a majority stake indirectly (through wholly-owned SOE), such as Ukmafta or the GTSO. As such, the dividend payment requirements cover a broader set of companies than most of the other corporate governance requirements applicable to SOEs. The amount of payments should be decided by May 1 and paid into the budget by July 1 following the results of the calendar year.

Subject to the 30% minimum rate, the exact dividend pay-out is a flat rate set by the CMU annually for the previous financial year (based on Resolution No. 702), and it should bear in mind industry specifics, income dynamics, and budgetary, social and economic considerations. In reality, however, the rate is often based on the fiscal needs of the state in a given year rather than SOE performance, strategic objectives or investment needs. The proposal for the dividend policy is prepared by the Ministry of Finance and MDETA. The Ministry of Finance focuses on the state’s fiscal needs, while MDETA should focus on the SOEs performance and objectives. In practice, MDETA has little accountability for and leverage over SOE performance which fall outside of the scope of its ownership responsibility, with the dividend policy being mostly driven by fiscal considerations.

As a result, the dividend rate applicable to SOEs may significantly vary each year. For example, in 2014 and 2016, the single rate was 50%, while in 2015 and 2017 it amounted to 75%. In 2018, the rate increased to 90%, and, in 2019, it was lowered to

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68 Part of the reason for high VAT payment includes the 20% VAT tax rate on natural gas operations applicable as of January 2016, as well as natural gas price increases (OECD, 2019[40]).
69 As a matter of law, public service obligations and state aid also apply to private companies. In practice, the former applies only to the SOEs, while the latter more often applies to SOEs.
70 The term “dividend” includes dividends paid as shareholder income per share or portion of corporate rights, as well as share of net profit in state unitary enterprises.
50%. Generally, the single dividend rate applies to all SOEs, with some differentiation. For certain SOEs, the CMU establishes a reduced or increased dividend rate though the rationale for differentiated rates was not provided to the assessment team. For example, it was common practice to impose a minimum 30% dividend pay-out rate on Oschadbank and Ukhrydroenergo. Comparably, Naftogaz has been subject to a 95% rate, and PrivatBank has been subject to 75% rate. Certain entities, such as the air traffic control, are excluded from paying dividends, while others may need to provide additional funds to the state budget through advance payments (e.g. Naftogaz in 2019) and additional pay-outs (e.g. most SOEs at the end of 2019), as determined by the CMU (CMU, 2007[133]) (CMU, 2011[134]) (OECD, 2019[40]). Since dividend pay-outs are driven by fiscal needs, effective payments by SOEs may take other forms, such as advance payments on other taxes.

The dividend policy has faced a number of challenges, despite the existence of general government guidelines. For one, it has been deemed arbitrary and driven by fiscal needs as opposed to being flexible enough to adapt to individual companies’ capital structure, profit realisation, financial performance, or objectives. In some cases, it has led to the undercapitalisation of SOEs, while risking their indebtedness. A further challenge is imposed if there are delays in approving financial plans, or if the dividend payment rate is reconsidered for certain SOEs by the end of the year, which may lead to delays and penalties in submitting dividend payments.

For another, there has been no clear policy regarding the payment of dividends from subsidiary companies owned by an SOE parent. Under the Law on Management of Objects of State Property, both the parent and subsidiary companies of an SOE are required to pay dividends directly to the state budget. If the parent prepares consolidated financial statements and pays dividends based on the consolidated results, it may face double dividend payments. Despite attempts to resolve this issue (notably, through draft law 6428), there has been limited progress (OECD, 2019[40]). Along with ambiguities regarding the dividend policy, the state may be unable to recover dividends from certain entities. To encourage investments in SOEs, the state may subtract the amount used for investment activities from the net profit before calculating the amount on which the dividend rate is applied. Depending on the results, some entities (such as Ukrenergo in 2018) may not be required to contribute to the state budget (OECD, 2020[69]).

Previously, if companies subject to the state dividend policy failed to accrue dividends by May 1 of the respective year, the law required them to pay a share of net profit proportional to the state’s stake to the state budget. In the past, this also led to dividends being paid out to the state, but not to private shareholders, as a matter of practice. The state could also receive part of the net profit of an SOE in case of non-decision on the accrual of dividends by the general meeting. However, this provision (Article 11.5.8 under the SOE law) has been deemed unconstitutional according to a decision adopted by the Constitutional Court of Ukraine in 2020 (CCU, 2020[135]).

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71 At the time of writing (April 2021), MDETA proposed a 50% dividend rate for most SOEs. The rates for Ukhrhydroenergo and Oschadbank were lower (30%), and higher for PrivatBank (80%) and Naftogaz (95%). The rationale for the dividend rates, however, was unclear (Boytsun et al., 2021[87]).

72 Deliberate efforts to avoid holding a general meeting would prevent it from making decisions regarding dividends. Even if held, general meeting could decide not to take a decision on dividend distribution for various reasons.
4.3.2. State aid and support measures for SOEs

SOEs in Ukraine often receive state aid and other support measures. According to the central and local governing bodies, in 2019 Ukraine provided UAH 3.9 billion in state aid to all enterprises (approx. EUR 136.7 million), amounting to 0.11% of GDP. Nearly 90% of the recipients of state aid were SOEs and other municipally-owned enterprises (MOEs). In addition, state and municipally-owned entities also received further support measures from the state, surpassing UAH 136.6 billion. It is worth noting that while any state aid qualifies as a support measure, not all support measures qualify as state aid and fall outside the scope of the law regulating state aid (as outlined below) (AMCU, 2020).

State aid is regulated by the Law on State Aid to Business Entities. The law came into force in 2017 and aimed to create a framework for state aid allocation and monitoring. It also sought to enforce control over the impact of state aid on competition and to provide the Anti-Monopoly Committee of Ukraine (AMCU) with relevant supervising authority. Ukraine has established a state aid register reporting on the providers, recipients and categories, and has published reports on state aid under the oversight of the AMCU. While it does not provide an exhaustive list of state aid forms, the law introduces the following forms of state aid:

- Subsidies, grants and donations, as well as compensation for losses
- Tax benefits and deferral of taxes and other mandatory payments
- Debt write-offs, including for services rendered by the state, as well as other penalty write-offs
- Guarantees, preferential loans and servicing loans, and reduction of financial liabilities and payments for the state social insurance funds
- Provision or purchase of goods and services (directly or indirectly) at below market levels, acquisition of goods or services at above market levels, and the sale of state property at below market price
- An increase in the state’s share in authorized capital of entities, or an increase in the value of state’s share on the conditions that may be unacceptable to private investors

In addition, Ukraine has developed applicable criteria to determine whether a certain measure may be considered state aid – notably, the beneficiary should be a business entity and the transaction should involve state or municipal resources. The aid should also constitute an advantage that cannot be obtained from the market, and have a potential for distorting competition.

While state aid is considered incompatible by default, in certain cases it may be deemed or considered compatible. Notably, compatible state aid may be granted if it has a social nature or for damage compensations due to man-made or natural disasters. Entities may also be eligible for aid to promote socio-economic development across regions, to implement a national development programme, or to promote certain types of economic activities. Moreover, such aid should be granted without discrimination related to the origin of the product (Verkhovna Rada, 2014).

While state aid should be notified ex ante to the AMCU and disclosed, other support measures are not required to be reported (see Box 4.1 and Section 12). Certain

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73 It is worth noting that at the time of writing, Ukrainian anti-trust authority is working on a proposal to amend the state aid regulations, according to which forms of state aid may be revised.
sectors are exempt from the applicability of the law on state aid, including agriculture and defence, and activities related to investment in infrastructure. As a result, support measures provided to entities operating in these sectors may not be disclosed. Enterprises in the energy sector that provide services at a lower cost as part of their public service obligation also fall outside the scope of the law.\textsuperscript{74}

Other support measures may include legal amendments to grant debt-write offs (for instance, to help settle arrears worth over UAH 30 billion in the electricity sector). Ukraine has also introduced a law on settling debts in defence SOEs (including Ukroboronprom and its affiliated companies). Ukroboronprom’s debts may be written off for services, including the use of thermal energy and natural gas (including any arrears owed to Naftogaz), as well as electricity and water supply (Verkhovna Rada, 2012\textsuperscript{138}). Moreover, the state budget provides an additional UAH 10 billion to cover arrears in the defence sector, along with a provision regarding support in finance and investment projects (CMU, 2020\textsuperscript{42}). Ukraine has also been assisting SOEs with their debt obligations, which are issued in the form of CMU resolutions and are recorded on the Treasury website (CMU, 2020\textsuperscript{42}).\textsuperscript{75}

\textbf{Box 4.1. Provisions for disclosing state aid to the Anti-Monopoly Committee of Ukraine}

Under Ukrainian law, the grantor of state aid is obligated to notify Anti-Monopoly Committee of Ukraine (AMCU) about support measures (state aid) prior to providing guarantees or financing to beneficiaries (including SOEs). Support measure is treated as state aid if the following criteria are met:

(i) aid is granted to an "undertaking" business entity

(ii) aid is granted through state or municipal resources

(iii) aid is favouring certain undertakings, production of certain goods and certain economic activities

(iv) aid is distorting or threatening to distort competition.

State aid (as well as other support measures) may be either direct from state or municipal authorities, or indirect through their respective resources. In case of the latter, key factor to consider is the degree of intervention of the state or municipal authority in considering the measure and the method of financing. For example, resources coming from the EU (e.g., structural funds) and IFIs (including the IMF and the EBRD) would be considered state resources if state and municipal authorities have discretion regarding resource allocation and selection of beneficiaries. However, if the financing organisations direct the use of financing and determine the regime of finance utilisation with no discretion on part of the state or municipal authorities, then such resource will not be considered state aid and the AMCU would not need to be notified.

State guarantees are one of the most frequently used form of state aid. The AMCU applies criteria similar to those provided by the EU applicable for determining whether a guarantee constitutes state aid. Thus, state and municipal bodies should notify the AMCU of provision of guarantees in the following cases: (i) a beneficiary of a guarantee is in a financial distress; (ii) a guarantee covers more than 80%...
4.3.3. Public service obligations

The government may impose a public service obligation (PSO), which in practice only applies to SOEs (CMU, 2016[140]). The PSO has been introduced in regulated activities, including the postal and courier services, and utilities, such as the supply of water, natural gas, and electricity (as elaborated in Section 12). In particular, price and tariff caps in the electricity and natural gas sectors have been imposed to keep utility tariffs low for certain consumers (notably households and religious organisations), though regulations are subject to change (CMU, 2019[141]). PSOs may also be imposed to support other SOEs. For example, in 2016 the CMU imposed a PSO on Naftogaz to supply gas to the Odessa Port Plant regardless of previous arrears.

4.3.4. Bankruptcy

SOE bankruptcy procedures have been framed through the Commercial Code and the Bankruptcy Code. Generally, SOEs may be declared bankrupt. However, according to the Commercial Code, bankruptcy proceedings cannot be launched for certain SOEs (kazenne or budgetary companies), while additional requirements apply for other SOEs.[77] The bankruptcy procedure is focused on restoring solvency through financial assistance and debt restructuring, and, if otherwise, engaging in their liquidation. The CMU co-ordinates with the ownership entities to restore SOE solvency, while the State Budget determines the amount of funding necessary.

The Bankruptcy Code further defines the roles of specific entities and measures, including analysing financial conditions, approving financial plans, and carrying out their re-organisation and liquidation. In case these efforts are unsuccessful, the Code states that SOEs should file for bankruptcy in a commercial court. Moreover, in majority-owned SOEs, ownership entity involved in the procedure may participate with an advisory vote in the committees of creditors (Verkhovna Rada, 2018[142]). However, the bankruptcy procedures may not be initiated against SOEs that are earmarked for

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[76] To further lower tariffs, PSO was imposed on some of the key electricity producers, such as Energoatom (nuclear electricity producer) and Ukhydroenergo (hydroelectric producer). Despite the launch of a new electricity market in 2019, the former sold up to 90% of the electricity it at below cost recovery levels, and the latter up to 35%. However, the PSO has been adjusted since and the SOEs can sell more of their electricity on the market. Similarly, while Naftogaz was to offer natural gas at market levels for industrial consumers, PSO was imposed to lower the cost of natural gas for household consumers. The PSO was partially lifted in August 2020 to introduce market pricing, as the company will be selling gas to heating plants at a regulated rate until May 2021.

[77] The ownership entities are not liable for SOE obligations, except for in budgetary companies.
privatisation, or until the completion of their privatisation and one year thereafter. According to the Ukrainian authorities, some of these procedures have been introduced to prevent illegal privatisation or to maintain operations of socially important SOEs.

While the bankruptcy procedures have been established, there may be challenges in implementation. For one, there are no provisions regarding the conditions under which the cases may be opened, though the proceedings should be initiated only by the SOEs. For another, certain procedures are limited to entities, such as judicial reorganisation to those engaged in state defence and military enterprises, and liquidation proceedings to those that will be liquidated by their ownership entities by 2022 (Verkhovna Rada, 2019[143]). Certain bankruptcy proceedings are not allowed to prevent illegal privatisations or to maintain operations of socially important SOEs, though applicability may vary on a case-by-case basis. In addition, the parliament has sought to introduce amendments to the Bankruptcy Code to protect certain enterprises from being declared bankrupt. Moreover, in some cases, rehabilitation of certain debtors before launching the bankruptcy proceedings may not be allowed.

4.3.5. Public procurement

The Law on Public Procurement establishes specific rules for the procurement of goods and services, which applies to certain SOEs (CMU, 2020[42]). In previous years, the National Anti-Corruption Bureau (NABU) stated that procurement was one of the key areas through which corruption took place among SOEs (NABU, 2017[144]). However, in 2016, ProZorro, an e-procurement platform was introduced, which has been lauded by international stakeholders as a means to promote fair competition, transparency, and non-discrimination practices, while working to prevent corruption. It has an appeals system under the jurisdiction of the AMCU. ProZorro must be used as long as certain thresholds for procurement are met. If procurement purchase value does not exceed UAH 50 thousand, a more simplified procedure is used (as outlined under Article 14 of the law). However, further conditions apply in case transaction values are higher.

The Law on Public Procurement applies mainly to majority-owned commercial SOEs that engage in certain activities, including gas transportation and postal services, though many SOEs use ProZorro marketplace as a platform for procurement (Table 4.1 outlines conditions for applying the procurement law to SOEs) (Verkhovna Rada, 2015[145]). Between 2019 until the end of November 2020, the SOEs organised 159,076 tenders and concluded 137,393 contracts with a total value of UAH 317.6 billion. However, it is worth noting that public procurement practices may disproportionately impact certain SOEs operating in the competitive marketplace, including the GTSO that is required to purchase gas through ProZorro, rather than through energy exchange platforms, which has an impact on the liquidity of the gas market (amendments to the Procurement Law are foreseen).

78 Notably, while Energorynok, a former wholesale electricity market operator, was to be liquidated following the launch of the new electricity market, the company accumulated UAH 30 billion in arrears. However, the draft amendments introduced in the parliament are looking to protect Energorynok from bankruptcy through debt restructuring (Interfax Ukraine, 2020[308]).

79 Specific procedures are also outlined here: https://infobox.prozorro.org/articles/shcho-take-sproshcheni-zakupivli-i-chim-voni-vidriznyayutsya-vid-doporogovih
Table 4.1. Conditions for applying the public procurement law to SOEs

<table>
<thead>
<tr>
<th>Conditions</th>
<th>Public procurement law applies to:</th>
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<tbody>
<tr>
<td>Value of purchased goods or services is equal to or exceeds UAH 200 thousand and work exceeds UAH 1.5 million</td>
<td>Legal entities that are enterprises, institutions and organisations that meet the needs of the state or local community, if their activities are not carried out on an industrial or commercial basis, and if:</td>
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<tr>
<td></td>
<td>• Legal entity is the administrator or recipient of budget funds</td>
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<td>• Public authorities or local governments have a majority of votes in the entity</td>
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<td>• State or communal shares in the legal entity exceed 50%</td>
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<tr>
<td>Value of purchased goods or services is equal to or exceeds UAH 1 million, and work exceeds UAH 5 million</td>
<td>Legal entities or businesses that carry out activities in the following areas (albeit with exceptions):</td>
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<tr>
<td></td>
<td>• Natural gas production, transportation, distribution, storage (injection, selection) and supply</td>
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<tr>
<td></td>
<td>• Fossil fuel development and production</td>
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<tr>
<td></td>
<td>• Thermal energy production, transportation and supply to consumers (exceptions apply)</td>
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<tr>
<td></td>
<td>• Electricity production, transmission, distribution, purchase and supply to consumers, along with monopoly functions (such as dispatch management, ensuring the functioning of the intraday market) (exceptions apply)</td>
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<td></td>
<td>• Drinking water production, transportation and supply, and ensuring the functioning of centralised drainage, along with other irrigation and drainage measures (exceptions apply)</td>
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<td></td>
<td>• Railway transport infrastructure and use (including subway) and operation of facilities for transportation activities, including services on bus stations, ports, airports, air navigation, etc.</td>
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<td></td>
<td>• Postal services</td>
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<td></td>
<td>Along with carrying out the aforesaid activities, at least one of the following conditions must also be met:</td>
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<td></td>
<td>• The share of state or local governments in the authorised capital should exceed 50%; have majority vote in the entity; or the right to appoint over half of the executive body or supervisory board of a legal entity</td>
</tr>
<tr>
<td></td>
<td>• Entities should carry special or exclusive rights that are granted within the powers of a public authority or local government, which affects the ability of others to carry out activities in a selected area. (The rights granted by tenders are not considered special or exclusive, as long as information was publicly available and the opportunity to participate was not limited, and if rights were granted based on an objective criteria)</td>
</tr>
</tbody>
</table>

Source: (Verkhovna Rada, 2015[40]).

4.3.6. Asset ownership

Further differences apply to SOEs regarding asset ownership. Notably, SOEs often have the “right of economic management” over their state assets, which were transferred to them by the state to perform their activities. While they may use property entrusted to them by the owner, they cannot dispose of it without the ownership entity’s consent. As a result, the SOEs are often unable to perform transactions, such as pledging assets as a collateral or writing off illiquid assets, and face challenges in meeting certain international requirements.80 Moreover, transferring legal ownership of these assets to SOEs that have been converted into joint-stock companies could be considered as de facto privatisation (OECD, 2019[40]) (OECD, 2020[69]). In the course of converting unitary SOEs into JSCs, some of state assets may be outlined in the charter capital of the JSC in exchange of the shares, which would allow the JSC to become an owner of such assets.81 Assets that must remain in state ownership (e.g., GTSO) are transferred to the JSC into use pursuant to an agreement. While the

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80 For example, Naftogaz has been restricted from selling its assets or from using them as collateral due to the existing restrictions in Ukrainian law. The company’s management reported that it could only use three types of collateral to attract loans, namely contract revenue of future periods, goods in turnover, and goods in inventory. In addition, challenges with regard to asset ownership particularly impacted Ukrenergo, the country’s transmission system operator, in meeting the European Energy Community requirements. Partly due to the lack of clarity regarding its asset ownership, Ukrenergo was unable to join the European Network of Transmission System Operators for Electricity.

81 Historically, the CMU transferred shares of some legal entities into the charter capital of Naftogaz, while retaining them in state ownership. As a matter of practice, Naftogaz is a registered owner of those shares and may enjoy all shareholders rights. However, as a matter of law, this practice is not sustainable and the CMU intervenes as needed.
seizure of state assets in entities with over 25% of the state’s share is generally prohibited, certain exceptions may apply.

### 4.3.7. Financial reporting and disclosure

General framework on financial reporting is applicable to SOEs, as outlined under the Law on Accounting and Financial Reporting. Under this framework, certain SOEs are required to adhere to IFRS, including “enterprises of public interest”, micro and small financial institutions, and those operating in the extractives sector (see Table 15.2). Statements prepared in accordance with IFRS are also submitted to NCSSM for joint-stock companies. Additional requirements with regard to reporting and independent audits may be imposed depending on SOE legal form, type and sector of operation (including banking and extractives).

However, specific disclosure requirements are applicable to SOEs under the Commercial Code and the CMU Resolutions. According to the current framework, SOEs are responsible for disclosing quarterly and annual financial statements, the company charter, ownership structure, risk factors, and information regarding their supervisory board members and CEOs, among others (as further elaborated in Table 15.1 in Section 15). Considering the size of the SOE portfolio, however, these requirements are often challenging to enforce.

Ukraine has also established entities that are responsible for conducting state audits, including the State Audit Service and the Accounting Chamber, and the SOEs fall under their oversight (see Section 15.2). The State Audit Service is under the direction of the CMU and the Ministry of Finance. It is responsible for implementing policy in state financial control and monitoring the efficiency of the use of public resources, while having broad legal and sanctioning powers. The Accounting Chamber is under the supervision of the parliament, and it controls the receipt of funds in the state budget and monitors their use.

In addition, Ukraine has started centralising financial information regarding the SOE financial performance. In 2015, it began issuing reports that analysed the performance of top-100 economically important SOEs, which have been discontinued. In 2019, the country launched ProZvit, a database that aggregates self-reported financial indicators of over 3,500 SOEs. While the database has been useful in monitoring information regarding the performance of the SOE sector, as well as individual SOEs, it is currently being updated and data may be unavailable. In 2019, the Ministry of Finance and MDETA issued a joint order (No. 1140/701) to ensure reporting and disclosure on the ProZvit platform. The government has also developed internal platforms (such as Best Zvit) to improve information collection regarding the SOE sector.

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82 Enterprises of public interest include enterprises (issuers of securities) whose securities are traded on stock exchanges, banks and other financial institutions (except for financial institutions and non-state pension funds that are considered micro and small enterprises), as well as “large enterprises”. According to the Law on Accounting and Financial Reporting, “large enterprises” are those that meet at least two of the following criteria: (i) employ over 250 individuals, (ii) have a book value of over EUR 20 million, or (iii) have a net income of EUR 40 million.
4.3.8. Sector-specific laws applicable to SOEs

In addition to the aforesaid laws and regulations, SOEs and their operations may be subject to additional laws and requirements depending on the sectors in which they operate. These include (and are not limited to) the following:83

- Laws on Natural Gas Market (329-VIII), on Oil and Gas (2665-III) and Pipeline Transport (192/96/VR): define the principles for the hydrocarbons industry and framework for pipeline transport, as well as the operation of the natural gas market.
- Law on the Electricity Market (2019-VIII): defines the roles of entities involved in electricity production, transmission and supply and distribution, and the overall management of the power system of Ukraine. Certain regulations and requirements apply to SOEs, including Ukrenergo (the transmission system operator), and other state-owned electricity production, supply and distribution companies.
- Law on the Use of Nuclear Power and Radiation Safety (39/95-BP): provides specific requirements on operating nuclear facilities, uranium mining and processing, and entities contracting the construction of nuclear facilities or radioactive waste disposal facilities.
- Air Code of Ukraine (3393-VI): defines restrictions on using state-owned airfields and facilities for flight security infrastructure.
- Law on Railway Transport (273/96-VR) and the Law on Establishing a General-Purpose Public Joint-Stock Rail Company (4442-VI): provide details on establishing and operating the state railway company.
- Law on Postal Service (2759-III): defines the role of the national post office and regulates Ukrposhta.
- Law on Sea Ports of Ukraine (4709-VI): defines the role of the SOEs operating in Ukrainian Sea Ports Authority and contains provisions regarding seaport operations and the use of infrastructure facilities, among others.
- Law on Banks and Banking (2121-III): provides a legal framework for the banking system, as well as specific provisions regarding the operation of state-owned banks.

4.4. Regulatory institutions

Along with sector-specific laws, SOEs may be subject to requirements of regulatory institutions within the sectors in which they operate. Most of these regulatory institutions are accountable to the President and the parliament (except for the NEURC, which reports only to the parliament), and are as follows:

- National Bank of Ukraine (NBU)
- National Commission for State Regulation of Communications and Information (NCCIR)

83 The list has been adapted from the following source: (MDETA, 2015[132])
Along with these institutions, additional entities (including line ministries) also perform regulatory functions. Notably, the Ministry of Infrastructure acts as a regulator and a policymaker within the railway sector, while performing ownership functions over Ukrzaliznytsia (as delegated by the CMU) (Kuzyo, Zatvornytska and Yablonovskyy, 2019[88]). The National Bank of Ukraine (NBU) is responsible for regulating the banking sector (including the state-owned banks) and overseeing financial services (as elaborated in Section 7). 84

NEURC, NCSSM and NCCIR are collegial bodies that participate in the development and implementation of state policy within their respective fields. They engage in market analysis, maintain registers of market participants, implement state development strategies and assist with drafting relevant laws and regulations. They may also submit policy proposals, supervise market participants and set tariffs (as applicable). For example, NEURC is responsible for licensing and tariff-setting in the energy sector, while the NCCIR performs these functions in telecommunications and postal services (NCCIR, 2011[146]) (NEURC, 2014[147]). In addition, SOEs registered as joint-stock companies are subject to regulations introduced by the NCSSM. As part of the corporatisation process, the NCSSM is involved in creating SOE shares and transferring them to the ownership entity.

As some SOEs are involved in heavily regulated sectors (particularly in the energy sector), regulatory institutions may have a significant impact on SOE operations and performance. For example, NEURC has been engaged in setting tariffs for electricity transmission and dispatching, which may impact operational and financial performance of Ukrenergo (the transmission system operator) and state-owned electricity distribution companies that perform non-competitive functions (CMU, 2020[42]). While NEURC has not been setting tariffs in the gas sector to reflect market pricing, it has continued to regulate transportation, distribution, and storage (OECD, 2019[40]). Moreover, although the regulatory bodies do not report to the CMU or line ministries that are SOE ownership entities, there have been concerns with regard to potential conflicts of interests. 86

Unlike the aforesaid regulatory bodies, the role of the AMCU is to ensure the development and implementation of competition policy in Ukraine. Established in 1993, its objective is to protect and promote fair economic competition, oversee coordinated actions of business entities and ensure legal compliance with competition regulations. The AMCU may also provide methodological support and draft regulations and proposals for the President and the CMU. Moreover, it may consider cases for violating competition regulations, including administrative offences, while appointing experts and conducting inspections. Considering its role, the AMCU has been heavily involved in monitoring SOE performance, such as assessing their

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84 It is also worth noting that the National Commission for State Regulation of Financial Service Markets was liquidated in 2020, and its functions were split between the NBU and NCSSM.

85 The National Bank and the Ministry of Infrastructure are not collegial bodies, and the Ministry of Infrastructure reports to the CMU.

86 Previous studies have revealed that national commissions (particularly in the energy sector) have frequently experienced political pressure in performing their activities (OECD, 2019[76])
operations and providing recommendations to help promote a competitive environment. It has also continued to be involved in monitoring the allocation of state aid (as outlined under 4.3.2) and activities related to SOE privatisation (AMCU, 2019[148]).

### 4.5. Anti-corruption bodies and framework pertaining to SOEs

Ukraine’s anti-corruption institutions are involved in overseeing cases involving SOEs. The National Anti-Corruption Bureau of Ukraine (NABU) was formed in 2015 as an independent body responsible for detecting and preventing corruption. The bureau mainly investigates heads and senior officials of large SOEs, while looking to combat corrupt practices across different levels of government and to recover funds (Box 4.2). NABU is under the oversight of the Specialised Anti-Corruption Prosecutor’s Office (SAPO), an independent structural sub-division of public prosecution. In addition, the National Agency for the Prevention of Corruption (NAPC) is responsible for overseeing and co-ordinating anti-corruption programmes in SOEs, along with maintaining registers on e-declarations and corrupt entities, and clarifying issues, such as conflicts of interest. In 2019, Ukraine established the High Anti-Corruption Court where corruption-related cases are brought. While corruption is prevalent in the SOE sector, defence and energy SOEs are considered to be most vulnerable to corrupt practices (forthcoming OECD studies will examine these concerns in detail, see Box 4.3).

#### Box 4.2. NABU investigations in the SOE sector

NABU has investigated over 100 criminal proceedings on corruption in the SOE sector. According to preliminary estimates, total losses incurred by the SOEs have exceeded UAH 20 billion, and the sector is considered to be one of the largest sources of corruption. In 2020 alone, both NABU and SAPO prevented the misappropriation of SOE funds and assets worth over UAH 800 million, and over UAH 1 billion was returned through pre-trial investigation. By the end of November 2020, NABU was pursuing 19 cases in connection with SOEs, suspecting 36 individuals of committing criminal offences. It filed 12 proceedings to the court against abuses in the activities of SOEs and their officials. In addition, SAPO informed that in 2020, out of 53 proceedings, three cases were related to management of the largest SOEs and its prosecutors were pursuing six SOE-related cases.

Over the years, some of the key SOEs have been investigated, including Naftogaz and its subsidiaries (notably Ukrgasvydobuvannya, which may have witnessed UAH 3 billion in losses due to corruption) and Ukrzaliznytsia (with nearly UAH 500 million in potential losses), as well as the Ukrainian Sea Ports Authority (UAH 247 million in potential losses) and Oschadbank (UAH 500 million in potential losses). Although cases have often been hampered in courts, investigations have continued. In 2020, three individuals were detained for an attempt to bribe the head of the State Property Fund regarding the appointment of the CEO of the Odessa Port Plant. Recent investigations have also revealed misappropriation of resources, including natural gas (worth up to UAH 729.8 million), and corruption in procurement, particularly among state-owned mines (worth up to UAH 51.2 million).

Source: (Boytsun, 2019[39]) (NABU, 2020[149]) (CMU, 2020[150]) (NABU, 2021[151])

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87 The AMCU should also be involved in creating new MOEs, but the local authorities often ignore this requirement.
88 The registry is available here: https://nazk.gov.ua/uk/roz-yasnennya-ta-reyestrty/
The Law on Prevention of Corruption outlines requirements with regard to promoting anti-corruption measures in SOEs. Some provisions relate to managing conflicts of interest and receiving gifts, along with transparency requirements. Further elements include setting up internal controls to detect and prevent corruption in SOEs, as well as ensuring whistleblower protection (Verkhovna Rada, 2014).\(^8^9\)

Requirements to introduce anti-corruption programmes in SOEs depend on whether they are: (i) enterprises that carry out highly profitable economic activities characterised by high corruption risks (if gross income is over UAH 70 million and there are over 50 employees, or the cost of procuring goods and services is at least UAH 20 million); or (ii) other SOEs. SOEs under the first category are required to:

- Develop anti-corruption programmes and implement anti-corruption standards and practices (internal control tools), as approved by the NAPC (decision No. 75 of 02.03.2017)
- Appoint individuals responsible for implementing the anti-corruption programme, and ensure their independence
- Carry out regular assessment of corruption risks (both internal and external), no less than once every three years
- Create secure communication channels (online tools and hotlines) through which whistleblowers may communicate and ensure anonymity

Other SOEs (under the second category) may create authorised units to prevent and detect corruption, implement anti-corruption measures, and assess corruption risks. According to the Ukrainian authorities, in 2019, 254 SOEs belonged to the first category, and 2939 SOEs belonged to the second category. Along with coordinating anti-corruption programmes, the NAPC is responsible for approving the dismissal of anti-corruption officers in SOEs. However, CEOs appoint anti-corruption officers, which creates risks of conflict of interest (as further elaborated in Section 14).

Among other activities, the NAPC is responsible for monitoring e-declarations. According to the Law on the Prevention of Corruption, supervisory board members (except foreign non-residents who are independent board members) in SOEs were obliged to disclose their assets and file e-declarations. The e-declarations were publicly disclosed (with the exception of certain personal data) and accessible, and penalties were applicable for disinformation.\(^9^0\) However, in October 2020, the Constitutional Court declared that the powers of NAPC regarding e-declarations was unconstitutional and cancelled existing penalties (Sukhov, 2020). Due to the court’s decision, over 100 corruption cases were closed, including those involving government officials who were being investigated by NABU and were expected to be heard by the High Anti-Corruption Court. During the second half of 2020, the Constitutional Court also declared that the appointment of the head of NABU in 2015, along with certain clauses and provisions regarding the law on NABU, were unconstitutional (Sukhov, 2020).

\(^8^9\) In 2021, a draft law (No. 3450) was passed that would have contributed to limiting whistleblower protection. Some provisions included requirements to “know with certainty” and confirm the facts of a corrupt offence, and to potentially reveal sources. The draft law was ultimately not signed by the President (TI Ukraine, 2021).

\(^9^0\) Initially, the requirements to file e-declarations applied to all supervisory board members. However, following the discussions with the international community and a number of board member resignations, since October 2019 the requirement to file e-declarations were lifted for foreign non-residents, who are independent supervisory board members in SOEs.
In December 2020, the parliament voted to reinstate the powers of NAPC and the e-declaration system, though all prior investigations that were closed due to the court’s decision may not be resumed based on the previously established facts. Moreover, while the NAPC’s powers to collect and check declarations of government officials have been reinstated, the High Court of Justice must be informed regarding all investigations concerning judges (Sorokin, 2020[155]). The reinstated law envisions fines and “restriction of liberty” (rather than imprisonment) for intentionally submitting false statements, the monetary threshold of which has been increased from UAH 500,000 to UAH 1,000,000 (ANTAC, 2020[156]).

**Box 4.3. Typology of Corruption Schemes in the Energy Sector**

A forthcoming report on the OECD Typology of Corruption Schemes in the Energy Sector in Ukraine will document cases of (alleged) corruption in the energy sector. Some of the typical schemes have the following characteristics (this list is non-exhaustive):

- A system of kickbacks at which the price of goods and services is increased at least several times in order to pay bribes to lobbyists, politically connected individuals, relatives or connections to SOE officials
- Tenders and purchases of unsolicited or superfluous services and goods (or via intermediaries)
- Schemes for the purchase of equipment, works or services, which were carried out with a significant excess of the planned cost. Suppliers that offer a lower price are simply “thrown out” of the tender on artificial, pre-set formal grounds. The winner’s product as a result is “expensive” in every sense of the word and the winner itself is usually a favoured supplier
- Prior agreement on the price between the bidders or participation of fictive competitors (usually represented by the companies whose beneficial owners are family members/ friends from the circle of political elite or energy companies’ leadership)
- Bid rigging the procurement process to ensure the bidder is predetermined, with a large payment made in advance to the selected supplier. The bid winner can be a shell company that immediately transfers the money to an offshore company or one that does not deliver on its contractual obligations
- Outsourcing services previously carried out by the SOE to an external provider, who then bribes the SOEs officials to use the SOEs own resources (equipment and staff) to carry out the outsourced services.

Source: (OECD, forthcoming[157]; OECD, 2020[156])
Chapter 5. Ownership arrangements and responsibilities

State ownership in Ukraine is decentralised, with over 80 entities exercising ownership rights. This excludes the ownership arrangements for entities held at the sub-national level (see Section 8) (OECD, 2019[40]). As noted in earlier OECD reviews, there is no centralised authority that co-ordinates or oversees SOE ownership practices, with disparate ownership entities combining multiple roles, including exercising ownership rights, formulating state policy and (often) setting regulation. This frequently results in a goal conflict and impairs the ability of the ownership entity to manage SOEs effectively and professionally, with a view to enhance their performance and raise accountability. This section outlines the ownership policy, arrangements and co-ordination in the SOE sector, and responsibilities of key actors, including the CMU, MDETA, line ministries and other ownership entities, and the State Property Fund of Ukraine (SPFU).

5.1. Ownership co-ordination: policy and main actors

The overarching legal and policy framework for exercising ownership functions in SOEs is outlined in the Law on Management of Objects of State Property (as amended). Introduced in 2006, the law was the first attempt to consolidate the fragmented system of state ownership in Ukraine. Its authors intended to empower the CMU to act as a centralised ownership entity, moving away from the decentralised model of ownership. However, the law that was actually passed was not as ambitious as its authors intended and the centralisation of state ownership lacked political support. Nevertheless, it introduced the first overarching legislation pertaining to SOEs with the aim of setting out the institutional roles and responsibilities involved in state ownership. The law has since been amended in various iterations, including the latest significant amendment in 2016 (though minor amendments have been introduced since), and remains the main reference with regard to SOE governance (OECD, 2019[40]).

According to this body of legislation, key institutions are involved in state ownership from a whole-of-government perspective: the Cabinet of Ministers (CMU), the Ministry for the Development of Economy, Trade and Agriculture (MDETA), the Ministry of Finance, and other line ministries. All exercise shareholder rights in their respective SOEs, while simultaneously having the broader mandate to shape to certain extent the institutional, legal and policy environment in which SOEs operate (as outlined in Table 5.1, with an SOE oversight policy framework depicted in Figure 5.1) and subsequent sections.

Though the Honcharuk government (2019-2020) considered reorganising ownership arrangements and establishing a centralised ownership entity, the plans were put on hold by the current government, and the previously planned budget for its establishment were reallocated in April 2020 due to the Covid-19 pandemic. While
discussions have continued, concrete plans regarding the establishment of such entity remain to be introduced.

**Table 5.1. State ownership in Ukraine: institutional framework**

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| *Cabinet of Ministers*  
Highest executive authority;  
Collegial body chaired by the Prime Minister;  
Accountable to the Parliament | - Assigns responsibility for governance of SOEs to ownership entities (including line ministries and agencies).  
- Approves the establishment, reorganisation and liquidation of SOEs that are strategically important, and delegates responsibility for control over their operations to relevant supervisory bodies.  
- Sets performance criteria for the management of SOEs and the processes for applying these criteria.  
- Approves the list of SOEs or assets that are strategically important for the national economy and security, and defines their non-economic or public policy objectives.  
- Responsible for approving selected candidates for CEO and supervisory board members in economically (and, in some cases, strategically) important SOEs, and for appointing independent committee members in the permanent nomination committee.  
- Enacts the dividend policy set by the Ministry of Finance and MDETA.  
- Engages in the process of SOE privatisation.  
- Exercises ownership functions over a number of key SOEs and state-owned banks, which are often delegated to other line ministries that also perform ownership functions over their own portfolios. |
| *Ministry for the Development of Economy, Trade and Agriculture (MDETA)* | - Defines general principles and strategic priorities for the management of state-owned enterprises, including corporate rights held by the State.  
- Developed the ‘Basic Principles of Implementation of Ownership Policy for SOEs’ for overall state-ownership, approved by a protocol decision of the government in 2018.  
- Responsible for aggregate reporting on SOE portfolio, submitted to the CMU.  
- Controls the authorities responsible for the management of corporate rights of the State through monitoring the performance of state-owned enterprises under their oversight.  
- Formally responsible for formulating state dividend policy in consultation with Ministry of Finance.  
- Identifies the state-owned enterprises that are strategically important for the economy and security of the state.  
- Establishes the permanent nomination committee for the competitive selection of CEOs and independent supervisory board members of economically important SOEs and monitors the process. |
| *Ministry of Finance* | - Responsible for the formulation and implementation of the state dividend policy (together with the MDETA).  
- Monitors the fiscal impact of state assets.  
- Approves budget subsidies in sectors where line Ministries manage and oversee SOEs.  
- Exercises ownership functions over state-owned banks (as delegated), Ukrenergo and the Main Gas Pipelines of Ukraine (the latter is a holding company for GTSO, the gas transmission system operator), which are expected to be transferred under the Ministry of Energy in 2021. |
| *Line Ministries* | - Exercise decision-making authority with respect to the establishment, reorganisation and liquidation of SOEs in relation to which they exercise ownership rights (decisions regarding strategic SOEs are subject to CMU’s approval).  
- Approve annual financial and investment plans, as well as charters of SOEs within the scope of their authority.  
- Appoint and dismiss executives of SOEs (subject to the definition of their responsibilities in the company’s charter and the presence of independent supervisory board members), and supervisory board members, as applicable.  
- Organise annual audits of their SOEs (may include the appointment of revision commissions), among other aspects. |
| *State Property Fund of Ukraine (SPFU)* | - Exercises right to establish, manage and liquidate SOEs.  
- Conducts privatisation of SOEs and other state property (subject to CMU’s oversight and approval).  
- Engages in managing state-owned real estate (upon request).  
- Acts as a lessor of integral property complexes of SOEs.  
- On behalf of the state, acts as a founding participant of business entities or shareholder in partially privatised companies.  
- Responsible for establishment and maintenance of the Unified Register of State-Owned Property. |

Source: (OECD, 2020[69])
Figure 5.1. Outline of SOE ownership co-ordination framework

Note: This chart describes key institutional actors, including an outline of their structure and reporting lines in co-ordinating SOE ownership arrangements. Specific corporate governance practices, however, may differ depending on the SOE category, including type (i.e. economically or strategically important) and sector of operation. Source: Author’s compilation is based on the Law on Management of Objects of State Property.

5.1.1. Cabinet of Ministers of Ukraine

The Cabinet of Ministers of Ukraine (CMU) is a central body responsible for policy oversight within the SOE sector. However, it delegates many of its responsibilities to other entities and line ministries, notably MDETA (responsible for policy setting in the SOE sector) and the Ministry of Finance (responsible for oversight and policy setting in state-owned banks). The CMU decides on the conditions for creating, reorganising, transferring and liquidating the SOEs, sets goals for their activities, and assigns ownership entities for their management. It is also involved in overseeing policy implementation delegated to other ministries, while gathering information regarding individual entities, conducting inventory and initiating state audits (CMU, 2020[42]) (Verkhovna Rada, 2006[122]) (CMU, 2016[140]).

With respect to SOE corporate governance, the CMU determines the overall state ownership policy. It sets criteria for forming a supervisory board in majority-owned SOEs (except in defence SOEs), establishes requirements for selecting and appointing supervisory board members (both independent and non-independent members) and CEOs, and develops remuneration methodology.91 The CMU may also be involved during the appointments of the supervisory board members (if relevant) or the CEOs through the presence of its representatives on selection committees and, in some cases, through the approval of nominated candidates (CMU, 2020[42]) (Verkhovna Rada, 2006[122]). For SOEs over which it exercises ownership rights, it can be directly involved in the selection and appointment of the CEOs as well.

In addition, the CMU approves annual financial plans for SOEs that are natural monopolies and whose turnover is above a specified threshold (e.g. exceed UAH 50

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91 The involvement of ownership entities in appointing the heads of SOEs and determining their remuneration has remained a contested issue in Ukraine, and the draft laws on improving corporate governance have sought to transfer these responsibilities to the SOE supervisory board members. According to the OECD SOE Guidelines, the supervisory board should be responsible for appointing the heads of SOEs and setting their remuneration.
Box 5.1. SOE annual financial plans

The financial plan is a key document for an SOE, based on which the enterprise outlines its (potential) revenues and expenditures, and determines the allocation of funds to perform its functions. The plan may be up to 300 pages, and it is used to distribute profits and allocate the amounts sent to the state and credited to the State Budget, as well as those necessary to cover costs, including depreciation, consumption, reserve, and product development. The implementation of the financial plan is monitored by the ownership entities and are communicated to the CMU. Currently, MDETA Order No. 205 regulates the submission of the final plans.

The financial plans are developed by the company officials and are approved by the ownership entities, and they are not necessarily linked with the company’s strategy, risk assessment or key performance indicators. The supervisory board, if formed, may approve draft financial plans only. However, the plans may be subject to the CMU's approval if the entities are natural monopolies or if their profits exceed UAH 50 million. In addition, other entities (such as NEURC) may also be involved in the approval process if they are engaged in forming tariffs in specific sectors (notably, in the energy sector). Unlike most SOEs, the state-owned banks do not develop financial plans.

However, financial plans have often been regarded as bureaucratic tools that over-regulate the SOEs. Lengthy approval processes and the involvement of multiple parties (including ownership entities, other line ministries and regulatory bodies, as needed) have often delayed their implementation and allocation of resources, and have resulted in penalties for SOEs due to delays in meeting certain financial requirements. In some cases, they have been approved significantly later in the year during which their implementation was planned, which prevented SOEs from carrying out significant transactions. Moreover, financial plans, in view of the complexity of its design and multi-layered approvals process, have reportedly opened potential opportunities for corruption or other irregular practices.

Source: (CMU, 2020[42]) (Verkhovna Rada, 2006[122]).

The CMU is also involved in privatising SOEs, as it selects the operator of the electronic platform (in this case, ProZorro) on which the entities may be privatised and determines payment procedures. It also approves a list of large-scale objects for privatisation, sets the procedure for selecting advisors in privatising these objects, and approves advisors selected by a commission under the State Property Fund of Ukraine (SPFU). On the proposal of the SPFU, the CMU also approves conditions for the sale of state property and oversees the conduct of electronic auctions for small-scale privatisation objects.

Moreover, the CMU approves a list of state-owned objects (currently approx. 300) that are considered to be strategically important for the economy and security of the state,

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[92] More specifically, the law states that the CMU is authorised to select operators of electronic platforms for the organisation of electronic auctions for small-scale privatisation, and to authorise electronic platforms to determine the amount and procedure of payment for participation in the electronic auction and determine the winner based on the results of the auction.
and oversees their activities (along with their creation, reorganisation and liquidation). Although Ukraine has repealed a law that formerly imposed a ban on privatising selected state-owned objects, SOEs that are deemed to be strategically important may not be privatised. (As mentioned earlier, a list that would ban privatising SOEs has been abolished, though a similar list with over 600 entities may be re-introduced with draft law 4020). The CMU approves the methodology for assessing leased objects, state property valuation and concession payments, and it is also engaged in approving action plans, preparing and implementing projects on public partnership, and developing and concluding international agreements with respect to SOEs (Verkhovna Rada, 2006[122]).

In addition to its central role, the CMU is engaged in performing ownership functions for over a number of key SOEs, including Naftogaz, Ukrzaliznytsia, and state-owned banks, among others. However, its ownership functions are often delegated to other SOE ownership entities. For example, the Ministry of Finance performs certain ownership functions over state-owned banks and the Ministry of Infrastructure performs ownership functions over Ukrzaliznytsia. It is important to note that the CMU also plays a key role in overall policymaking and setting public service obligations. Such responsibilities, if not separated at arms-length, could pose potential conflicts of interest.

5.1.2. Ministry for the Development of Economy, Trade and Agriculture (MDETA)

While the CMU is engaged mainly in policy oversight, it delegates policy development and implementation, as well as performance of SOE ownership functions to the line ministries. Within each policy sphere, the CMU appoints a central body of executive power responsible for ensuring policy development and implementation in a particular sector. In the area of state property management, it has assigned the policymaking function to the Ministry for the Development of Economy, Trade and Agriculture (MDETA) (Verkhovna Rada, 2006[122]). Along with performing policy functions, MDETA exercises ownership rights over nearly 350 entities.93 The CMU delegates additional functions to other line ministries – notably, the Ministry of Finance is involved in setting and implementing dividend policy, monitoring the fiscal impact of state assets and approving budget contributions.

MDETA defines general principles and priority areas for developing state policy in the SOE sector, as well as the criteria for effective management of corporate rights of the state. It also helps develop and implement state financial and dividend policy based on the procedures set by the CMU, and provides methodological and regulatory support in managing state property. According to the questionnaire response, MDETA is responsible for conducting an inventory of state property, gathering information on CEO appointments (such as whether contract has been signed, vacancies, etc.), managing corporate rights, protecting state property rights, and monitoring the effectiveness of state property management. MDETA also engages in co-ordination activities and exercises control over performance management of SOEs, while centralising information received from other governing bodies regarding financial and economic activities of SOEs. However, ownership entities have often been unable to

93 Sources: (CMU, 2020[42]) (CMU Secretariat, 2020[309]) (CMU, 2019[309]) (CMU, 2014[310]).
communicate relevant information to MDETA, rendering the latter unable to perform an in-depth analysis of the SOE sector (CMU, 2020[42]).

Along with regulatory and methodological support, MDETA provides the CMU with legal assistance in managing state property. This involves developing and submitting draft laws to the CMU regarding the management of state property and summarising the application of legislation, such as managing state corporate rights. Based on its legal (as well as economic and financial) analysis, MDETA may also submit relevant conclusions and proposals for the CMU’s consideration. Some of MDETA’s additional functions include drafting a list of entities deemed strategically important to Ukraine for the CMU’s approval and considering which SOEs should be corporatised, while engaging in the process of privatisation (Verkhovna Rada, 2006[122]).

MDETA has been at the centre of SOE reform efforts in Ukraine for the past six years (as further elaborated under Section 11). It has developed a number of policy proposals which CMU enacted, including the CMU decisions to implement corporate governance reforms in line with OECD standards in the top-15 SOEs. It has also developed the Basic Ownership Policy, drafted key legislative inputs to improve corporate governance of SOEs, and started issuing annual aggregate report for the top-100 SOEs (while this has been phased out, MDETA created ProZvit platform, an online SOE inventory), among other areas. Furthermore, it has initiated plans for the reorganisation of ownership arrangements, and has been responsible for organising competitive selection procedure in economically important SOEs (including both supervisory board members and CEOs). However, as elaborated in Part II, MDETA has limited control over the actions and activities of other ownership entities and lacks the political support of the CMU. In addition, according to the point of view of some insiders to the reform process, more broad-based reforms have been stalled largely due to a lack of political will on a whole-of-government scale.

5.1.3. State ownership entities

The line ministries are involved in policy implementation in the SOE sector and within their policy areas, while exercising ownership rights over SOEs. State agencies may also perform ownership functions, though they are often under the oversight of the line ministries. For example, the State Agency on Forest Resources, which performs ownership functions across more than 350 entities, is under the oversight of the Ministry of Environmental Protection and Natural Resources. Collectively, these ownership entities are referred to as “authorised management bodies” in the Ukrainian legislation. Some of their responsibilities include implementing CMU decisions regarding the creation, liquidation and reorganisation of SOEs under their ownership, making relevant proposals and assisting with SOE corporatisation. In addition, they maintain contracts and records regarding the company’s economic and financial activities, corporate structure and strategic plans, which they submit to MDETA and the CMU (CMU, 2020[42]).

With respect to SOE corporate governance, the ownership entities are involved in the selection of supervisory board members (where they exist), and in the appointment of the CEOs of SOEs (unless the charter reserves this right to supervisory boards in

94 In particular, MDETA reports to the CMU have arguably pursued a “formal goal” without working towards improving SOE corporate governance or managerial decisions. Despite identifying shortcomings (for example, on issues related to reporting and disclosure), the recommendations to the CMU have been insufficient to address ongoing problems (CMU, 2020[42]).
practice). In SOEs that are especially important for the economy, the ownership entities propose state representatives on supervisory boards and assist MDETA with the competitive selection of independent supervisory board members which are carried out in accordance with specific procedures (see also sections 6.2.1, 11.6 and 16 for more details). In other SOEs, they may organise nomination processes themselves.

Moreover, the ownership entities are involved in approving strategic, financial and investment plans for enterprises (except for economically significant SOEs and natural monopolies, in which case it is carried out by the CMU), and in overseeing their implementation. The ownership entities also develop key performance indicators and monitor their implementation, and manage corporate rights of SOEs. They can also initiate unscheduled inspections of financial and economic activities in case the CEO is removed, and approve conclusions of agreements on independent audits of the annual financial statements if there is no supervisory board. Furthermore, ownership entities should approve agreements regarding joint activities, public-private partnerships and concessions, and make decisions regarding the financing of the SOEs if 100% of the shares belong to the state.

In addition to the line ministries and agencies, some of the ownership functions may be performed by parent companies in SOE holding groups. These include developing annual financial and investment plans, among other functions. Despite their oversight and reporting responsibilities over their subsidiaries, the powers of holding entities may be limited across areas, including supervisory board and CEO appointments, SOE property management and bankruptcy proceedings. Moreover, ownership entities of the parent company may still be involved in approving strategic plans for the subsidiaries (CMU, 2020[42]) (Verkhovna Rada, 2006[122]).

While the line ministries and agencies are responsible for exercising ownership functions over SOEs, their resource availability significantly varies in performing these functions. The funds to cover SOE management are allocated through the state budget. Often, however, remuneration and compensation packages for (along with qualifications of) civil servants are insufficient for the work they perform. Notably, three employees within the Ministry of Education and Science oversee 71 SOEs, and four employees in the Ministry of Energy oversee hundreds of SOEs. Other entities, such as the Ministry of Infrastructure, have employed 30 individuals to oversee 116 entities under its ownership, and the Ministry of Finance has 13 employees to oversee 15 SOEs, with a separate unit responsible for monitoring SOE corporate governance issues.

Ukroboronprom, a state “concern” which operates as a “quasi-ministry”, employs over 200 individuals to oversee 116 active SOEs. However, historically it has had a poor level of efficiency as a corporate centre, and the government reports that remuneration has not always been competitive with the private sector. As a result, along with decentralised ownership, large discrepancies in salaries, staff availability and qualifications, and budget size may further impact the effectiveness and efficiency of the overall management of the SOE sector, and that of individual SOEs (CMU, 2020[42]).

5.1.4. State Property Fund of Ukraine

The State Property Fund of Ukraine (SPFU) is responsible for carrying out Ukraine’s privatisation programme, exercising ownership functions over SOEs
OWNERSHIP ARRANGEMENTS AND RESPONSIBILITIES

until they are privatised (Box 5.2.) and managing other state assets (such as real estate). Its activities are co-ordinated by the CMU, though it is accountable to the President. Its work involves setting up corporate governance bodies, financial planning and reporting on SOEs under its ownership. In addition, the SPFU submits quarterly and annual reports to the President, the parliament and the CMU regarding its work on the privatisation of state property (OECD, 2019[40]) (CMU, 2020[42]).

Along with engaging in privatisation, SPFU acts as a lessor of state property, engages in bankruptcy proceedings, arranges audits and approves rents and sublease agreements for entities under its ownership. Under the directive of the CMU, the SPFU also manages the Unified Register of State Property, which contains SOE records. As noted in Box 5.2, Ukraine has yet to privatise large SOEs following the passage of the Privatisation Law in 2018, though plans for further privatisation are under discussion. To incentivise privatisation, the SPFU has developed a draft law that would allow ownership entities to retain a part of the proceeds from privatisation before transferring funds to the state budget, while using 2% of earnings for small privatisation and 3% of earnings for large privatisation to cover the costs. Despite these initiatives, concrete steps to promote large scale privatisation remain to be taken.

Box 5.2. State Property Fund and SOE privatisation

In order to reduce the size of the SOE sector, Ukraine has sought to privatise state-owned entities, in which the SPFU has been playing a leading role. While adopting the Law on Privatisation in 2018, Ukraine undertook the so-called “triage” by sorting SOEs into three categories, namely those to maintain under state ownership, privatise or liquidate. Under the previous government, the following breakdown was provided for approximately 3,700 SOEs:

- Liquidate 1,261 enterprises (along with 585 located in Crimea and the Donbass)
- Retain 300 SOEs identified as having a strategic value (including enterprises in defence and energy sectors, natural monopolies, as well as those with high social value, such as the national railway and postal service)
- Privatise approximately 1,000 SOEs
- Maintain approximately 750 SOEs under state ownership until their transfer to the National Wealth Fund (an SOE centralised holding entity, the development of which was previously under consideration).

In 2019, 530 enterprises were transferred to the SPFU for privatisation, compared to 93 enterprises that were transferred over the previous 10 years. Those to be privatised were further divided into objects of small-scale and large-scale privatisation. Small-scale privatisation objects were those with an asset value of less than UAH 250 million, which could be sold through the ProZorro platform. Large-scale privatisation objects were those with an asset value of over UAH 250 million, and their sale must involve advisors (such as M&A consultants), audit firms and investment companies. Despite reduced economic activities due to Covid-19, Ukraine continued small-scale privatisation. In July 2020, the emblematic Dnipro Hotel in central Kyiv was privatised through ProZorro for over

95 In some cases, the SPFU has appointed its employees as supervisory board members of SOEs under its oversight, though there is no clear selection procedure.
UAH 1.1 billion. While large-scale privatisation has remained blocked for the duration of the pandemic, in 2021 the parliament passed a bill (No. 4543) to resume the process.

Source: (SPFU, n.d.)
Chapter 6. Supervisory boards and CEOs in SOEs

In recent years, Ukraine has sought to promote corporate governance reforms in SOEs, which has included improving procedures for supervisory board member and CEO appointments. Prior to launching corporate governance reforms in 2014, supervisory board members were rarely appointed in SOEs, with no requirements to appoint independent directors, and CEOs were directly appointed by ownership entities. With the onset of reforms, Ukraine has mandated the establishment of supervisory board members in large SOEs and defined requirements and procedures for appointing independent directors. However, depending on the SOE legal form and type, there are a number exceptions and contradictions in the legal and policy frameworks regarding the functions of board members and their appointments, which limits their roles. Significant challenges may be observed in the process of CEO appointments, where ownership entities and the CMU may be involved. As elaborated in Parts II and III of this review, further streamlining these areas and promoting practices based on the SOE Guidelines is paramount to improving corporate governance in SOEs.

6.1. Overview of supervisory boards in SOEs

To improve corporate governance framework in SOEs, in 2014 Ukraine introduced requirements regarding the appointment of independent supervisory board members. Under the current legislative framework, a supervisory board must be established in majority-owned SOEs in any of the following conditions:

- the value of assets of the enterprise based on its latest financial statements exceeds UAH 2 billion;
- the net income the enterprise is higher than UAH 1.5 billion;
- the size of the authorised capital of a new enterprise on the date of its establishment is over UAH 2 billion; or
- the SOE is a public joint-stock company (or a private joint-stock company with 10 or more shareholders).

So far, the focus of these reforms has been on the top-15 SOEs in the government’s portfolio, with the explicit aim to bring corporate governance practices of these enterprises line with the recommendations of the OECD SOE Guidelines. While adopting ownership policies, these entities were to develop new charters that would provide supervisory board members with requisite duties and responsibilities, including the appointment and dismissal of CEOs, and the approval of strategic documents, such as financial plans (MDETA, n.d.). At the time of writing,

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96 This was done in line with efforts to gradually corporatise SOEs (since 2014, only three major SOEs Ukrazaliznytsia, Ukrposhta, and Ukrenergo were corporatized), install proper systems of internal control, and financial reporting in line with international standards.
supervisory boards with independent members have only been formed in 8 of the top-15 SOEs based on the established procedures (CMU, 2020[42]). In companies that have yet to develop independent supervisory boards, the ownership entities are directly involved in SOE corporate governance.

Table 6.1. Corporate governance reform in top-15 SOEs

<table>
<thead>
<tr>
<th>SOE (by size)</th>
<th>Ownership entity</th>
<th>Corporatised</th>
<th>Individual ownership policy</th>
<th>Individual corporate governance plan</th>
<th>Supervisory board (majority independent)</th>
<th>Permanent CEOs</th>
<th>Supervisory board KPIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Naftogaz</td>
<td>CMU</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>UKrzaľnytsia</td>
<td>CMU</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Ukroboronprom</td>
<td>CMU (Concern)</td>
<td>No (Concern)</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Ukrenergo</td>
<td>Ministry of Finance (to be transferred under Ministry of Energy)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Gas Transmission System Operator of Ukraine (GTSO)</td>
<td>Ministry of Finance (via MGU – Main Gas Pipelines of Ukraine) (MGU to be transferred under Ministry of Energy)</td>
<td>No (LLC)</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Ukrainian Sea Ports Authority</td>
<td>Ministry of Infrastructure</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Boryspil International Airport</td>
<td>Ministry of Infrastructure</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Ukposhta</td>
<td>Ministry of Infrastructure</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>UKSATSE Air Traffic Service</td>
<td>Ministry of Infrastructure</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Energoatom</td>
<td>CMU (transferred from Ministry of Energy in 2021)</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Ukrydroenergo</td>
<td>CMU (transferred from Ministry of Energy in 2021)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Polygraph Combine Ukraina</td>
<td>MDETA</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Agrarian Fund</td>
<td>MDETA</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>State Food and Grain Corporation</td>
<td>MDETA</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Automobile Roads of Ukraine</td>
<td>State Agency on Motor Roads</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Notes: Information is current as of April 2021. Along with supervisory board member appointments, following the adoption of a new Protocol Decision No. 62 the ownership policies started to be developed, while charters were brought in line with the current legislation. The key document used for developing the ownership policy is the Basic Ownership Policy adopted in 2018 complying with a new corporate governance model, and includes guidelines for developing new ownership policies. Ownership entities are to approve respective ownership policies according to the principles set out in the Basic Ownership Policy, while controlling and monitoring their implementation, corporate governance plans and performance indicators of the supervisory board, as further elaborated in Part II.

1. Ukroboronprom has a supervisory board. However, (a) by law it may not have independent members, (b) the board members are nominated by President and the CMU deviating from the nomination process established for other SOEs, (c) board members may not be remunerated by law, and (d) the supervisory board has no power to appoint and dismiss the CEO. In addition, the CEO is appointed and removed directly by the President without a competitive process.

2. MGU (Main Gas Pipelines of Ukraine), the company that holds the Gas Transmission System Operator of Ukraine (GTSO), has a supervisory board, but it is decoupled from GTSO and cannot effectively perform its supervisory function. Currently, the supervisory board of MGU serves as a general meeting for the GTSO.

3. However, MGU has an acting CEO.
In Polygraph Combine Ukraina, independent board members were not appointed initially according to CMU Resolution 777 and a new competition was to be held once the board members’ contracts expired in February 2021. However, the company’s assets and profits are lower than the thresholds needed for a mandatory competitive selection process. While contracts of some existing board members were extended, new members were appointed, though their selection process was unclear.

GTSO is a limited liability company and its ownership structure is unique compared to other SOEs, as further elaborated in Annex B.

Individual ownership policies have been approved by the respective ownership entities for these SOEs, but in most cases they are being reviewed and updated pursuant to CMU Protocol Decisions No. 26 dated December 18, 2019 and No. 62 dated July 29, 2020.

While companies are expected to develop KPIs for companies, they are also expected to develop KPIs for supervisory board members, as further elaborated in Sections 11 and 16.

KPIs are approved for the company since Energoatom has no supervisory board.

However, Naftogaz has been exempt from the applicability of a competitive selection procedure of its CEO. After the CMU dismissed the CEO in April 2021, it directly appointed a new CEO to a permanent position. The current board have submitted their resignation effective May 15, 2021, and plans for the replacement of the board members are unknown.

Ukrainian SOEs currently have two-tier boards. Supervisory boards in SOEs may have between 5 and 11 members, with an independent majority. However, specific conditions apply in their composition depending on the SOE legal form and type, including joint-stock companies (also see Sections 11 and 16), state-owned banks (Section 7) and defence SOEs (Section 3.3 and Annex D).

In most SOEs, board members elect a chair and establish committees on audit, appointments and remuneration chaired by independent board members, though others may be established as needed and as required by law (as further outlined in Section 16) (CMU, 2020). The members exercise their rights and obligations on the basis of civil contracts concluded (individually) with the CEO on behalf of the company. The contract stipulates mutual rights and obligations, terms and conditions for remuneration, and early termination of the contract, among other elements.

Supervisory board members are generally required to act in the company’s interest (as further outlined in Section 16), though the concept of “fiduciary duty” is rather new and underdeveloped in Ukraine. The JSC law does not expressly impose duties of care or loyalty upon supervisory board members. However, the Corporate Governance Code and the Limited Liability Company Law provide that board members of JSCs and LLCs must act “in good faith, reasonably, and in the best interests of the company.” Moreover, a draft law (No. 2493) as well as the draft law ex-6428 promotes the concept of “fiduciary duty” which at the time of writing was still under discussion.

Due to limited coherence within the legislative framework (currently under revision) and, challenges in interpreting corporate governance procedures, supervisory boards have had limited empowerment to perform their functions in line with the government’s reform intention. This has often resulted in undue political interference and involvement of ownership entities in the operational decision-making of SOEs.

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It should be noted that Ukrainian legislation provides for the possibility to establish two-tier boards in joint stock companies. Draft Law No. 2493 dated November 25, 2019, which has passed the first reading in the parliament, proposes to allow establishing single-tier boards in joint-stock companies, except for in companies of public interest (including top-15 SOEs).
6.2. Supervisory board member and CEO appointments

6.2.1. CMU resolutions applicable to the nomination and appointment of supervisory board members and CEOs in SOEs

Overall, supervisory board member nomination process in SOEs is governed by three CMU Resolutions, Nos. 777, 142, and 143, which are applicable depending on the SOE type. Provisions under Resolution No. 777 also apply to CEO selection. Specifically:

- **Economically-important SOEs.** Procedures for supervisory board member and CEO selection in "economically important SOEs" are outlined in CMU Resolution No. 777. These are mandatory for SOEs where asset value (according to the latest financial statement) exceeds UAH 2 billion or annual net profit exceeds UAH 1.5 billion. Moreover, while state representatives are generally appointed by ownership entities, they are subject to the nomination committee’s approval in economically important SOEs (CMU Resolution No. 143).

- **Strategic SOEs.** Certain procedures under CMU Resolution No. 777 are applicable during CEO nominations in strategic SOEs with asset value or net income exceeding UAH 200 million. (Notably, the CMU is responsible for approving the selected CEO candidate in these entities). The criteria for defining “enterprises of strategic importance for the economy and security of the state” (referred to as “strategic SOEs”) are set by CMU Resolution No. 999. Based on this criteria, a list of strategic SOEs is established.

- **Other SOEs.** In other SOEs, independent supervisory board members are appointed based on CMU Resolution 142, with a general framework regarding CEO appointments outlined in CMU Resolution 777. The ownership entity may decide to use the same procedures as those specified for economically important or strategic SOEs, but this decision is optional. In practice, the ownership entity may still use direct appointments without holding competitive selection procedures.

These nomination processes, however, have mostly been applied to economically important SOEs, and, despite the established framework, remain to be used in other SOEs. Considering that the regulations evolved as the need for nominations developed, there have been non-systematic and patchwork changes that may be contradictory and difficult to apply. A long list of SOEs also fall under exceptions and are excluded from coverage under these regulations, including Naftogaz’s subsidiaries, Ukrzaliznytsia, and the National Public Television and Radio Broadcasting, among others.

In April 2021, the CMU introduced an amendment exempt Naftogaz from the applicability of Resolution 777 in appointing its CEO (CMU, 2021). Moreover, different procedures apply to state-owned banks and municipally-owned enterprises (as outlined in Sections 7 and 8, respectively), as well as defence SOEs (as further elaborated in Section 3.3 and Annex D, and in subsequent paragraphs).

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98 Details regarding the nomination committee responsible for appointments in economically important SOEs are outlined in Section 11.

99 Exceptions may also be used for supervisory board nominations. For example, the nomination of Naftogaz supervisory board members in 2017 and 2019 were exempt from these regulations, and the appointments were done directly by the CMU without a transparent selection process.
6.2.2. Supervisory board member appointment

The ownership entity is responsible for establishing a supervisory board based on the criteria developed by the CMU, as further elaborated in Section 16. Independent board members are subject to a competitive selection procedure. However, as mentioned above, the appointment process differs depending on the SOE type. For example, if an SOE is considered to be economically important, supervisory board members are appointed through a procedure involving a permanent nomination committee, consisting of Ministers (or Deputy Ministers) of Finance, MDETA and the ownership entity, as well as four independent members of the international community selected by the CMU with the right to an advisory vote. Moreover, the selected candidates may ultimately require approval from the CMU. In other SOEs, the ownership entity can appoint a selection commission that will select independent board members. (Specific procedures are detailed in Section 11 and Annex D, with key procedural differences depicted in (Figure 6.1). The process also differs in state-owned banks, as further elaborated in Section 7.

In most cases, state representatives on supervisory boards may be directly appointed by ownership entities. However, in economically important SOEs, the ownership entities may only recommend state representatives, who are subject to approval by the permanent nomination committee. In case of disagreement, the MDETA should submit respective candidates for CMU approval, after which these candidates should be elected by the decision of the ownership entity. The board member selection process is basic in defence SOEs that have no independent supervisory board members. Notably, the board of Ukroboronprom consists of five members (who are not remunerated), three of whom are appointed by the President of Ukraine and two by the CMU.

Figure 6.1. Procedures for appointing independent supervisory board members in SOEs

*Note: Boards may consist of 5-11 members in state unitary enterprises, though numbers may vary in JSCs. The process applies to SOEs other than those that are economically important, state-owned banks and municipal enterprises.

Source: Author’s compilation is based on the CMU Resolution No. 142 (CMU, 2017[161]).
6.2.3. CEO appointment

As general rule, where supervisory board exist, they should be responsible for appointing and dismissing the CEO. Specific procedures differ depending on the SOE type – for example, the selection process is the same for CEOs and independent supervisory board members in economically important SOEs (specific procedures are further described in Sections 16 and Annex D). In addition, in state-owned banks, supervisory boards may design the CEO selection process (see Section 7), while in Ukroboronprom, the CEO is appointed by the President of Ukraine. In SOEs with no supervisory boards (such as Energoatom), the ownership entities are involved in the CEO selection process.

However, the ambiguity surrounding the laws and resolutions regarding CEO appointment procedures has remained a subject of contention. Regardless of whether a supervisory board has been appointed in an SOE, the ownership entities and, in some cases, the CMU may need to approve the selected candidate. As such, not all SOEs in Ukraine provide supervisory boards with the power to appoint and dismiss CEOs, and their ability to do so is usually specified in the company charter. Some of the recent cases of CEO appointments are outlined in Box 6.1.
Moreover, although nomination procedures for CEOs has been developed, in practice, many SOEs have so-called “acting CEOs” (as outlined in Table 6.1). During an interim period, an acting head of an SOE may be appointed by the ownership entity and, as needed, in co-ordination with the CMU. This may be seen as a way of circumventing the transparent nomination process. In particular, acting CEOs can be dismissed and replaced easily (a new acting CEO can be replaced by a new acting CEO, thereby bypassing the competitive selection process), have an indefinite or very short planning horizon, and typically have no KPIs. This may give room for the ownership entity to exercise leverage over these individuals and their contracts.

Box 6.1. Recent CEO appointments in SOEs

Following the changes within the corporate governance framework, Ukraine has sought to re-launch competitions for CEO appointments. Prior to legislative amendments, the ownership entities (and, in some cases, the CMU) were responsible for appointing and dismissing the heads of state enterprises. The establishment of supervisory boards and the corporatisation of SOEs have introduced provisions that have sought to reduce the state’s role in CEO appointments. As a result, in recent years some of the top SOEs have launched competitions and appointed permanent CEOs, including Ukrenergo and Ukrlazniznytsia, while others are underway. Nevertheless, CEO appointments have often be fraught with controversies, with some of the recent examples outlined below:

- In 2019, Ukrhydroenergo’s supervisory board extended the contract of the CEO for a term of five years, even though the existing contract was valid for almost another three years at that time. This has led to a conflict between the Ministry of Energy and the supervisory board, with the Ministry trying to dismiss the chair of the supervisory.

- In 2014, the CMU appointed the CEO of Naftogaz. The CEO was re-appointed in 2020 without a competitive selection procedure, though upon nomination by the supervisory board. In April 2021, the CMU dismissed the CEO and the supervisory board, citing unsatisfactory performance due to significant losses faced by Naftogaz in 2020 (within the context of the pandemic) as a key reason. While the same supervisory board members were re-appointed within two days after their dismissal, the CMU appointed a new CEO (former acting Minister of Energy) while their powers were suspended. Board members subsequently submitted their notices, effective mid-May 2021.

- In 2019, Ukrlazniznytsia's supervisory board decided to keep the acting CEO (after which the CMU appointed the CEO on a permanent basis), but then reversed its decision, dismissing the CEO and launching a competitive selection in February 2020. Although the process was delayed due to the Covid-19 pandemic, the supervisory board eventually nominated a candidate, but the decision was changed after a meeting with government bodies, suggesting that the process was subject to irregularities. The selected candidate has since been dismissed.

- Oschadbank’s supervisory board appointed then CEO for a term of five years without launching a competitive selection (as required by law), although the contract was still valid for another several months. The NBU intervened and dismissed five out nine supervisory board members, and new board members were selected by the end of 2019. Afterwards, the bank’s supervisory board launched a CEO competition in March 2020 as the CEO’s contract expired, but cancelled the competition without a sound explanation (referring to external circumstances). The process was re-launched in May 2020, which ultimately led to a nomination in June 2020. Nevertheless, the candidate could not be appointed because the contest was blocked in the court due to litigation initiated by other contestants.
• Ukrnafta, a company in which the state-owned Naftogaz owns 50% + 1 share, launched a CEO selection in 2019. The company’s nomination committee had identified a short list of candidates in May 2020. However, the process was stopped abruptly, with Ukrnafta citing the oil crisis induced by the Covid-19 pandemic as the reason. In the meantime, the acting CEO was appointed on a permanent basis without an open competition.

• Ukrenergo launched a competition for the position of CEO in January 2020. The process was, however, suspended by a decision of the Cabinet of Ministers (dated February 12, 2020, Minutes No. 9), calling for the suspension of the competitive selection for the position of CEO until all the Supervisory Board seats had been filled. The Decision further called for the urgent appointment of an acting CEO according to the procedures enumerated in CMU Resolution 777. Although the process was to be finalised in March, the competition was finalised in August 2020, and the supervisory board selected the acting CEO for a permanent position.

• Further challenges have been introduced in CEO appointments in companies under the management of the State Property Fund of Ukraine (such as the Odessa Port Plant). In addition, the on-going court cases filed against the appointment and dismissal of the CEOs have reportedly contributed to delays in their privatisation.

Overall, there have been very few cases to date where a new CEO was effectively selected and appointed by the SOE supervisory board, with the boards often reconfirming the incumbent CEOs in their positions.

Note: along with sources outlined below, information was gathered through interviews with SOEs and Ukrainian authorities within the scope of the project.

Source: (Interfax Ukraine, 2020) (UNIAN, 2020)
Chapter 7. State-owned banks

State-owned banks are key players in Ukraine’s financial sector, holding approximately 54% of total assets in the banking system. Although the state’s role in the market was less dominant during the early 2000s, its involvement significantly increased following the political and economic turmoil in 2014-2015. While witnessing high levels of inflation and recession, imprudent lending contributed to a significant increase in non-performing loans (see Section 1). In response, the banking sector began witnessing significant restructuring and reforms, and an increase in the state’s role in the sector following the nationalisation of PrivatBank. Considering their relevance to the state-owned sector, this section provides an overview of the state-owned banks, including their financial performance and on-going reforms, as well as their corporate governance practices which differ from those in other SOEs.

7.1. Description of state-owned banks

In 2020, Ukraine had 75 banks operating in the country, including five that were state-owned:

- Joint Stock Company “The State Export-Import Bank of Ukraine” (Ukreximbank)
- Joint Stock Company “State Savings Bank of Ukraine” (Oschadbank)
- Joint-Stock Company Commercial Bank “PrivatBank” (PrivatBank)
- Joint Stock Company Joint Stock Bank “Ukrgasbank” (Ukrgasbank)
- Settlement Centre (Rozrakhunkovy Tsentr)

These banks are regulated by the National Bank of Ukraine (NBU), a central body of state management and an independent banking sector regulator. NBU does not perform ownership functions over the state-owned banks, except for the Settlement Centre, which is responsible only for monetary settlements and transactions involving securities, along with other financial instruments on the stock exchange and over the counter.

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100 According to the Central Bank Governor Valeria Gontareva, nationalising PrivatBank was “the only possible way to protect deposits placed with this bank and rescue the financial system” (BBC, 2016).


102 https://bank.gov.ua/en/statistic/supervision-statist/data-supervision#1

103 The functions are performed so long as settlements are based on the “delivery vs payment principle”. 83.5% of its shares are owned by the National Bank of Ukraine, with other beneficiaries including the CMU (6.41%) and the Ministry of Finance (3.2%), with remainder of the shares owned by an individual stakeholder.
The remaining state-owned banks perform standard banking functions. Oschadbank and Ukreximbank have been under state-ownership the longest, dating back to the Soviet period. Oschadbank was established as a savings bank in Ukraine, and, in recent years, it has worked towards improving its services, such as offering online banking and self-service terminals that were previously not available (Boytsun et al., 2017[165]). Ukreximbank was established as a development bank, with objectives to support export and import operations, stimulate trade and act as the government’s financial agent. Ukrgasbank and PrivatBank, however, were nationalised, the former following the global financial crisis of 2007-2008, and the latter in 2016 after the discovery of a USD 5.6 billion gap in its balance sheet and a high share of non-performing loans resulting from insider lending.\footnote{PrivatBank and its previous owners have been engaged in on-going arbitration in domestic and foreign courts, with the former seeking to reclaim losses. In February 2021, the UK Supreme Court ordered former owners (Ihor Kolomoisky and Gennady Bogolyubov) to pay PrivatBank’s legal fees amounting to GBP 1 million. At the time of writing, PrivatBank is also involved in court cases in Ukraine, USA, Switzerland, Cyprus and Israel (Kossov, 2021[337]).}

While these banks are under state-ownership, it is worth noting differences in their legal forms, which has an impact on their corporate governance framework. According to the Law on Banks and Banking (Article 7), a state-owned bank is a bank registered as a joint-stock company, in which 100% of the charter capital belongs to the state. Currently, only Ukreximbank, Oschadbank and PrivatBank meet this requirement and the CMU is responsible for managing their corporate rights. Ukrgasbank, though state-controlled, falls outside the scope, as 94.94% of its charter capital is owned by the state, and, therefore regulations other than Article 7 apply with regard to its corporate governance. Ukrgasbank’s ownership functions are exercised by the Ministry of Finance.

As of mid-2020, assets and liabilities of these state-owned banks constituted 54% and 56%, respectively, of the total banking sector. Collectively, they had 4,900 branches and 57,900 employees, with both gradually decreasing (Ministry of Finance, 2020\footnote{According to the Ministry of Finance, in 2020 the share of non-performing loans in the portfolio of state-owned banks decreased to 57.4% (Ministry of Finance, 2021[342]).}). 63% of loans in their portfolio were non-performing, amounting to UAH 391 billion.\footnote{According to the Ministry of Finance, in 2020 the share of non-performing loans in the portfolio of state-owned banks decreased to 57.4% (Ministry of Finance, 2021[342]).}

Comparably, the share of non-performing loans of private bank portfolios was only 30% (Ministry of Finance, 2020\footnote{According to the Ministry of Finance, in 2020 the share of non-performing loans in the portfolio of state-owned banks decreased to 57.4% (Ministry of Finance, 2021[342]).}). All state-owned banks can be considered competing with private banks, as they conduct business in the same markets and offer similar products (Boytsun et al., 2017[165]). The key financial ratios for state-owned banks are presented in Table 7.1.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|c|c|c|}
\hline
 & Total assets (UAH million) & Equity, total (UAH million) & Profit / (loss) after tax (UAH million) & ROA & ROE & Adequacy of regulatory capital (N2) & Share of non-performing loans \\
\hline
PrivatBank & 552,058 & 54,529 & 32,609 & 6% & 60% & 14% & 80% \\
Oschadbank & 314,675 & 19,195 & 255 & 0% & 1% & 13% & 57% \\
Ukreximbank & 202,212 & 8,905 & 64 & 0% & 1% & 20% & 58% \\
Ukrgasbank & 127,453 & 8,254 & 1,289 & 1% & 16% & 15% & 21% \\
\hline
\end{tabular}
\caption{Selected financial ratios of state-owned banks (2019)}
\end{table}

7.2. Performance of state-owned banks

According to the NBU’s Banking Sector Review, the profitability of Ukrainian banks rose to an all-time high in 2019 and their ROE reached 34%. Over half of the profits were generated by PrivatBank, though ROE in other state-owned banks has remained lower. In 2019, the interest rates on foreign currency denominated corporate loans decreased to historical low. However, due to the shortage of creditworthy borrowers, this had no substantial impact on the amount of loans provided by the banks (NBU, 2020[168]). Covid-19-related restrictions, however, contributed to contracting both corporate and retail loan portfolios during the second quarter of 2020, while retail loans witnessed their first drop since the beginning of 2017 (NBU, 2020[169]).

In addition, NBU’s Financial Stability Report (H1 2020) found that the current crisis could lead to nine banks – collectively accounting for 30% of the total banking sector assets, with 25% attributable to two state-owned banks – failing to comply with core or regulatory capital adequacy ratios (NBU, 2020[170]). In late September 2020, the CMU decided to recapitalise Ukreximbank in the amount of UAH 6.8 billion by issuing 15-year domestic government bonds to the bank’s share capital at a yield of up to 9.3% (Ministry of Finance, 2020[171]). The state-owned banks have also increased the volumes of domestic government debt securities in their portfolios during the pandemic, while lending to municipalities and financing infrastructure projects. By the first quarter of 2021, state-owned banks reported significant losses, with PrivatBank’s profit falling fourfold and Oschadbank’s by tenfold compared to the same period in 2020 (Boytsun et al., 2021[87]).

As NBU has allowed refinancing, state-owned banks have been able to scale up their transactions. In May 2020, state-owned banks were responsible for 84% of the total volume of bonds held by Ukrainian banks on their balance sheets. In March-May 2020, they also increased investment in government debt by UAH 60 billion, though private banks have been comparably less active. According to the NBU’s estimates, the share of government bonds may increase up to 50% of the total assets held by state-owned banks, which could have negative implications. Notably, the banks may become quasi-funds, i.e. vehicles for financing government programmes, which would diminish their primary lending function and force them to adjust their business model by reducing the share of regular banking business in their operating income. In addition, the share of funding from the NBU for their liabilities is expected to increase (NBU, 2020[170]).

To improve performance in state-owned banks, Ukraine continues to implement reforms. Notably, the Ministry of Finance, in collaboration with the government and the IFIs (including IMF, World Bank, IFC and EBRD), has developed the Principles for Strategic Reform of the Public Banking Sector, revised in September 2020. Some of the key elements include improving corporate governance in the state-owned banks and adopting operational models to promote efficiency of their activities, in line with the principles developed by the OECD and the Basel Committee on Banking Supervision. These consist of appointing at least two-thirds of independent directors on supervisory boards, establishing committees and adopting market-based remuneration mechanisms. Further aspects cover improving operational models to maximise revenue and meeting the needs of customer’s financial services (Ministry of Finance, 2020[172]). Along with promoting efficiency, competitiveness and profitability of state-owned banks, reforms are expected to improve opportunities for their privatisation. Notably, the CMU have envisaged reducing the state’s share in the
banking sector from 60% to below 25% by 2025, which would involve their partial or full privatisation. After achieving economic recovery from the Covid-19 pandemic, state-owned banks, in collaboration with the Ministry of Finance, are expected to develop a roadmap for the state’s exit from their capital (Interfax Ukraine, 2020[173]) (Unian, 2020[174]).

As part of these reforms, the CMU adopted key priorities (also known as main activities) for Ukreximbank, Oschadbank and PrivatBank over 2020-2024, though they differ for each bank. For example, Ukreximbank should focus on creating and developing instruments adapted to export and export-oriented activities (Ministry of Finance, 2020[175]). Comparably, Oschadbank should continue strengthening its position as a leading universal bank of Ukraine, particularly in retail lending and providing services to small and medium-sized enterprises. It should, however, decrease amount of loans provided to SOEs (Ministry of Finance, 2020[176]). In addition, PrivatBank’s main objectives focus on providing financial services to support and strengthen its position in the market as a leading retail bank in Ukraine (Ministry of Finance, 2020[177]). While an overview of the main activities of state-owned banks have been made publicly available, their full contents are not accessible. The Principles also keep in mind on-going challenges, such as the Covid-19 pandemic, and do not exclude government involvement in state-owned banks (for example, through ensuring emergency lending and purchasing short-term government bonds).

In addition, the Principles outline that the share of non-performing loans should fall below 20% of total assets. In June 2020, the meeting of the Financial Stability Board approved action plans of state-owned banks to reduce the amount of non-performing loans in their portfolios. Following the adoption of the action plans and the Principles, the banks began working towards developing strategies for dealing with distressed assets and meeting relevant goals. They began using instruments, including restructuring and write offs, while continuing to work on returning the funds on assets that have been written off.

The banks are also working towards reducing the state’s share in the banking system. Notably, in January 2021, Ukrgasbank and the IFC signed a pre-privatisation convertible loan, which would provide IFC with an opportunity to convert the loan into the bank’s share capital in the amount of 20% and contribute to reducing the state’s share in banking assets (Economic Truth, 2021[178]). In addition, in April 2021 the CMU supported a draft law on Oschadbank joining the Individuals’ Deposit Guarantee Fund, which is a first step towards the EBRD’s entry into the bank’s capital, while the possibility of privatising PrivatBank has also been discussed (Boytsun et al., 2021[87]) (Boytsun et al., 2021[72]).

7.3. Corporate governance in state-owned banks

Corporate governance framework of state-owned banks is outlined in the Law on Banks and Banking. As previously mentioned, provisions under Article 7 of the law are applicable only to those banks that are fully-owned by the state. However, other laws are applicable (such as the Law on Management of Objects of State Property) for those that are not fully owned (namely, Ukrgasbank). The CMU performs ownership function over 100% state-owned banks (through the Ministry of Finance) and is referred to as the highest governing body in this body of law, though the banks
also have supervisory and management boards.\textsuperscript{106} The exclusive competences of the CMU as the highest governing body include:

- Approving and amending the charter of the state-owned bank (which must meet the requirements of the Ukrainian laws and NBU’s regulations), which should also be approved by the NBU;
- Setting the main (strategic) directions of activities of the state-owned bank and approving reports on their implementation
- Approving the state-owned bank’s development strategy and annual reports
- Appointing or terminating the powers of the supervisory board, approving board regulations and contracts (civil law agreements) with supervisory board members, and setting their remuneration (along with approving remuneration regulations and reports as defined in NBU requirements)\textsuperscript{107}
- Increasing or decreasing the state-owned bank’s authorised capital, approving its annual dividends, and issuing shares (along with their splitting, consolidation, and annulment of repurchased shares)
- Approving follow-up measures based on the report of the supervisory board (including the implementation of the state-owned bank’s development strategy)
- Reorganising and liquidating the state-owned bank, as well as changing the type of joint-stock company under which the state-owned bank is formed
- Setting the selection criteria for the independent auditor
- Approving significant transactions, as well as any transactions that may include conflicts of interests (upon submission of the supervisory board)
- Dissolving the state-owned bank (including setting up a commission on dissolution or liquidation) and approving the liquidation of its balance sheet.

The CMU can neither decide on issues regarding the state-owned banks that are not within its exclusive competence, nor engage in day-to-day management.

The supervisory board is a collegial governance body that runs the state-owned bank within its competence and controls and regulates the activities of the management board to implement the state-owned bank’s development strategy. State-owned banks should have nine supervisory board members, including six independent members and three state representatives (procedures regarding their appointments are detailed in subsequent sections). According to Article 7 of the Law on Banks and Banking, the state-owned bank’s supervisory board must act in the interests of the bank and protect the rights of depositors, creditors, and the state as a shareholder. Moreover, the board forms the development strategy, which, along with the main strategic directions of the bank, is subject to the CMU’s approval. The strategy should envisage the expected key performance indicators of the state-owned bank aimed at increasing the bank’s market value in the long run.

The competences of supervisory boards are defined by Article 39 of the Law on Banks and Banking and are applicable to all banks, including those that are state-owned. While the list is extensive, some of these functions include appointing and dismissing

\textsuperscript{106} The functions in Article 7 of the Law on Banks and Banking refer to the “highest governance body”, and the Law defines the CMU as such a body. Draft decisions of the CMU in its capacity as the state-owned bank’s highest governance body are prepared by the “central executive body engaged in public financial policy” (i.e., the Ministry of Finance) and must not be agreed with other interested government bodies.

\textsuperscript{107} The NBU has not yet adopted such requirements.
the CEO and the head of internal audit, approving internal regulations and developing a risk management strategy. However, Article 7 provides additional provisions applicable to supervisory board members in state-owned banks, including:

- Consenting to significant transactions or submitting these issues for the highest body's (CMU's) consideration
- Consenting to transactions with conflicts of interests in cases prescribed by JSC Law
- Approving regulations on the management board of the state-owned bank, as well as the principles (code) of corporate governance of the bank
- Reviewing the reports of the management board, as well as the conclusions of the internal and independent audit, and approving relevant measures based on these reviews
- Deciding on establishing supervisory board committees and approving their regulations

The supervisory board of a state-owned bank must also set up an audit committee, a risk management committee, and an appointments and remuneration committee. The majority of members on the committees on risk management and appointments and remuneration must be independent, and they must be chaired by an independent member. The audit committee must consist only of independent members. Other functions of the supervisory board may be further specified in the charter.

A meeting of the state-owned bank’s supervisory board is quorate if six board members are present. The decisions of the board are adopted by a simple majority of votes of those present at the meeting, unless a higher number of votes is set by the state-owned bank’s charter for a particular decision. The CMU may require over six votes for certain decisions, which, along with the votes of independent members, would require the presence of at least one state representative.

7.4. Selecting supervisory board members in state-owned banks

The selection procedures for supervisory board members in 100% state-owned banks are outlined in the Article 7 of the Law on Banks and Banking. Independent board members are appointed through a competitive selection procedure, while the President, the CMU, and the Committee of the Verkhovna Rada engaged in banking activities can each nominate a state representative. The chair is elected by the supervisory board from among its independent members. Board members are appointed for three years and cannot hold this position for more than two consecutive terms.

Supervisory board members of any bank, including those that are state-owned, should meet specific educational and professional requirements. These include higher education, an irreproachable business reputation, a clean criminal record, and a clean record on administrative corruption-related offences. In addition, at least half of the supervisory board members should have the expertise and experience in the banking or financial sectors, and no board member should have conflict of interest.

An individual cannot be an independent member of the state-owned bank’s supervisory board if he/she:
(i) is or, in the previous five years, was a top officer\(^{108}\) of this state-owned bank (except an independent member of the supervisory board) and/or its branch, representative office, and/or other standalone unit or legal entity in which the state-owned bank has a qualifying holding;

(ii) is or, in the previous three years, was an employee of this state-owned bank and/or its branch, representative office, and/or other separate subdivision or legal entity in which the state-owned bank has a qualifying holding;

(iii) is a related party of the state-owned bank, or has received, in the previous three years, a sizable income from the state-owned bank or legal entities in which the state-owned bank has a qualifying holding;\(^{109}\)

(iv) is a qualifying holder, top officer, official, and/or member of the supervisory board or other governance body, or an employee of another bank registered in Ukraine;

(v) is a person authorised to perform functions of the state;

(vi) is, or in the previous two years, was an official holding a position of responsibility or special responsibility;

(vii) is, or during any period within the previous three years preceding his/her appointment to the supervisory board of the state-owned bank, was an external auditor or took part in an external audit of the state-owned bank;

(viii) is a member of the executive body of a legal entity, a member of the supervisory board of which is any top officer of the state-owned bank; or

(ix) is a closely related person with the above-mentioned persons.

All the above requirements for independent members also apply to state representatives on state-owned bank’s supervisory board, with two exceptions. For one, while the first requirement (i) on the list is the same for state representatives as for independent board members, it would allow any previous supervisory board membership in this state-owned bank (while in the case of independent members, it only allows previous independent board memberships in this state-owned bank). For another, the sixth requirement (vi) does not apply to state representatives. Moreover, it is worth noting that the NBU sets additional requirements for independent supervisory board members in banks, including those that are state-owned (for example, through Resolution No. 149 dated December 22, 2018).

Independent supervisory board members are appointed by the CMU based on the submission by the competitive selection commission (as outlined in Figure 7.1 and Annex E). The candidates for the position of independent board member are selected by this selection commission on a competitive basis in line with the procedure set out by the CMU.\(^{110}\) The selection commission consists of one representative of the President, three representatives of the CMU, and one representatives of the Committee of the Verkhovna Rada engaged in banking activities (currently, the

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\(^{108}\) According to Article 42 of the Law on Banks and Banking, top officers of the bank are: the supervisory board’s chair, his/her deputies, or members; management chair, his/her deputies, or members; and the chief accountant and his/her deputies.

\(^{109}\) A sizable income means income exceeding 5% of the total annual income of such a person for the year in question.

\(^{110}\) CMU Resolution No. 267 dated March 27, 2019.
Committee on Finance, Tax and Customs Policy).\textsuperscript{111} In addition, representatives of international financial organisations may participate as observers.

The selection commission (Box 7.1) is responsible for verifying the candidates in terms of their compliance with relevant requirements. The NBU as the regulator sets further qualification requirements for management and supervisory board members of all banks. This means that candidates nominated by the selection commission and approved by the CMU as the highest body still need to be approved by the NBU as the regulator. In practice, this has resulted in several supervisory board members of Oschadbank and Ukreximbank being rejected.

Only the candidates who have been approved through a competitive selection by the executive search company may participate in the competition. The executive search company is selected by the CMU.\textsuperscript{112} Eligible companies must have at least 10 years of international executive search experience with banks. The executive search company submits a list of candidates to the selection commission for selecting the candidates and prepares a proposal. The executive search company is engaged for a fee that is paid from a state-owned bank’s funds and/or other sources as permitted.\textsuperscript{113} Comparably, state representatives on supervisory boards are formally appointed by the CMU with no particular selection procedure, other than the nomination of respective candidates by the President, the CMU, and the banking committee of the Rada.

**Box 7.1. Competitive selection commission for appointing independent board members in state-owned banks**

The CMU is responsible for forming a selection commission that will be responsible for nominating supervisory board members in state-owned banks. The requirements for the members of the competitive selection commission are set in CMU Resolution No. 8 dated January 10, 2019.

The selection commission consists of five members, of which three are selected by the CMU, one by the President, and one by the Verkhovna Rada’s Committee on Finance, Tax and Customs Policy.

While fulfilling certain educational, civil and professional requirements (including at least three years in financial sector), the following individuals may not be members of the competitive selection commission:

- Top officer of a state-owned bank, subsidiary or branch for five years prior to appointment, or an employee for three years prior to appointment
- Qualifying holder of a private bank registered in Ukraine, or top officer, official, and/or a member of the supervisory board or other governance body of such a bank
- Employee of a private bank registered in Ukraine or a person that can influence decisions on the main direction and/or has a material impact on management and activities of such a bank
- External auditor (including a participant in performing external audit) of a state bank, or its branches and subsidiaries, or was such an auditor at any time in the past three years prior to appointment

\textsuperscript{111} The requirements for the members of the competitive selection commission are set in CMU Resolution No. 8 dated January 10, 2019.

\textsuperscript{112} CMU Resolution No. 159 dated February 13, 2019.

\textsuperscript{113} In practice, “other sources not prohibited by the law” mean the funds of the international organisations. This implies that an SOB’s possible refusal to finance the executive search services should not obstruct the competitive selection of the supervisory board.
• Participant in providing consulting services to the state-owned bank currently or at any time over a three year period prior to appointment
• Individual with significant business or civil relations (over 5% of the income of such individual for the previous reporting year) with the state-owned bank or another entity where the bank holds a significant share, or a beneficial owner or official that has had such relationship
• Member of the executive body or supervisory board of any state-owned bank
• Person that has no irreproachable business reputation as determined for top officers of banks according to the NBU regulations.

Moreover, a member of the competitive selection committee or his/her affiliate may not participate in the competitive selection of the supervisory board member or the selection of the executive search company. A member of the commission may not be appointed on the supervisory board of a state-owned bank for three years after his/her powers are terminated. In addition, a commission member should avoid conflict of interest during the decision-making.

Sources: (CMU, 2019[179]) (CMU, 2019[180]).

The CMU should launch the competitive selection of independent supervisory board members no later than four months prior to the expiry of term of office. If, after the expiry of the term, the CMU has made no decision on the appointment of new members, the supervisory board continues to perform its functions until new members are appointed. In the event of reappointment of a person to the position of independent supervisory board member, he/she is not required to take part in the competitive selection. The board members enter into contracts (civil law agreements) which stipulate their rights, duties, and working conditions, including remuneration set by the CMU upon the proposal of the selection commission.

The CMU as the highest governing body may terminate the powers of supervisory board members exclusively on grounds, including:

• Failure to implement the state-owned bank’s strategy and/or business plan (as confirmed by the annual evaluation, the procedure for which is set by the highest body)
• Repeated disapproval by the CMU of the state-owned bank’s strategy (should be made solely with respect to all the members of the supervisory board)
• Supervisory board member’s failure to comply with the eligibility criteria for independent members or state representatives, as defined in Article 7 of the Law on Banks and Banking
• On demand of no less than five members of the supervisory board or of the NBU in case a board member does not appropriately perform his/her duties, or does not meet the requirements on professional suitability and business reputation.

The CMU cannot terminate the powers of supervisory board members on grounds other than the above exhaustive list, which is meant to protect the independence of the board. These requirements are much stronger in state-owned banks compared to other SOEs, where the powers of a supervisory board member can be terminated for no cause. A supervisory board member may also resign voluntarily or may be dismissed due to a court decision that prevents their ability to exercising duties. Powers may also be terminated in case of death or being declared legally incapacable, or if the Deposit Guarantee Fund establishes an interim administration or decides to
liquidate the state-owned bank. In addition, state representatives may be recalled only by those entities that proposed their appointment.

The CMU can also suspend the powers of a supervisory board member at any time for a term no longer than six months (i) if demanded by no less than five members of the supervisory board in case the supervisory board member does not appropriately perform his/her duties or there is a justified suspicion that he/she does not comply with the eligibility criteria for independent members or state representatives; (ii) in case the supervisory board member is notified of a suspicion of committing a criminal offence; and (iii) if demanded by parties that proposed their appointment.

**Figure 7.1. Appointing supervisory board members in state-owned banks**

While key elements have been put into place, a draft law has been introduced to improve corporate governance practices in state-owned banks in co-operation with IMF and the World Bank. According to its provisions, draft law seeks to ensure that supervisory board begins its tenure only after NBU’s approval. In addition, it provides for “collective suitability” of the supervisory board, and would allow the NBU to request changes in personnel if the criteria is not met. These legislative changes are also expected to ensure that supervisory boards have collective expertise to develop strategies for banks and protect not only the rights of the state as a shareholder, but also the rights of creditors and depositors in state-owned banks (CMU, 2020).

Along with supervisory board members, state-owned banks have a management board (executive body) responsible for the operational management of the bank. The chair and members of the management board are appointed and dismissed by the supervisory board (subject to NBU’s approval), based on the proposals of its appointments and remunerations committee. The candidates are selected through a competitive procedure established by the supervisory board. The charter of the bank

114 http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=70415
establishes powers of the management board, including procedures for convening and holding meetings and adopting and executing decisions, among other elements.

Requirements related to internal audit applicable to state-owned banks are the same as those applicable to other banks. In particular, a state-owned bank must establish a permanent internal audit department, as part of the system of internal controls, which reports to and acts on the basis of regulations approved by the supervisory board. The NBU sets requirement on the professional qualifications of the internal audit staff and approves the nomination for the position of chief internal auditor. The dismissal of the chief internal auditor not at his or her initiative must be approved by the NBU. The state-owned banks must also submit to the NBU a report on activities of the internal audit department. In addition, the state-owned bank’s financial statements are subject to mandatory external audit, and the banks are not required to draw up annual financial plans similarly to other SOEs. Moreover, a framework co-operation agreement may be concluded with a state-owned bank and the CMU, which must be made available publicly. The agreement regulates co-operation between the bank and the government, and the body responsible for forming public financial policy (Ministry of Finance).

As noted earlier, the positions of members of supervisory boards and management boards in any Ukrainian bank, including state-owned banks, are subject NBU’s approval. In addition, the NBU may demand the replacement of any of the bank’s managers in case they do not meet the requirements, fail to carry out their responsibilities, or violate any laws (CMU, 2020[42]). In 2019, it used its power to reject most (5 out of 9) of the newly elected supervisory board members of the state-owned Oschadbank, citing conflicts of interest as a main reason. According to the NBU, disqualification was largely motivated by the decision of the supervisory board of Oschadbank to prolong the contract of the incumbent CEO without launching a new competition (OECD, 2020[69]).
Chapter 8. Municipally-owned enterprises

Along with centrally-owned SOEs, Ukraine has a large portfolio of municipally-owned enterprises (MOEs) under the oversight of local councils. Over the years, the number of MOEs has continued to increase. They are mainly active in healthcare, administration, utilities, and transport sectors, and remain key recipients of state aid, though they continue to underperform financially. Compared to centrally-owned SOEs, corporate governance practices in MOEs remain informal and less transparent. Although they fall outside the scope of central government’s oversight, operations, as well as regulatory and corporate governance frameworks of MOEs should be taken into consideration within the context of promoting reforms in Ukraine’s state-owned sector.

8.1. Overview of the municipally-owned enterprises

According to the State Statistics Service, Ukraine has 14,182 municipal (“communal”) unitary enterprises (municipally owned enterprises, or MOEs). The number of MOEs has been growing in the past few years, with a 24% increase since 2016. The figure, however, is a lower-bound estimate, as companies owned by municipalities may also exist in other legal forms (such as LLCs or JSCs), though no formal or informal estimates are available. Overall, MOEs are much more numerous – albeit generally smaller – than SOEs in Ukraine. MOEs are often underperforming and receive state aid, and frequently witness conflicts of interests in their operations.

MOEs generate significantly lower rate of ROE than private companies and SOEs. They also exhibit lower ROA, profit margins, asset turnover, and profitability ratios, suggesting that these enterprises are either not focused on profit or engage in earnings management that produces break-even results (which, in theory, allows profit siphoning and tax minimisation). At the same time, MOEs exhibit much lower levels of debt than private companies or SOEs (see Table 2.2 in Section 2.4). Over the past three years, there have been no significant changes in the financial performance of MOEs, except an increase in their current ratio (Table 8.1).
MOEs operate mainly across twenty different industries, and their number varies across different oblasts. In terms of sheer number, majority are involved in healthcare and administrative support services. In terms of asset value, MOE activities are concentrated mainly in the transport sector, followed by healthcare and utilities (including the supply of electricity and gas). While MOEs are also crucial for services, including waste management and water supply, their share in terms of number and asset value is lower (Centre for Economic Strategy, 2020[181]).

One of the major MOEs is Kyiv Metro. Registered as a “communal enterprise”, in 2018 it operated 52 underground stations and carried 496 million passengers (approximately 1.36 million passengers a day) (Kyiv Metro, n.d.[182]). In addition, Kyivpastrans is a communal enterprise that provides local transportation by buses, trolleybuses, tramways, and local railway to more than 1.5 million passengers a day (Kyivpastrans, n.d.[183]). Moreover, Kyivvodokanal claims to be one of the largest water utility companies in Europe (Kyivvodokanal, n.d.[184]) . Incorporated as a private joint-stock company, 25% is owned by the territorial community of Kyiv and 67% is owned by Kyivenergoholding (which, in turn, is 60% owned by the territorial community of Kyiv) (Kyivvodokanal, 2020[185]).

Along with utilities, MOEs conduct business across sectors, including construction, security, and IT (Prokhorov and Yablonovsky, 2019[186]). Kyivmiskbud Holding, registered as a private joint-stock company, is a large construction company in which the territorial community of the city of Kyiv owns 80% stake. The company is only marginally profitable, while witnessing heavy debts (Table 8.2) (Kyivmiskbud, 2020[187]). In 2019-2020, it took on its balance sheet more than twenty unfinished residential construction buildings of a private company Ukrbud Development, which had gone bankrupt. According to the CEO, Kyivmiskbud will be using retained earnings from the past decade and attract loans from state-owned banks in order to complete these residential buildings (Kolesnichenko, 2019[188]).

Table 8.1. Key financial ratios (median) for MOEs (2019)

<table>
<thead>
<tr>
<th></th>
<th>Return on equity</th>
<th>Return on assets</th>
<th>Profit margin</th>
<th>Current ratio</th>
<th>Quick ratio</th>
<th>Debt-to-equity ratio</th>
<th>Asset turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.34</td>
<td>1.00</td>
<td>0.07</td>
<td>0.90</td>
</tr>
<tr>
<td>2018</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.47</td>
<td>1.00</td>
<td>0.06</td>
<td>0.86</td>
</tr>
<tr>
<td>2019</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.81</td>
<td>1.02</td>
<td>0.05</td>
<td>0.93</td>
</tr>
</tbody>
</table>

Note: SOEs were distinguished based on the register provided by the CMU. MOEs were defined based on their legal form: Companies registered as a “communal enterprise” were selected, although some of MOEs may be registered as JSCs or LLCs. Ratios were computed based on raw data for each observation and then used the median, as it is not sensitive to outliers.

Source: Author’s calculations, based on YouControl data for 2019.

Table 8.2. Key financial ratios for Kyivmiskbud (2019)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net financial result (UAH thousand)</td>
<td>35,146</td>
</tr>
<tr>
<td>Total assets (UAH thousand)</td>
<td>8,537,568</td>
</tr>
<tr>
<td>Shareholder’s equity (UAH thousand)</td>
<td>1,590,288</td>
</tr>
<tr>
<td>ROE, %</td>
<td>2</td>
</tr>
<tr>
<td>ROA</td>
<td>0.4</td>
</tr>
<tr>
<td>Debt-to-equity ratio</td>
<td>4.37</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations based on Kyivmiskbud 2019 annual report (Kyivmiskbud, 2020[187]).
8.2. Legal and regulatory framework of MOEs

MOEs are defined in the Commercial Code as “business entities in the municipal sector of economy” that act on the basis of municipal property. These include entities with over 50% of municipal ownership in the charter capital, providing municipalities with decisive influence over their activities. They are formed by local self-governing bodies under their sphere of management. Local bodies are responsible for forming their authorised capital, the size of which is determined by the local council and is paid before the end of the first year from the date of registration of such enterprise. Regulatory framework set by the Commercial Code, Law of Ukraine on Local Self Governance, and other legislation for the state unitary enterprises generally applies to municipal unitary enterprises. Moreover, depending on the MOE legal form, other relevant laws may be applicable, such as laws on LLCs and JSCs.

The central government has limited oversight power over MOEs, and co-ordination between central and local authorities regarding state property management is often insufficient. However, the central government may provide support measures (such as transferring state-owned objects to MOEs) and influence their operations. Notably, the Ministry of Communities and Territories Development is responsible for monitoring and supporting utilities to meet national standards. The ministry is also responsible for forming policies for drinking water supply and drainage, approving heat supply schemes, and ensuring the development and implementation programmes in waste management. Moreover, specific resolutions introduced by the CMU and NEURC may impact the operation and profitability of certain MOEs, particularly in the energy sector, where entities are subject to tariffs set by the regulator. At the same time, it is worth noting that local authorities often lack necessary resources to maintain MOEs (particularly in the transport sector) and appeal to the central government for financial assistance (OECD, 2018[6]).

Other entities, such as the Antimonopoly Committee of Ukraine, are responsible for approving the creation of new municipal enterprises, though there are challenges in enforcement. In 2019, only 54 out of the 369 newly created MOEs were approved by the AMCU. In addition, AMCU should approve MOE transactions that may impact competition, including the creation of local entities and setting rules on market behaviour, among other aspects (CMU, 2020[150] (Centre for Economic Strategy, 2020[181]). While the MOEs have a greater accountability to communities and local authorities, they also witness informal influence and conflicts of interest, which work towards weakening their institutional capacities. For example, the shares of certain electricity distribution system operators (responsible for dispatching electricity) that have been partially privatised are often affiliated with vested interests (OECD, 2019[76]). As such, the MOEs often face challenges in attracting credit guarantees and investments. The AMCU has frequently launched investigations against MOEs for abusing monopoly position or for their anticompetitive actions, particularly in funeral services and security services markets (CMU, 2020[150]).

In terms of financial support measures, MOEs are recipients of formal and informal state aid. Collectively, they are the largest recipients of support measures (especially from the local budgets), amounting to approximately 80% of the decisions of the AMCU, which may include financial and non-financial forms, such as tax and rental benefits, among others. For example, some MOEs receive rental rates at significantly reduced costs (or at no cost) at the expense of the budget, as well as investments in their fixed assets through the allocation of funding from local development.
programmes. Local councils may also approve an increase in authorised capital with limited justification for expenses, and their decisions may often include conflicts of interest. Significant amount of the authorised capital is allocated to MOEs in water supply and sewerage (UAH 424 million in 2019) and energy supply (UAH 273 million in 2019), followed by transportation, construction and waste management. More broadly, MOEs have also received support measures from local budgets to compensate for their reduced fares, including in transportation, energy and administrative services (Centre for Economic Strategy, 2020[181]).

More broadly, MOEs are subject to similar transparency standards as SOEs under the Commercial Code. However, as further elaborated in Section 15, transparency standards are often not enforced in practice. In addition, challenges related to corruption and conflicts of interest may be more difficult to address among municipally-owned entities due to opacity of their operations and transactions.\textsuperscript{115}

8.3. Ownership arrangements and corporate governance in MOEs

The Commercial Code of Ukraine states that business activity of municipal enterprises should be managed by territorial communities and local self-governing bodies. The executive bodies of villages, settlements and city councils (Executive Councils) are authorised to manage municipal property, review draft plans of MOEs belonging to local communities, and provide suggestions and remarks regarding their management. Typically, heads of communities appoint management (which may be the representatives of local councils) and direct MOE work, while determining their strategy and work areas. City Councils approve company charters, development and investment programmes, and increase their authorised capital, while governing bodies within the council monitor the operational activities of MOEs. Other entities, such as the Standing Committees on budget and competition, and the Executive Committee of the City Council, can influence activities and financial plans of MOEs (Centre for Economic Strategy, 2020[181]).

Unlike in SOEs, there is no direct obligation for the MOEs to prepare financial plans, and it is up to the ownership entity to decide whether these are required for a particular MOE and approve the procedures for its preparation. Consequently, in unitary MOEs, it exclusive authority of the Executive Councils in their capacity as ownership entities to determine the requirements for financial plans and to stipulate the rules on their approval. The Executive Councils usually issue formal regulations on the development, approval and control of financial plans applicable to unitary MOEs of relevant local communities. It is also not unusual for the charters of MOEs to contain provisions regarding financial plans, including the requirements towards their content and timeline for approval.

In addition, annual financial statements of the municipal enterprises maybe audited and criteria for the auditor are set based on the procedure set by the local council. The enterprises should also disclose their objectives, financial statements, audited

\textsuperscript{115} For example, MOEs can be used for registering land plots for permanent use without auctions (Verkhovna Rada, 2004[342]). According to the State Cadastral Service of Ukraine (SCS), following the decentralisation reform approximately 4 million hectares of land were transferred to local governments between 2018-2020. As of 2020, the state reportedly owned only 750 thousand hectares of agricultural land, rather than the declared 6.4 million hectares (Matuszak, 2020[341]).
reports, charters, and annual reports, among others elements, though in practice this requirement is not enforced. The state or local authorities are responsible for providing compensation in case of any damages (Verkhovna Rada, 2003[5]).

In terms of their corporate governance, MOE governing bodies include:

- Head of enterprise, appointed by the ownership entity or by the supervisory board (if formed), who is accountable to the body responsible for his/her appointment. In practice, mayors are often responsible for appointing and dismissing the heads of MOEs, with an informal influence from the members of the city council. While competitions are formal, reappointments take place without competition.

- Supervisory board (if formed), which is responsible for monitoring and directing the activities of the head, as well as other activities defined by the charter. The ownership entity is responsible for forming the board. Local council is responsible for setting the criteria of and the process for appointing board members, and establishing procedures for formation, organisation and liquidation of the board and its committees.

According to a recent assessment, supervisory boards in MOEs are infrequent, and requirements and practices pertaining to their appointment and composition vary by oblasts. For example, in Odessa, one-third of the board members should be independent, and boards should be established in large enterprises (for example, in large monopolies with over 2,000 employees, or if asset value is over UAH 200 million or net income or authorised capital is over UAH 100 million). In Zhytomir, eleven MOEs have established supervisory boards, where all members belong to the city council. In addition, criteria for defining independence of board members can vary, and, in some cases, local council members have been considered as independent representatives on boards.

However, supervisory boards which are often not independent may have conflicts of interest (for example, local council members or their family members and affiliates are frequently appointed as CEOs or other officials in MOEs). As a result, the decisions made by the MOEs may be taken to benefit the council, rather than the enterprise. Moreover, board members often do not have competences needed to perform supervision and receive no remuneration. The heads of MOEs are remunerated based on the CMU resolution applicable to SOEs. That is, the amount of their salary depends on the value of assets, net income from sale and the number of employees, while other indicators are used to determine bonuses. However, the salaries for the heads of MOEs and their staff are often considered to be too low and uncompetitive (Centre for Economic Strategy, 2020[181]).

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Chapter 9. Recent and on-going reform

Over the past six years, successive governments in Ukraine have sought to implement certain structural reforms to restore macroeconomic stability and promote sustainable development. The SOE sector has been at the forefront of these reforms. In 2014, top-100 SOEs witnessed a loss of approximately UAH 117 billion, while starting to turn profit in subsequent years. Along with introducing amendments to corporate governance framework and launching privatisation, the government also sought to improve transparency and reporting in the SOE sector (including the launch of the ProZvit platform). The government’s efforts to introduce reforms within the sector were strongly supported by the international community and financial institutions, including the EU, IMF, EBRD and the World Bank. The agreements between Ukraine and the IMF in the past years have contained provisions on SOE reforms and privatisation (IMF, 2020). Similarly, the EU-Ukraine Association Agreement outlined the importance of adhering to the OECD corporate governance standards and subsequent EU financial assistance packages contained provisions regarding the improvement of the SOE corporate governance framework (European Commission, 2018) (European Union, 2014). This section provides an update on the most recent and on-going reform.

9.1. Reform of the top-15 SOEs

As noted above, the Honcharuk Cabinet issued a CMU Protocol Decision No. 26 on December 18, 2019 to bring top-10 SOEs in line with the recommendations of the OECD SOE Guidelines. It implied establishing majority-independent supervisory boards in SOEs where they have not yet been established (see Table 6.1). In addition, while adopting individual ownership policies, the top-10 SOEs would develop new charters that would provide supervisory board members with more requisite duties and responsibilities, including the appointment and dismissal of SOE management and the definite approval of strategic documents (such as financial plans). The CMU


118 Stand-By Arrangement (SBA) between Ukraine and IMF set a benchmark to adjust Naftogaz’s corporate charter based on the OECD recommendations. As a result, Naftogaz’s charter was amended in October 2020, though it is not fully compliant with the OECD Guidelines. According to the amendments, the supervisory board may approve Naftogaz’s strategy and mission (however, the Strategic Development Plan is still subject to CMU’s approval), and appoint other members of the management board. While it may decide on the election/dismissal of the CEO, the decision is subject to the ownership entity’s approval. Moreover, the ownership entity will continue to approve the direction of the company’s activity, financial and investment plans, and KPIs for supervisory board members in consultation with them.
decision also envisaged that key performance indicators (KPIs) would be set for supervisory boards and that corporate governance action plans for each of these SOEs would be developed.

To restart the effort following the change in government, the Shmyhal Cabinet issued another CMU Protocol Decision, No. 62 dated July 29, 2020, that was essentially the same, except that it expanded the number of SOEs to top-15. According to the latest available information, 8 out of top-15 SOEs have supervisory boards with independent members, and the process has been on-going for the remainder of these SOEs.\(^{119}\)

According to MDETA, between December 2019 and March 2020, the board member nomination process for a number of SOEs had started, though there were delays due to change in government and remuneration limits introduced during Covid-19. The nomination committee continued developing evaluation criteria for certain entities in the meantime and the nomination process for CEOs and board members in a number of SOEs. However, there have been additional challenges regarding the involvement and remuneration of professional consultants in the competitive selection process, and MDETA has been working towards improving respective procedures. In the meantime, individual ownership policies have been developed for the top-15 SOEs.

In August 2020, MDETA organised a meeting with the representatives from the top-15 SOEs and presented a template for individual action plan on improving corporate governance. The Ministry also developed individual plans for large SOEs under its ownership, and has continued co-ordinating plans on improving corporate governance practices with other line ministries and ownership entities. In December 2020, the plans were renewed whereby the Government supported the proposal of the Ministry of Economy to approve an updated action plan to bring the corporate governance system in the large and economically-important SOEs in line with OECD corporate governance standards (Minutes of 16.12.2020 № 127). According to this plan, measures to reform corporate governance, which began in December 2019, should be completed in September 2021, however their status remain unknown to the assessment team.

Along with developing ownership policies and appointing board members, the Ukrainian government has sought to corporatise the country’s key SOEs. Currently, Ukraine has 13 SOEs earmarked for corporatisation, including those in the top-15 (namely, Energoatom). As further elaborated below, draft laws are also being considered that would impact reforms in some of the top-15 SOEs (particularly in the defence sector), while others are currently being developed to further streamline legislative framework and improve corporate governance practices in the SOE sector.

Despite improvements, the country has continued to witness challenges in the full implementation of these reforms, partly due to opposition and rollbacks, government restructuring and changes in the political agenda. Moreover, the existing legal loopholes and ambiguities, along with the lack of policy implementation, have posed further difficulties in moving forward (MDETA, 2015\(^{[132]}\)) (Boytsun, 2019\(^{[39]}\)). Moreover,

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\(^{119}\) Overall, 9 out of the top-15 SOEs have independent board members. However, Polygraph Combine Ukraina is excluded because board members were appointed before the existing framework under CMU Resolution No. 777 was introduced. A competitive selection procedure was to be held once the contracts of the existing board members expired in February 2021. However, based on an announcement by the CMU, contracts of certain existing board members were extended and new members were appointed, though whether the process involved a competitive selection is unclear. It is also worth noting that Polygraph Combine Ukraina’s asset value and income were below the threshold requiring a mandatory competitive selection procedure for board members (CMU, 2021\(^{[343]}\)).
until recently the government has instituted reforms through “protocol decisions” – an internal decision of the CMU that does not get published – that have a weak legal power and poor enforceability (as further elaborated under Section 10 of this review).\textsuperscript{120} In March 2021, the CMU adopted 2030 National Economic Strategy that would aim to focus reform efforts, among other areas, around improving institutional capacity and management of SOEs (CMU, 2021\textsuperscript{[129]}). However, since the strategy has been approved as a CMU resolution, it may be easily amended, and there is no mechanism in place that would ensure holding the Cabinet accountable for non-implementation.

Current draft legislative proposals are also under discussion to address challenges identified under existing legal frameworks (see also section 9.4). These developments may allow for reforms that can be further anchored into legal and regulatory frameworks to ensure a higher degree of transparency and political accountability, while also safeguarding reforms from the risk of policy reversal.

9.2. Board nomination practices

One of the key changes through the legislative amendments has been appointing independent board members and professionalising the process, particularly in economically important SOEs (see Sections 6 and 11, and Annex D). These processes were used to appoint board members in some of the top SOEs, including Ukrenergo, Ukrzaliznytsia, Ukrposhta, Boryspil Airport and the Ukrainian Sea Ports Authority, though the process is on-going in other entities. Despite the existing framework, professionalised recruitment of independent board members remains to be applied in practice in other SOEs (particularly in state unitary enterprises). Moreover, exemptions have been made to appoint new board members without competitive or transparent selection processes (particularly in appointing new board members after the independent supervisory board members in Naftogaz resigned in 2017).

While the board members in defence and banking sectors were political appointees, the process in the latter was changed following the involvement of international financial institutions. As a result, the state-owned banks witnessed the appointment of independent board members through a selection process involving a nomination committee and an executive search company (as elaborated in Section 7) (Boytsun, 2019\textsuperscript{[39]}). However, the selection process in defence SOEs remains largely political – notably, in Ukroboronprom, the President and the CMU appoint supervisory board members without a formal process.

Despite some advances, reforms in this area remain under constant threat. Over the course of 2020, draft laws No. 3193-1 and No. 3955 were introduced into the parliament that have sought to limit supervisory board appointments to Ukrainian

\textsuperscript{120} Protocol decisions are not mentioned in the Law on CMU, and they are instead outlined in the Rules of Procedure of the CMU, which are adopted by the CMU itself. When CMU is not required to adopt an act or a resolution, it can make decisions that are documented in the minutes of the meeting (protocol decisions). The decisions are communicated to those responsible for implementing them, as an excerpt from the minutes of the meeting, and they are not required to be disclosed. Decisions are primarily developed to co-ordinate among central bodies and are not considered to be source of law.
nationals and to cap board remuneration. These drafts have also contained provisions that would deprive SOE boards of the status of “governing body” and increase the role of ownership entities in the board appointment processes. Considering that they were introduced by minority opposition in the parliament, and were not supported by the government, observers do not consider the draft laws to gather enough support to be passed in under this parliamentary convocation. However, they represent on-going challenges to corporate governance reforms in Ukraine and to the focus of reform efforts by the government.

9.3. Board and CEO remuneration

Board remuneration in SOEs has remained a contested issue. The discrepancy between pay scales for board members across SOEs has in the past created unequal opportunities in the sector. Naftogaz and Ukrzaliznytsia have offered packages for the supervisory board members worth up to USD 240,000 annually (though the fees were later decreased). However, companies generating smaller revenue have historically had less generous pay packages, which could potentially have impacted their ability to attract board candidates. For example, Ukposhta, which employs over 70,000 individuals, offered a less competitive package (USD 48,000 annually) (Boytsun, 2019[39]). While remuneration of supervisory board members and executive are subject to disclosure, practices vary between entities and they often remain undisclosed (see Section 15). In January 2021, Verkhovna Rada passed a draft law to improve access to information regarding board member and CEO remuneration in SOEs and in the meantime remuneration levels have been revised to ensure more balance between SOEs (Verkhovna Rada, 2020[191]).

The government has imposed caps on the remuneration for supervisory board members and CEO. Specifically, the monthly remuneration amount for the CEOs (excluding bonuses) may not exceed UAH 1,250 thousand (CMU, 2020[192]). These measures, however, have been challenged by critics of remuneration policy due to its potential impact in attracting qualified candidates (foreign and domestic) for these positions, while also being viewed as a means to push incumbent board members out. With the onset of the Covid-19 pandemic, based on the amendments to the State Budget Law, the government imposed a temporary cap on remunerations. According to a CMU resolution, the monthly pay of top executives and supervisory board

121 Other draft laws include No. 4199 and 4199-1, though they may not have widespread support. 4199 contains provisions, including stricter requirements for electing supervisory board members, timing and procedure for approving strategic and financial plans, obligations for board members to attend all meetings and vote only “for” or “against”. It also proposed introducing financial liability for board members for failure to fulfil tasks.

122 According to the service agreement (contract) with the Naftogaz board members, in 2019 remuneration for each independent board member amounted to UAH 6.3 million and 75% of that amount for state representatives. Board members were also entitled to additional remuneration depending on their additional functions and committee membership. Salary for each management board member ranged between UAH 18 million to UAH 30 million (Naftogaz Group, 2020[61]). Similarly, the total compensation for the seven supervisory board members of Ukrzaliznytsia in 2019 amounted to UAH 43.4 million, with each member receiving UAH 6.2 million on average (Ukrzaliznytsia, 2019[314]).

123 The basic annual level of remuneration for members of supervisory boards reduced threshold levels for individual enterprises, including NJSC Naftogaz of Ukraine and Ukrzaliznytsia, from UAH 6.3 million to UAH 2.9 million (maximum), and increased the level of remuneration for other particularly important enterprises (including USPA, Boryspil, etc.) from UAH 1.3 million to UAH 2 million. The approach for determining annual level of remuneration for supervisory boards and executives is differentiated and based on the performance of enterprises and the growth of employee income.
members was limited to UAH 47,230 (CMU, 2020\textsuperscript{193}). Moreover, board members were urged to sign a modification to their contract agreeing to take a pay cut and, if otherwise, they would receive no payment for performing their functions (the board members of Ukrzaliznytsia received no salary starting from March 2020 until the cap was lifted, as they did not agree to the cap). The decision was criticised, as the savings would be minimal and reallocating funds to the state budget would have been challenging, while taxable income from managers would have been reduced (Boytsun and Lysenko, 2020\textsuperscript{194}). In addition, as the contracts of some of the board members were drafted under UK law, the applicability of the CMU cap was legally contested. As a result of the cap, a number of officials from SOEs resigned, and it is understood that competitive nomination processes were hindered during this period.

Despite introducing a draft law (No. 3708) to lift the salary cap, it was soon withdrawn. In August 2020, the Constitutional Court ruled that restricting the salaries during the quarantine was illegal for civil servants and judges, though the decision did not apply to SOE officials (Ukrainian Pravda, 2020\textsuperscript{195}). In September 2020, the parliament passed a law (which was also signed by the President and became effective) empowering the CMU to limit the duration of restrictive measures imposed during the quarantine. In addition, MDETA organised a meeting chaired by the Prime Minister of Ukraine with the representatives of supervisory boards, where the parties discussed remuneration issues and the status of SOE corporate governance reforms. Certain agreements were reached, particularly regarding CEO appointments and filling vacancies on supervisory boards, as well as providing third party liability insurance coverage for board members and CEOs.\textsuperscript{124} While the cap limiting remuneration to UAH 47,230 was eventually lifted (CMU Resolution 996), other caps (albeit with a higher threshold) remain in place.

\section*{9.4. Draft corporate governance law}

As noted above, Ukraine has introduced legislative amendments to improve corporate governance in SOEs. Relevant amendments were introduced in 2016 to amend the existing laws, improve disclosure requirements, introduce mandatory audits, and establish supervisory boards (with a majority of independent members). The law also required to publish information regarding SOE strategic goals and objectives, along with quarterly and annual financial statements, and non-commercial objectives. SOEs would also need to disclose their charters, company reports and information regarding their executives and supervisory board members (Law 1405-VIII) (OECD, 2019\textsuperscript{40}) (Verkhovna Rada, 2016\textsuperscript{197}). While the law underwent a number of revisions, it was approved only after SOEs in the defence sector were excluded from these requirements (Boytsun, 2019\textsuperscript{39}). These efforts, however, have been more of a patchwork of attempts to bring corporate norms applied to SOEs in line with international standards. For example, despite introducing independent boards within

\textsuperscript{124} Along with remuneration, the provision of liability insurance for board members and CEOs has remained a contested issue. Until recently, having a liability insurance for managers was deemed irrelevant as the labour code restricted penalties that could be imposed for damages due to industrial or economic risks. However, there have been on-going challenges determining responsibility in case of financial losses, as well as failures to take measures to prevent substandard products, theft, and damage to property. In response, relevant amendments were introduced in January 2021, which allows company officials to be provided with liability insurance. According to the current provisions, the maximum cost of insurance premium under the insurance contract must correspond to the insurance costs provided for in the budget for the bank or in the financial plan of the SOE (CMU, 2021\textsuperscript{196}).
SOEs, there is a lack of clarity regarding their role and competencies. Attempts to resolve inconsistencies through changes to individual company charters have proven vulnerable to change.

In order to address some of these challenges, a draft law (No. 6428) was developed to harmonise the existing legislative framework within the SOE sector. Initially registered in May 2017, the draft law contained provisions to empower the supervisory board members by granting them the exclusive power to approve strategic development plans, to appoint the CEO and other members of the executive board, and to vote on significant transactions within the company so long as this was reflected in the company charter. Despite numerous revisions, the draft law never passed. In the meantime, presidential and parliamentary elections were held and, due to the change in parliament, the draft law became invalid (Verkhovna Rada, 2017). The draft was then updated by MDETA within the Honcharuk Cabinet and was offered for public consultation. The government was subsequently reshuffled in March 2020 and a revised version of the draft law is being developed. The revised version was shared by the Ukrainian government with international partners, including the EBRD and OECD, for comments in November 2020 (see Box 9.1). The draft is currently being finalised by MDETA and it is expected to be submitted to the CMU by May 2021.

**Box 9.1. Draft law on improving SOE corporate governance**

To improve corporate governance practices in SOEs, the government of Ukraine has been developing a revised version of the draft law (ex-6428) on corporate governance. According to the explanatory note, the draft law seeks to improve SOE governance by (i) expanding the powers of board members to approve strategic documents, carry out annual independent audits, appoint and dismiss CEOs and set their remuneration; (ii) improving procedures for the payment of dividends; and (iii) streamlining issues related to property management and ownership practices, among others.

The draft law proposes to amend a body of legislation, including the Commercial and Civil Codes of Ukraine, the SOE, JSC and LLC laws, and the laws regarding remunerations, exports, railways and the Cabinet of Ministers. Commitments to reform corporate governance practices in SOEs are also outlined in the Government Priority Action Plan for 2021 and a CMU programme to improve investment attractiveness, as well as in Ukraine’s agreements with international partners and financial institutions.

An initial version of the draft law was submitted to the OECD Secretariat for comments in November 2020, which were subsequently shared with the Ukrainian Government (following consultations with the assessment team and the EBRD). The comments focused on further streamlining the existing laws and regulations, and aligning practices with the SOE Guidelines, while minimising exceptions and carve-outs.

Following subsequent revisions, the draft law was made available for public consultation in April 2021. While some comments from both the OECD and EBRD were taken into consideration, certain provisions under the new version remain problematic, notably:

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125 The draft law was submitted in a previous convocation of the Verkhovna Rada and was registered as Draft Law No. 6428 (http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=61755).
In addition to the draft corporate governance law, Ukraine has introduced other draft legislation to improve corporate governance practices in joint-stock companies (which may impact corporatised SOEs). Draft law 2493 (introduced in November 2019 and passed in the first reading in June 2020) aims to harmonise provisions with EU regulations, particularly Directive 2007/36/EC, to bring the rules on shareholder representation in line with the EU law. It also looks to streamline the regulations on mergers, acquisitions, divisions of JSCs according to the Directive 2017/1132/EC. Other areas include proposals to introduce a one-tier management system (except in enterprises of public interest, including the top-15 SOEs) and holding general meetings with the use of electronic voting, while eliminating revision commissions (as further elaborated in Section 16.10).

9.5. Ownership policy

In 2018, the government introduced a nascent ownership policy called the Basic Principles – Introduction of an Ownership Policy for State-Owned Enterprises (Basic Principles), which was enacted through a protocol decision of the CMU. The document identifies broad-based rationales for the government’s ownership of SOEs, but does not go into specifics on individual SOEs. Instead, it requires the development and approval of tailored ownership policies for selected SOEs. The Principles put forward some priorities for SOE reform, including separating ownership and regulatory functions of ownership entities, converting state enterprises into joint-stock companies, ensuring competitive and transparent board nomination process, and promoting transparency in the company activities to limit the risks of corruption (OECD, 2020[69]). However, there is no systematic monitoring of the implementation of the policy. Moreover, despite adopting ownership policies for a number of SOEs,
they may witness sudden changes, which may impact their operational performance. A full analysis is provided in Section 10.

9.6. Privatisation programme

While improving corporate governance in SOEs, Ukraine has been working to reduce the size of its SOE sector through privatisation. Since the 1990s, the privatisation of state assets significantly slowed, amounting to less than 0.2% of GDP in 2013 (OECD, 2019[40]). To re-launch the process, in 2014 the CMU authorised the SPFU to develop a list of 160 entities to privatise. However the framework for privatisation was outdated and the country faced difficulties in selling state-owned entities, including the Odessa Portside Plant and Centrenergo, which, to date, have remained under state ownership.

In 2018, Ukraine introduced the Law on Privatisation of State and Municipal Property, which sought to ease the sale of both large-scale and small-scale objects. The law also contained provisions regarding transparency and integrity of individual transactions, and provided guarantees for investors (OECD, 2019[40]) (Verkhovna Rada, 2018[130]). From the perspective of the international community and financial institutions, the adoption of this law was a key step towards launching a new phase of privatisation in Ukraine, especially as it facilitated small-scale privatisation (with a value of less than UAH 250 million) through the ProZorro electronic platform.

In a push to accelerate the process, the previous government initiated the so-called “triage” that categorised the SOEs to remain under state ownership, privatised, or liquidated (as outlined in Box 5.2. in Section 5). However, large-scale privatisation plans (including preparatory work) were initially stalled, and later banned due to Covid-19, while the SPFU’s budget was significantly reduced. Preparatory work for privatisation was eventually allowed to resume and, in early 2021, a draft law to continue large-scale privatisation was passed (Verkhovna Rada, 2021[200]).

In the meantime, the government declared an intent to retain only 300 entities under its ownership, though the list was later doubled (Ukrinform, 2020[201]). A draft law (No. 4020) which excludes state assets from privatisation was approved in its first reading by the parliament (Verkhovna Rada, 2020[121]). The draft law identifies a list of over 600 SOEs to remain in state-ownership. The SPFU has also continued developing draft laws to incentivise privatisation (for example, the possibility to allow ownership entities to keep proceeds from privatisation), though they remain subject to CMU’s consideration. In parallel, IPO plans have been announced for some of the key SOEs. In April 2020, the CMU instructed Naftogaz to prepare the company for an IPO, which is currently planned for 2025, and relevant amendments were made to the company’s ownership policy. The CMU also intends to allow the privatisation of 50%-1 shares in other key SOEs, including Ukrposhta and Ukrzaliznytsia (Zubkova, 2021[202]).

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127 Changes to SOE ownership policies can significantly impact their operations. For example, if Naftogaz’s rationale for ownership was to achieve energy independence, it would need to invest in gas production infrastructure and energy savings. If, on the other hand, the rationale was to maximise profits, then the company would need to increase gas imports (Boytsun, 2019[39]).

128 Notably, the recent privatisation of the shares of state-owned electricity distribution companies have been concentrated under a handful of individuals.
9.7. Ownership arrangements

Under the previous government’s Five-Year Programme, concrete plans to establish a centralised ownership entity, to be called the “National Wealth Fund”, were developed (Box 9.2). The Fund would exercise ownership over the strategic state-owned companies (OECD, 2020[69]). The government’s advisors were working to develop plans for the Fund, particularly regarding its legal form and corporate governance structure. As a sign of political will, the previous government allocated UAH 250 million to launch the Fund, which was approved by the parliament. However, with the start of the quarantine due to Covid-19, the Law on the State Budget for 2020 was amended and the budget line for its establishment was removed by the new government in April 2020, and plans for its establishment were put on hold.

Box 9.2. National Wealth Fund

According to the plans shared by the MDETA in 2019, the National Wealth Fund (NWF) would have been responsible for a portfolio of 69 state-owned enterprises operating across a wide range of sectors. Corporate governance arrangements of the fund were under discussion, including the extent to which the state could still exercise “political control”. At the time, policymakers preferred the option to establish the fund at arm’s length from the government and to appoint independent directors to its board.

Although this plan remained one of the most concrete to date, centralise ownership arrangements for the NWF shared with the assessment team had not yet elaborated a number of key areas of importance, including:

- The legal form of the Fund
- Transparency and disclosure requirements applicable to the Fund
- Accountability mechanisms of the Fund towards relevant representative bodies
- Mechanisms for distribution of dividends paid by SOEs
- Mechanisms for interaction with the rest of the government on the overall ownership policy, sectorial priorities and corporate objectives
- Anti-corruption and integrity measures
- Capacity, funding and operational aspects of the Fund, among other areas

To establish the Fund, UAH 250 million was allocated through the State Budget for 2020, which was approved by the parliament. However, due to Covid-19, the Law on the State Budget for 2020 was amended and the budget line for its establishment was removed.

Source: (OECD, 2020[69])

The concept to develop a National Investment Fund (NIF) introduced by the President’s Office and the National Commission on Securities and Stock Market has been more successful. In March 2021, the government formally established the state enterprise "National Investment Fund of Ukraine" and approved its charter, which

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129 While establishing a centralised ownership entity would assist in overcoming challenges, it would be important to ensure that proper requirements are in place for it to effectively undertake its functions. In part, the entity would need to be resourced sufficiently, notably with finances and staff, and have institutional authority. Further elements would require ensuring a whole-of-government approach and co-ordination between the Fund and the current entities, including line ministries, that exercise ownership rights over SOEs (CMU, 2020[42]).
defines its corporate governance structure (CMU, 2021[203]). The NIF will seek to create favourable conditions to attract investments in Ukraine and promote competitiveness. Currently, work is underway to prepare a law that will lay foundations for its establishment and outline its functions. While plans remain to be further clarified, NIF is expected to hold shares of 10-15 large SOEs (Interfax Ukraine, 2021[205]).

In the meantime, a number of Ukrainian SOEs in the top-15 have changed ownership entities. Notably, Energoatom and Ukrhydroenergo have been transferred from the Ministry of Energy under CMU, while MGU and Ukrenergo are expected to be transferred under the Ministry of Energy (CMU, 2021[45]). Part of the reason for the transfer reportedly includes implementing EU’s Third Energy Package on delimiting transmission system operators (including Ukrenergo and GTSO under MGU) and electricity producers (including Energoatom and Ukrhydroenergo) (Economic Truth, 2021[206]). However, transferring gas and electricity transmission system operators under the Ministry of Energy has raised concerns with regard to potential conflicts of interest in performing policymaking and ownership functions.

The assessment team is informed that the government is in consultations with the Energy Community Secretariat to ensure that such a move would not interfere with Ukraine’s commitments under the Third Energy Package and Association Agreement. The roadmap for the transfer of the two transmission system operators, which was not shared with the assessment team, reportedly develops measures that seek to address conflicts of interest. This includes establishing “Chinese walls” within the structure of the Ministry of Energy to delimit ownership of the TSOs from other functions, as well as developing a compliance policy and oversight role that would ensure non-interference in the operation of the TSOs. However, at the time of writing (April 2021), discussions were still on-going and concrete steps towards mitigating such conflicts remained to be determined.

9.8. Reform of defence SOEs

Further issues have emerged in the corporate governance of the defence sector with the recent establishment of the Ministry of Strategic Industries. Along with coordinating state industrial policy, the new ministry may also be involved in performing ownership functions within defence. According to its mandate, it will be engaged in determining candidacies of state representatives on supervisory boards, managing corporate rights, and approving and dismissing CEOs within defence entities. The Ministry will also form state companies within its competence, approve statutes, monitor their financial activities and approve their financial plans (CMU, 2020[207]). Its establishment, however, raised questions regarding the extent of the Ministry’s involvement within the defence sector and the impact on on-going corporate governance reforms of Ukroboronprom, the quasi-ministry state concern responsible for state-owned enterprises of the defence industrial complex.

As noted in Section 3.3, it was announced that Ukroboronprom would be reorganised into corporatised holding companies, and that some of its affiliated SOEs would be

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130 Similarly to the Fondul Proprietatea (Sovereign Development and Investment Fund in Romania), NIF could be envisaged as a minority shareholder in some of the top SOEs and work towards improving investment opportunities (Government of Romania, 2020[204]).
privatised. A draft law for the transformation of Ukroboronprom (No. 3822) was adopted in the first reading in January 2021, which would include appointing independent board members, converting SOEs under Ukroboronprom into JSCs or LLCs, and corporatising Ukroboronprom.\footnote{http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=69418} However, there have been concerns with the current wording of the draft law, as it maintains potential conflicts of interests in the state performing ownership, policymaking and regulatory functions; opens room for political intervention; and allows for easy replacement of the management.
Part II. Assessment of Ukraine relative to the SOE Guidelines
Chapter 10. Rationales for state ownership

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

10.1. Articulating the rationales for state ownership

A. The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources.

The decision to establish SOEs or to maintain participation in the capital of commercial companies generally emanates from the CMU. As outlined in the Law on Management of Objects of State Property, the CMU:

- Determines conditions for the establishment and operation of SOEs
- Makes decisions on the establishment, reorganisation and liquidation of SOEs under its oversight
- Determines which ownership entities should exercise control over SOEs
- Approves the decisions of ownership entities regarding the establishment, reorganisation and liquidation of SOEs that are strategically important

Ownership entities (that are typically line ministries) decide on the establishment, reorganisation and liquidation of SOE, except for those entities deemed "strategic".

The first-ever overarching ownership policy on a national scale was established in 2018 as a non-binding cabinet-level protocol decision, which outlines rationales for state ownership.132 Prior to the adoption of Basic Principles – Introduction of an Ownership Policy for State-Owned Enterprises, there was no explicit policy document that provided details on the rationales for state ownership, except for the Law on Management of Objects of State Property which introduced a first vague concept – namely to "satisfy state or social needs." The rationales for owning SOEs with public policy functions were determined from relevant sectoral regulations and the charters of the respective companies.

The Basic Principles state the following rationale for ownership of SOEs: “The state owns (performs management functions of) economic entities to preserve and further increase the value of their assets, ensure the economic interests of the Ukrainian people, perform the social function assigned to the state, [and] profit by these entities in commercial activities.” While the Basic Principles are a welcome first step towards developing a state-ownership policy in line with this Recommendation, many

132 Beforehand, a CMU Decision No. 351 dated April 26, 2017 approved basic principles of state ownership in relation to Naftogaz.
stakeholders consider that there is still a lack of sufficient clarity and articulation, from a whole-of-government perspective, of the rationales for maintaining ownership in predominantly commercially-oriented companies, keeping in mind the very large size of the Ukrainian SOE portfolio. The policy document explicitly recognises many of the challenges related to incoherent policy towards the sector and multiple and competing objectives for individual entities, and a lack of separation of ownership from policy and regulatory functions which results in conflicts of interest. However, it neither articulates general plans on how the state seeks to deal with these challenges, nor does it go so far as to consider the trade-offs of maintaining state-ownership. Moreover, since the policy was introduced as a protocol decisions, it is not easily accessible, has a weak legal power and lacks enforceability. A draft corporate governance law (so-called ex 6428) currently under consideration includes reference to the ownership policy as a policy document that the CMU would have to approve, which, if passed, may give the ownership policy more weight.

To complement the set of Basic Principles, the government has mandated ownership entities of the top-15 SOEs to develop individual ownership policies establishing, among other areas, the rationale for why the enterprise should remain under state ownership (i.e., importance for national security, natural monopoly, or provision of services in areas where there are market failures). Some of the individual ownership policies make references to value maximisation or efficient allocation of resources (not systematically). However, references to these concepts do not translate into a clear statement from the state-owner outlining where there may be trade-offs between shareholder value, long-term investment capacity, public service obligations and other public policy goals (see Box 10.1). Moreover, individual ownership policies may actually introduce further ambiguity insofar as sector regulations may also establish specific goals for SOEs (e.g. transport strategy, defence strategy, domestic aircraft construction strategy, etc.). In most cases, the objectives for the establishment and maintenance of state ownership in SOEs have been inherited from the planned economy. The draft corporate governance legislation (so-called ex-6428) may further widen the practice of developing ownership policies for individual SOEs to a broader sub-set of the portfolio. At the time of writing, the provisions of the draft law were still under discussion and may be subject to further modification.

In addition, following the adoption of a new Privatisation Law in 2018, the government developed the so-called “triage” that sorted SOEs into three categories, namely those to maintain under state ownership, privatise or liquidate (see Box 5.2. under Part I). Among the portfolio of approximately 3,700 SOEs, only 300 were identified to remain under state ownership. However, the detailed triage outcomes are not publicly accessible and are not directly linked to an explicit ownership rationale. According to information shared by Ukrainian officials, in 2019-2021, 960 SOEs are planned for

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133 As outlined under the Rules of Procedure adopted by the CMU, protocol decisions are usually introduced in order to help co-ordinate activities among ministries and other central bodies. These decisions are not considered to be a source of law and their contents are usually communicated only to those responsible for implementation. They are not subject to disclosure or publication, although information regarding CMU’s decisions and activities can be made available through press releases and briefings.

134 For example, the current ownership policy of Naftogaz states the company has to promote energy efficiency and market efficiency by promoting the formation of competitive energy prices, while also pointing to the need for the company to provide public service obligations in the form of gas supply to certain customer segments. The ownership policy was recently revised. The previous version (2017) had a more explicit statement about “increasing the profitability of the shareholder” which is not in the current ownership policy, but it also contained a multitude of conflicting goals (CMU, 2017[161]).
privatisation, while 910 SOEs are expected to remain under state ownership, and 897 are to be liquidated or reorganised (CMU, 2020[150]) (Verkhovna Rada, 2015[208]).

Ukraine has also defined certain SOEs to be of “strategic importance for the economy and security of the state”, which is mainly used for applying certain corporate governance procedures. CMU Resolution No. 999 establishes criteria for classifying SOEs as strategic, while CMU Resolution No. 83 provides a list of strategic SOEs based on the established criteria. There are approximately 300 SOEs on the list (sometimes the same ones as those on the list to maintain under state-ownership), which include Naftogaz, Ukrenergo and Ukrzaliznytsia, as well as certain electricity distribution companies, research institutions and state-owned banks, among others.  

The categories of businesses that should remain under state-ownership and those identified by the respective CMU Resolutions to be of strategic or economic importance introduce some ambiguity as to which enterprises are intended to remain under state-ownership. For example, the government has adopted a strategy for the state-owned banks (see Section 7) which aims to reduce the share of the state in the banking sector to 25%, while some of these same state-owned banks figure on the list of strategic companies and would, by virtue of their size, also be identified as “economically important” (Ministry of Finance, 2020[209]). There is no articulate statement of the government’s current policy towards maintaining state-ownership. According to stakeholders, many state-owned entities exist today without a clear rationale, often as a result of the unfinished transition and privatisation process, or due to vested interests (IMF & EBRD, 2019[49]).

Recently, the parliament passed in its first reading a new list of companies which are to be excluded from privatisation. The draft law 4020 “On the List of Objects of State Property Not Subject to Privatization” identifies 659 SOEs that should remain in full or partial state-ownership. The draft law lists SOEs based on five loosely defined categories (e.g. JSCs to be partially privatised, cultural facilities, forestry enterprises, etc.), though it does not specify rationales for maintaining those enterprises in state-ownership (Verkhovna Rada, 2020[121]). Broad rationales are instead provided in an “explanatory note” (but not for each enterprise), which outlines that entities have been selected if they (i) are responsible for ensuring energy independence and defence capability of the state; (ii) are natural monopolies; and (iii) engage in activities critical to society. According to the explanatory note, MDETA will be responsible for maintaining and updating the list of SOEs excluded from privatisation, on the basis of the criteria established in Article 4 of the Law on Privatisation and a 2017 list maintained by the Ministry of Economy which is subject to regular update (the list was

If an enterprise is deemed strategic, then (i) the CMU must approve enterprise’s restructuring and issuance of new shares, and (ii) if either asset value or net value of the company surpasses UAH 200 million, the CMU approves CEO appointment. In addition, SOEs are deemed economically important if their asset value (or authorised capital of a newly established SOE) exceeds UAH 2 billion or net income exceeds UAH 1.5 billion (Resolution No. 142-2017-n), in which case further corporate governance practices are applicable (particularly regarding CEO and supervisory board member appointments, as outlined in Sections 6, 11 and 16).

The annexes are divided into the following categories: Annex 1: at least 50%+1 shares owned by the state in JSCs; Annex 2: companies and associations where the state’s share is 100% in the authorised capital (in case some SEs are converted into JSCs or authorised capital is reduced, at least 50%+1 of authorised capital should remain state-owned); Annex 3: list of cultural and sports facilities; Annex 4: list of SOEs that are not subject to privatisation, but may be converted into business associations; Annex 5: list of forestry objects. Among the top-15 SOEs, the following were identified in Annex 1: Naftogaz, Ukrzaliznytsia, Ukrposhta (presumably their partial privatisation will be allowed); and in Annex 2: Ukrenergo, Energoatom, Ukrhydroenergo, Sea Ports Authority, Air Traffic Service, GTSO.
not made available) (Verkhona Rada, 2018[210]). No direct links to the Basic Principles, CMU Resolution No. 83 establishing a list of “strategic enterprises” (and the definition for “strategic” identified in CMU Resolution 999) and the triage exercise from 2018 (see Box 5.2) are explicitly provided to determine which policy document should be the authoritative source to articulate the rationales for state ownership.

At the municipal level, the Commercial Code (Article 78) allows Ukrainian municipalities to establish MOEs (Verkhovna Rada, 2003[5]). However the exact procedures and the underlying rationales for their establishment are not known to the assessment team, and there is very little transparency regarding their operations and financial situation. As noted in Section 8, the number of MOEs has been growing in the past few years, with a 24% increase since 2016. Moreover, MOEs are often established in competitive markets, for which no rationale exists.

10.2. Ownership policy

B. The government should develop an ownership policy. The policy should inter alia define the overall rationales for state ownership, the state’s role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.

As mentioned, in 2018 the Government of Ukraine established an ownership policy entitled Basic Principles – Introduction of an Ownership Policy for State-Owned Enterprises, which was enacted through a protocol decision of the CMU. This non-binding policy document identifies broad-based rationales for the government’s ownership of SOEs, but does not go into specifics on individual SOEs (CMU, 2018[211]). Instead, it requires the development and approval of tailored ownership policies for selected SOEs. According to the Principles, ownership entities having ownership rights in enterprises of economically important SOEs (i.e., assets exceeding UAH 2 billion or net annual revenue exceeding UAH 1.5 billion) should draft company-specific “ownership policies” regarding these particular enterprises. 137

The Basic Principles identify key objectives for exercising state ownership and general principles for exercising management of SOEs, such as (i) the definition of clear (commercial and non-commercial) objectives for the company by the ownership entity; (ii) corporatisation of commercially-oriented SOEs to ensure a regulatory level-playing field; (iii) separation of ownership and regulatory functions of the ownership entity; (iv) competitive and transparent board nomination process; and (v) transparency of company activities to reduce corruption risks, among other aspects.

It is also worth noting that some ownership entities have their own ownership policies. For example, the State Property Fund of Ukraine has as separate policy outlining its role as a shareholder of SOEs, rationales for ownership, and which distinguishes of its functions as owner and regulator, and provides stipulations as to individual

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137 The assessment team is informed, subject to a Memorandum of Understanding with EBRD signed in end-2020, that Ukraine has agreed to adopt a comprehensive principles of state ownership policy, which will determine the State’s direct ownership regarding state property, the role of the state in the management of state-owned enterprises, the ways in which the state implements its property policy, as well as the relevant functions and responsibilities of those state institutions that are involved in its implementation. A roadmap for implementation is currently being discussed.
corporate governance requirements for SOEs, including audit functions and disclosure of information (SPFU, 2019[212]).

Prior to the adoption of individual state-ownership policies, most SOEs implemented the policies of their line ministry in accordance with sectoral policies and national priorities, as well as individual objectives (sometimes implicit or explicit) and expectations laid out in their respective statutory acts (when applicable), statutes, and business programmes. While these various sources of information are generally available to the public for the top-15 SOEs, they fail to provide a clear understanding of the state’s overall objectives as an owner. Rather than setting goals, they typically describe types of activities in which the SOE will engage.

Further to the government’s initiative to upgrade corporate governance practices in the top-15 SOEs, the CMU mandated the ownership entities to develop individual state-ownership policies for these enterprises. By April 2021, ownership policies for the top-15 SOEs had been approved (see Recommendation D below) (MDETA, 2021[213]). The draft corporate governance legislation (so-called ex-6428) may further widen the practice of developing ownership policies for individual SOEs to a broader sub-set of the portfolio. According to the draft law, individual ownership policies should define the purpose of state ownership, the main objectives of state-owned companies, the main activities and the main indicators of their effectiveness. The ownership policies should also specify the types of indicators by which the achievement of the goals will be measured. At the time writing the provisions of the draft law were still under discussion in government and may be subject to further modification.

10.3. Ownership policy accountability, disclosure and review

C. The ownership policy should be subject to appropriate procedures of political accountability and disclosed to the general public. The government should review at regular intervals its ownership policy.

In general, national and sectoral legislation bearing on SOEs follows the legislative procedure, though drafts are usually not published for public consultation. Depending on national priorities, the government reviews these drafts and, if necessary, proposes amendments. Other government decisions in the form of resolutions are made public, and regular acts of the government involve consultations with various stakeholders and relevant line ministries (with the involvement of MDETA and the Ministry of Finance, as a general rule). After approval by relevant stakeholders and the CMU, the government decision comes into force (publication is required for CMU resolutions).

However, not all government decisions are subject to consultation, nor are they published (such as CMU protocol decisions). The current ownership policy was approved as a “protocol decision”, which, as an internal decision of the CMU to coordinate among ministries and other central executive bodies, remains weak in terms of ensuring political accountability and enforceability, and is not subject to disclosure. In addition, the CMU only published a communication on its website that it approved the Basic Principles, and its contents are available only through MDETA’s website.

138 A draft law on public consultation (No. 7453) was introduced into parliament but was not formally approved. CMU Resolution No. 996 has been introduced regarding public participation in forming and implementing public policy (CMU, 2010[220]).
Individual ownership policies of SOEs, if they take the form of CMU Resolutions, are generally searchable on the government’s web portal. MDETA also has a dedicated page on its website for the approved ownership policies of the top-15 SOEs identified as priority for corporate governance reform (MDETA, 2021[213]). However, when issued as a decision of a line ministry, the ownership policies are not always readily available, neither on the websites of respective ownership entities nor on the websites of SOEs.\(^\text{139}\) The disclosure of the ownership policy of individual SOEs also does not appear to be a requirement under current disclosure requirements (CMU, 2016[214]). A proposed amendment to the Commercial Code, which would fall under the so-called corporate governance law (ex-6428) would seek to make general and individual ownership policies among key documents to be enacted by the ownership entity and would be subject to disclosure. However, at the time writing the provisions of the draft law were still under discussion and may be subject to further modification (see Section 9.4 for further details on the draft law).

The individual state-ownership policies are subject to different approval procedures. They are notionally to be developed by the ownership entity, but often a first draft is prepared by the SOE itself. For those entities that are not falling under the CMU’s authority, the process of approval only involves a decision by the ownership entity. In practice, MDETA may co-ordinate meetings regarding the approval of ownership policies between different ministries and agencies for the top-15 SOEs. For example, in the case of Naftogaz, the ownership policy was approved by the CMU (its shareholder), though the approval process required consultations with MDETA and the Ministry of Energy.

While this can be perceived as a useful step towards approaching state ownership practices from a whole-of-government perspective, it can introduce complexity with regard to the approval process and has, according to stakeholders, opened doors for undue political interference in designing the policy. Part of the problem emanates from the fact that the individual ownership policy, as it is structured today (see Section 10.4 below), includes elements of “ownership expectations”, including “key performance indicators” or “expected results”. In fact, some of the ownership policies include targets and expected results established for a four-year time horizon (e.g., the ownership policy of Ukrenergo or Ukrzaliznytsia). The best practice approach would be to develop individual ownership policies, which is well understood by the board and discussed with the state-owner.

While an inter-agency process can be important to ensure the policy is in line with broader government objectives, this should not be an opportunity for the line ministries responsible for sectorial policies and regulations to unduly influence the ownership policy, in particular through “add on” public policy objectives that are assigned to the SOEs. The policy should be based on a sufficiently long time horizon to allow governing bodies of the company to develop a corporate strategy and establish goals that are in the long-term interests of the company and shareholder, and subject them to recurrent review. At the municipal level, information is much harder to come by. While local councils establish MOEs, the assessment team is unaware of any instances regarding the development of their ownership policies.

\(^{139}\) With the exception of Ukrainian Sea Ports Authority published on the website of the Ministry of Infrastructure. (Ministry of Finance, 2018[276]). The Ministry of Social Policy, however, may develop ownership policies of groups of SOEs, while applying individual policies for selected SOEs (Ministry of Social Policy, 2019[263]).
10.4. Defining SOE objectives

D. The state should define the rationales for owning individual SOEs and subject these to recurrent review. Any public policy objectives that individual SOEs, or groups of SOEs, are required to achieve should be clearly mandated by the relevant authorities and disclosed.

Individual ownership policies are to be established in accordance with the structure approved by CMU Protocol Decisions No. 26 (18.12.2019) and No. 62 (29.7.2020), which apply to the top-15 SOEs. The decisions require that ownership policies:

- State the rationale for why the enterprise should remain under state ownership (i.e., the importance for national security, natural monopoly, provision of services that will not be provided by the private sector)
- Establish goals and main activities of the SOE
- Establish key performance indicators/expected results which should include a financial indicator, and other possible industry indicators in accordance with the government's program.

While the protocol decision establishes a minimum standard for ownership policies, the actual format and contents may differ from one entity to another. In addition, according to responses submitted by the authorities, the ownership policies can be revised as needed. For example, some ownership policies outline expected results of the company for a period of four years (Ukrenergo for 2020-2024, and Ukrzaliznytsia for 2019-2023). This would imply that the company's ownership policy should be reviewed and renewed after this period. However, the ownership policy of Naftogaz does not include a specific timeline.

While the establishment of individual ownership policies for SOEs represents a welcome first step, the respective ownership entities and the government as a whole will have to prove that the establishment of individual ownership policies are not merely a formality. As noted earlier and below, many times SOEs are subject to multiple and competing objectives, and the shareholder may identify priorities for SOEs, but it does not clarify how inherent trade-offs should be handled. For example, in the gas sector, the government must contemplate the trade-off of requiring Naftogaz to sell gas at a regulated price to certain households, while also asking it to create value and ensure profit maximisation in other gas segments if it does not have a viable methodology to compensate the company for the fulfilment of public service obligations (PSOs). There are many similar examples of individual SOEs, which do not have a clear understanding of how to reconcile their commercial and non-commercial objectives (Box 10.1). This creates considerable room for conflict between the shareholder and the respective governing bodies of SOEs. The government must be able to clearly indicate its priorities for individual SOEs, and avoid giving contradictory messages to the board and management as to the stated goals and expectations. Moreover, it will help avoid ad hoc PSOs and other opportunities for undue political interference in the operations of individual SOEs (OECD, 2019).

140 Recently, Ukreximbank provided UAH 3 billion to Antonov State Enterprise to finance the construction of three aircraft, although the bank's main activities are to support export and import activities (Interfax Ukraine, 2021).
Furthermore, the concept of “ownership policy” is often confused with the concept of “owners’ expectations”\textsuperscript{141}, and the individual ownership policies of SOEs end up being a hybrid of the two. However, as noted by earlier OECD studies, objective setting for SOEs is generally weak in Ukraine (OECD, 2019\textsuperscript{40}). Most individual ownership policies do not establish linkages with the existing government sectorial strategies or obligations set out in relevant sectorial legislation. The ownership policy should clearly define the scope and range of public policy objectives to be carried out, which will avoid situations resulting in “add-on” obligations.

For the remainder of the portfolio, forthcoming legislation on SOEs might help establish a rationale for ownership that is mostly anchored in the public policy objectives, or outline public services that the SOE is required to provide. However, to date little has been done to clarify ownership rationales and integrate them into the broader government ownership policy.) The draft corporate governance legislation (so-called ex-6428) may further widen the practice of developing ownership policies for individual SOEs which should include the main objectives of the company, and should in turn inform the development of a strategic plan by the company. At the time writing the provisions of the draft law were still under discussion in government and may be subject to further modification.

\textbf{Box 10.1. Excerpts of rationales established for individual SOEs}

\textbf{Ukrenergo (ownership policy)}

The ownership policy of Ukrenergo approved in June 2020 establishes: 1) public policy objectives, such as dispatching electricity and ensuring operational security of the Integrated Power System of Ukraine, and 2) commercial objectives, such as the provision of electricity transmission services and commercial electricity metering service, among others aspects. It also identifies priorities such as: improving the quality of service provision through the modernisation of fixed assets, including the implementation of programmes of capital construction, technical re-equipment and reconstruction of the trunk and interstate power grids that will create conditions for improving efficiency and reducing operating costs; and ensuring the security of electricity supply and reliability of the functioning of the integrated power system of Ukraine.

\textbf{Naftogaz (ownership policy)}

The ownership policy of Naftogaz, approved in October 2020 (CMU Resolution 982), sets the following rationale for state-ownership: 1) security of natural gas supply to Ukrainian consumers; 2) achievement of Ukraine’s energy independence, in particular, independence from natural gas imports; 3) successful transformation of the energy sector and completion of the natural gas market reform of Ukraine; 4) efficient representation and protection of interests of Ukraine in the domestic and international energy markets, including in relation with national oil and gas companies of other countries, oil and natural gas production, and oil and petroleum products transmission.

\textsuperscript{141} The requirements are set in the legislation according to paragraph 3 of the “Procedure for setting clear objectives for SOEs” (as approved by CMU Resolution No.1052 in November, 2016), ownership entities (or the General Shareholder’s Meeting for majority-owned SOEs) are required to set clear objectives (both commercial and public policy objectives) for their enterprise(s), taking into account the main business activities of the enterprise, and set these on an annual basis by December 15 for the following year. These provisions are also often reiterated in the individual charters of companies.
**Ukrzaliznytsia (ownership policy)**

The ownership policy for Ukrzaliznytsia, approved in 2019 (CMU Resolution 628), establishes the following rationales for state-ownership: 1) satisfying [...] the needs of consumers in services for transportation of passengers and goods by rail (in domestic and international traffic), taking into account the principles of sustainable development; 2) modernising and optimising the infrastructure of public railway transport and the railway rolling stock, and implementing necessary measures for investment activities and capital repairs in order to promote the development of the national economy and improve services for the population; 3) maintaining and improving the financial position of the company; 4) creating a transparent, competitive environment for the introduction of a competitive railway transportation market into the unified transport system of Ukraine, 5) increasing the value of assets managed by the company, particularly through investment attractiveness; 6) ensuring proper corporate governance and compliance with the requirements of the legislation in the field of management of state property and anti-corruption policy; 7) ensuring the development of human resources of the company and the implementation of the function of social responsibility during the activities of the company; 8) ensuring the appropriate level of safety of railway transportation.

**Ukreximbank (Charter)**

The charter of the bank, approved in 2017 and amended in 2020, establishes that the purpose of the bank’s activity is creating favourable conditions for economic development and the support of domestic producers; servicing export-import operations; providing credit and financial support to structural adjustment processes; strengthening and realising production and trade potential of branches of economy and enterprises that are export-oriented, or carry out activities related to the production of import-substituting products; and making profit in the interests of the Bank and its shareholder. More recently, “main directions of activity” for the state-owned banks has been approved by the CMU, which is closer to an ownership policy or owner’s expectations than the charter. Although a broad overview is made publicly available, specific details regarding the activities are not accessible.

Source: (CMU, 2020[215]) (Ukrenergo, 2020[216]) (CMU, 2020[217]) (CMU, 2019[141]) (CMU, 2020[218])
Chapter 11. The state’s role as owner

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

11.1. Simplification of operational practices and legal form

A. Governments should simplify and standardise the legal forms under which SOEs operate. Their operational practices should follow commonly accepted corporate norms.

The legal forms under which SOEs may operate are not fully standardised in Ukraine and include:

- State (unitary) enterprise, which operates as a state-owned commercial entity or as a budget-supported (kazenne) entity
- Joint-stock company (including companies incorporated as “public joint-stock companies” and “private joint-stock companies”), which may also exist as a state-owned management holding company
- State-owned or stated-controlled business association
- Limited liability company
- Municipal unitary enterprise, though other legal forms exist
- Other entities, including state organisations, concerns, institutions, communal enterprises and consortiums, among others

As outlined in Section 4 (also see Figure 4.1), majority of SOEs in Ukraine (86%) operate under the legal form of state unitary enterprises and under the applicable framework, their corporate governance norms often differ from those applicable to JSCs under the JSC law. For instance, state unitary enterprises may face limitations in raising capital or forming alliances through joint ventures, and may not be subject to bankruptcy (if they are budget-supported or kazenne enterprises) (MDETA, 2015[132]). In recent years, however, regulations have been adopted to align certain corporate governance practices in state unitary enterprises with JSCs, including the framework to establish supervisory boards (including independent board members) and committees, as well as disclosure requirements. However, corporate governance practices and standards in state unitary enterprises (especially supervisory board member powers and internal controls) remain weaker compared to JSCs, and often lack enforcement.

Along with introducing legislative amendments, recent reform efforts in SOEs have focused on converting state unitary enterprises into joint-stock companies, particularly those considered to be economically important. A recent example is Ukrenergo, the
transmission system operator in the electricity sector, which was corporatised in 2019 (OECD, 2020[69]). Currently, only 6% of the Ukrainian centrally-owned portfolio of SOEs have been corporatised into joint stock companies and, among the top-15 SOEs, only 8 are corporatised. According to the MDETA, while working towards corporatising the remainder of the top-15 SOEs, approximately a dozen additional SOEs out of the total SOE portfolio are planned for corporatisation.142

However, corporatising SOEs to ensure the application of the JSC law does not automatically mean that they will be subject to the same corporate governance norms as comparable privately-owned companies. Differences may apply across various areas, including public procurement practices, bankruptcy or insolvency procedures, access to finance and the availability of state guarantees, independence requirements for supervisory boards, and requirements regarding setting up supervisory board committees, as well as nomination and appointment practices of their governing bodies (further elaborated in subsequent sections).

The main legal framework applicable to SOEs, regardless of corporate form, is the Law on Management of Objects of State Property (SOE law). In addition, there are orders, decrees and regulations that further frame corporate governance practices in the SOE sector. This body of law elaborates certain procedures (including supervisory board member and CEO appointments) and differentiates practices across state unitary enterprises and JSCs, as well as entities deemed “strategic” or “economically important”. The existence of multiple SOE legal forms and categories has meant that there are no simplified or standardised practices that apply to SOEs in Ukraine in terms of corporate governance and the applicability of laws.

Notable differences in their corporate governance practices are summarised in Table 11.1 and some examples (non-exhaustive) are provided as follows, and in subsequent sections:

- **Selection and appointment of supervisory board members.** The JSC law calls for supervisory board members to be elected during the general meeting of the shareholders. However, in majority-owned SOEs, supervisory board members are elected based on the CMU resolutions 142, 143 and 777, and are formally subject to approval by their ownership entities and/or the CMU (note: as further elaborated in this review, procedures vary depending on whether an SOE is deemed economically important).143

- **CEO selection process.** JSCs and state (unitary) enterprises must have an appointments committee involved in the CEO selection process. However, the extent of the involvement of supervisory board members in selecting CEOs varies between SOEs based on the provisions laid out in CMU Resolution 777. Actual practice will depend on provisions in company charters and may involve the government nomination committee (note: in state-owned banks, the supervisory board determines the procedures for CEO selection).

- **CEO appointment and dismissal.** According to the SOE law and certain CMU resolutions, CEOs may be appointed and dismissed directly by ownership entities

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142 The list communicated to the Secretariat as of end January 2021 includes: Ukrhimtransamiak, Market Operator, Energoatom, Uktelefilm; Antonov, Plant 410 CA, Chuguyevskiy Aviation Repair Factory, Production Association Karpaty, General purpose aviation research and development bureau, Plant Electrotyazhmash, State enterprise of special communication, Ukrainian Research Institute of Radio and Television, and Ukrainian special systems.

143 Moreover, these processes are not applicable to the GTSO, which is an LLC and is not directly owned by the state.
or the CMU (unless otherwise indicated in the Charter). The JSC law grants the supervisory board the right to appoint and dismiss the CEO (note: however, in JSCs, the charter may grant the general meeting the right to dismiss the CEO).

- **Minimum number of independent directors.** The SOE law requires a majority of independent members on supervisory boards of SOEs (regardless of corporate form), whereas the JSC Law requires a minimum of one-third (or at least 2) independent directors (in practice, requirements under the former are met). Currently, 8 SOEs out of top-15 are in alignment with this requirement (with the exception of Polygraph Combine Ukraina).

- **Board committee requirements.** While the CMU Resolution 142 contain basic provisions regarding the establishment of board member committees, the JSC law outlines more thorough requirements regarding the functioning of the committees. Moreover, the Law on Banks and Banking contains provisions to establish a risk committee, which is absent in the JSC law and resolutions applicable to SOEs.

- **Limited powers of supervisory boards.** In SOEs, the state is still involved in the approval of key corporate documents that would traditionally sit with the supervisory board, such as the strategy and financial, business and investment plans. In addition, in JSCs supervisory board can approve significant transactions (including those over 50%) if it has at least one-third independent directors and if this is allowed in the charter, which is not applicable to state unitary enterprises.

- **Transparency and disclosure.** In large SOEs, public interest enterprises and those that have monopoly or exclusive rights, requirements for transparency and disclosure are more strictly enforced (compared to other SOEs), and independent audits are required (see Section 15). However, implementation is still nascent. Moreover, further reporting requirements may be strictly applicable to JSCs that fall under the oversight of the NCSSM.

- **Bankruptcy and insolvency.** While only budget-supported SOEs are exempt from bankruptcy rules (as per Commercial Code), all SOEs in Ukraine access finance with an explicit state guarantee due to a legal requirement for the assets of an SOE to remain in state ownership. *De facto*, many SOEs are prevented from bankruptcy due to state intervention, or other laws and moratoria in place that prevent any action by creditors.

Legal forms of SOEs do not affect the position of employees compared to other companies, as far as the assessment team is aware, except for the requirement for employees to fulfill the electronic asset declarations.
Table 11.1. Comparison of corporate governance practices across SOEs

<table>
<thead>
<tr>
<th>Legal form</th>
<th>Summary of corporate governance practices</th>
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| State unitary enterprise          | • Governed under the Law on Management of Objects of State Property and the Commercial Code. Ownership entities (including the CMU) exercise ownership rights, approve statutes and strategic, financial and investment plans, develop SOE key performance indicators, and engage in supervisory board member and CEO selection and appointments. For the SOEs deemed economically important, the supervisory board member and CEO appointments carried out through a nomination committee under MDETA, while the CMU approves appointments. Supervisory board (with a majority of independent members) is required to be established only if SOE assets (or authorized capital) exceed UAH 2 billion or net income exceeds UAH 1.5 billion, or if the SOE is a public JSC, or a private JSC with at least 10 shareholders. Independent board members are appointed through a competitive selection procedure, while state representatives are directly appointed by ownership entities. Supervisory board establishes committees (including on audit, remunerations and appointment), sets up internal audit, and selects independent auditor (although revision commissions may still be present, see Section 16.10). Supervisory board also approves draft strategic and financial plans. The financial plans may be subject to CMU’s approval if an SOE is a natural monopoly or its profits exceed UAH 50 million. SOEs are required to publish information, including financial statements, annual reports, and charters, as outlined in Section 15 of this review (also see CMU Resolution 1067).  
• Supervisory board and CEO appointments are subject to mandatory independent audits by an external auditor proposed by the supervisory board, though the process is less rigorous. 
• Supervisory board and CEO appointments are subject to the National Bank of Ukraine’s approval. Supervisory board appoints/dismisses the head of internal audit. Similarly to other SOEs, revision commissions may still be present in some state-owned JSCs (as elaborated under Section 16.10). 
• Corporatised SOEs are subject to similar disclosure requirements as other SOEs (as further outlined in CMU Resolution 1067). The companies may be subject to additional reporting and disclosure requirements, under the regulations of the National Commission on Securities and Stock Market.  |
| Joint-stock company               | • Governed under the Law on Joint Stock Companies and the Law on Management of Objects of State Property, among others. CMU and ownership entities may corporateise SOEs to improve their corporate governance functions. Supervisory board (1/3 independent and at least two independent directors across JSCs, but in practice, there is consensus that there should be an independent majority in JSCs that are SOEs) is required to be formed in joint-stock companies that are public, or private with 10 or more shareholders. Similarly to other SOEs, supervisory board members should form committees on audit, remuneration and appointments. They may also be more actively engaged in performing functions, including setting remuneration and determining terms of contract with company officers, approving significant transactions, and defining issues related to the company’s sub-divisions. Under the JSC law, the power to appoint the CEO is reserved for the supervisory board, though in corporatised SOEs, this is often not the case and procedures are outlined in the company’s charter.  
• Annual financial statements are subject to mandatory independent audits by an external auditor proposed by the supervisory board for approval for the general meeting (shareholding entity). The supervisory board appoints/dismisses the head of internal audit. Similarly to other SOEs, revision commissions may still be present in some state-owned JSCs (as elaborated under Section 16.10). 
• Corporatised SOEs are subject to similar disclosure requirements as other SOEs (as further outlined in CMU Resolution 1067). The companies may be subject to additional reporting and disclosure requirements, under the regulations of the National Commission on Securities and Stock Market.  |

<table>
<thead>
<tr>
<th>Status</th>
<th>Summary of corporate governance practices</th>
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| Economically important SOEs        | • Entities deemed economically important are those with over UAH 2 billion in asset value (or authorised capital in a newly created entity), or over UAH 1.5 billion in net income. 
• Supervisory board members are appointed through a competitive procedure and are selected by a permanent nomination committee, consisting of the Ministers (or Deputy Ministers) of MDETA, the Ministry of Finance, and the ownership entity, and non-governmental members appointed by the CMU (applicable to SOEs directly owned by the state). State representatives are also subject to approval of the nomination committee, though the process is less rigorous. 
• Supervisory board and CEO appointments are subject to CMU’s approval, though some SOEs may be exempt depending on the requirements under the company charter and its legal form. Supervisory boards may appoint CEOs only if stated so in the charter.  |
| Strategically important SOEs       | • CMU determines the list of strategically important SOEs (Resolution No. 83 2015-n), under which certain corporate governance practices would apply. Notably, CEO appointments, as well as any reorganisation of the SOE, are subject to the CMU’s approval.  |

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<tr>
<th>Exceptions by type</th>
<th>Summary of corporate governance practices</th>
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| State owned banks                  | • Governed under Article 7 of the Law on Banks and Banking (except for Ukrgasbank, which is 94.94% state-owned and operates under the legal framework of private banks and other SOEs. Article 7 applies to state-owned banks that are 100% state-owned). CMU approves the charter, determines the main activities of the state-owned bank, develops the strategy and approves annual reports (often through the Ministry of Finance). It determines the bank’s strategic activities and approves development strategies. The CMU also appoints and terminates the powers of the supervisory board members, sets their remuneration, and determines the criteria for selecting an external auditor. 
• State representatives on boards are appointed by CMU, the President, and Verkhovna Rada. Independent supervisory board members are appointed based on a competitive procedure and are subject to the NBU’s approval. Supervisory board approves principles of corporate governance and auditors’ conclusions, and establishes board committees (including on risk, audits, appointments and remunerations). It also drafts development strategies and selects the CEO (subject to the National Bank of Ukraine’s approval).  |
Defence companies
- Governed under the Law on Managing State Property in Defence-Industrial Complex (applies to Ukroboronprom and its members).
- Supervisory board members in Ukroboronprom are directly appointed by the CMU and the President, without a formalised competitive, merit-based procedures, and are not remunerated.
- In other defence SOEs (fully owned by the state) that are “participants of State Concern Ukroboronprom” (that is, overseen by Ukroboronprom), the CEOs and member of other governing bodies (including supervisory board members) are appointed by the CEO of Ukroboronprom without a formal procedure.
- Ownership entity appoints and dismisses CEOs of Ukroboronprom’s subsidiaries, but the President appoints and dismisses the CEO of Ukroboronprom (parent company) upon the Prime Minister’s proposal.

Municipally owned enterprises
- Established by local governing bodies that form its authorised capital. Governing bodies include the head and the supervisory board (which is often not formed).
- Ownership entities are responsible for appointing the heads of entities under their sphere of management, and the supervisory board members (if formed) monitor and direct their activities. There are no requirements regarding the establishment of an independent supervisory board. The CEO selection process needs to be competitive in certain entities (including military and educational institutions).
- Annual financial statements of the municipally owned enterprises may be audited, and information should be published regarding their objectives, audited reports, annual reports, etc. according to the Commercial Code.

Other exceptions
- Ukroboronprom: Governed under the Law on Peculiarities of Establishment of Joint Stock Company of Railways Transport of Common Use. The CMU is the ownership entity and exercises ownership rights through the Ministry of Infrastructure, which prepares the respective decisions of the CMU. The Ministry of Infrastructure also acts as a regulator in the railway sector.
- Naftogaz’s subsidiaries: governed by applicable legislation depending on their legal form. Naftogaz exercises its shareholders rights with certain restrictions (e.g., financial plans of natural monopolies are subject to approval by the CMU).
- Odessa Portside Plant and other SOEs in the process of privatisation being under management of the SPFU: governed by applicable legislation depending on their legal form. In many instances, supervisory boards with independent members are not appointed regardless of whether the SOEs qualify for the mandatory appointment of such board. The SPFU, being a majority shareholder, often appoints its representatives to the supervisory board without a clear and transparent selection procedure.

**Note:** A more thorough review of SOE corporate governance functions may be found under the subsequent sections. Source: Author’s compilation is based on the Law on Management of Objects of State Property, the Law on Joint-Stock Companies, the Law on Banks and Banking, among others.

### 11.2. Political intervention and operational autonomy

**B. The government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management. The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner.**

The Law on the Management of Objects of State Property defines the list of powers vested in the governing bodies of an SOE and the powers generally do not provide for day-to-day interference by owners. However, the state is still involved in approving key corporate documents (e.g. strategy, financial and investment plans), which often results in multiple and competing objectives for SOEs.

The JSC law delineates the role of the supervisory board and enumerates their rights and obligations to “protect the right of shareholders” and the Commercial Code (Articles 6, 19, 23, 136) directly prohibits illegal interference in SOE activities by the ownership entity, public authorities, local governments, their officials, as well as officials directly involved in the exercise of state control and supervision (Verkhovna Rada, 2003(9)). However, as noted above, the absence of clarity and visibility for governing bodies in the relevant body of law and regulation that assigns their respective roles and responsibilities creates opportunities for undue political intervention. Moreover, Article 5 of the State Property Management Law and CMU resolution 777 provide wide powers to the state as an owner to be involved in the appointment and dismissal of the CEO (especially for economically important SOEs and those falling under the ownership of the CMU). The draft corporate governance legislation (so-called ex-6428), while intending to secure the autonomy of supervisory boards and better enumerate grounds for board member dismissals, does not rule out
the possibility for political interference. Moreover, an important sub-set of the economically-important SOEs (including those under the CMU’s ownership and the defence sector) remain carved out from the applicability of certain provisions pertaining to corporate governance practices of the draft law. At the time writing, the provisions of the draft law were still under discussion in government and may be subject to further modification.

Among some of the top-15 SOEs and state-owned banks, which have undergone major corporate governance reforms and have functioning independent supervisory boards, significant improvements have been made to limit the incidence of undue political interference. Nevertheless, stakeholders observe that there is persistent pressure on supervisory boards in the form of direct or indirect political influence on decisions reserved for the governing bodies of SOEs, or threat of law enforcement action and criminal investigations being initiated against executive and non-executive directors. This type of undue interference has led to a slew of prominent board members to resign over the course of the last few years (OECD, 2019[40]) (Reuters, 2017[219]) (Kyiv Post, 2020[220]) (Atlantic Council, 2020[221]) (Aslund, 2020[222]).

Undue interference by the state-owner in SOEs’ day-to-day operations can manifest itself through a variety of mechanisms, including (non-exhaustive):

- As sole or dominant shareholder in most SOEs, the state can control corporate decisions (due to the appropriation of powers generally conferred to the general shareholders’ meetings)
- Contradictory legal provisions that limit SOEs’ operational autonomy, especially with regard to the roles and responsibilities of supervisory boards of SOEs
- Direct oversight responsibility over management and audit functions of SOEs which lack supervisory boards, or where there is no independent supervisory board
- Ability to appoint CEOs in SOEs (except in rare cases where the Charter of the company says otherwise), as well as direct Presidential appointment of the head of Ukroboronprom
- Multiple and competing commercial and non-commercial objectives, and ad hoc PSOs
- Approval of key corporate documents, such as the strategy and financial, business and investment plans

Some international board members have cited political pressure, undue political interference in boards and the threat of criminal cases being initiated to impose pressure as examples of challenges in associated in working on the supervisory boards of Ukrainian SOEs. In addition, in February 2021, Ukraine’s acting Minister of Energy proposed that the Prime Minister submit for the CMU’s consideration the dismissal of Naftogaz’s CEO and the termination of contracts with the supervisory board members (Ukrinform, 2021[328]). In April 2021, the CMU dismissed both the supervisory board and the CEO of Naftogaz (citing unsatisfactory performance in 2020), and appointed the acting Minister of Energy as the new CEO, after which the same supervisory board members were re-appointed (CMU, 2021[67]). The CMU also amended Resolution No. 777 to exempt the appointment of Naftogaz’s CEO based on the established competitive selection procedure in economically important SOEs (CMU, 2021[160]).

While appointments are competitive in economically important and strategic SOEs, the process may be more basic in other SOEs where ownership entities can directly appoint CEOs.

SOE law also has language regarding the functions of ownership entities that may further extend their powers. For example, they should monitor the “implementation of indicators of financial plans of enterprises belonging to the scope of their management and take measures to improve their work”—which is open to interpretation. In some cases, the ownership entities may also delay the approval of strategic documents (such as financial plans), which interferes with SOE operations.
- Unexplained delays or set-backs in convening the nomination committee for supervisory board or CEO appointments
- Nomination of candidates with perceived or actual conflicts of interests in SOE governing bodies, and nomination of state representatives according to minimal selection criteria and quick nomination process
- Direct instructions to the state representatives on matters that are within the supervisory board’s competence
- Direct dismissal of individual supervisory board members by the ownership entity (except in state-owned banks)
- Appointment of acting CEOs in economically important SOEs, thereby bypassing a competitive selection process
- Existence of revision commissions directly in SOEs and conducting unscheduled audits when CEOs are dismissed
- Approval of domestic and foreign borrowings
- Unwarranted inspections by state audit and other oversight bodies, or potential for politically-motivated criminal prosecutions against executives or supervisory board members.

A draft law is currently under development, which would aim to address some of the inconsistencies in the legal framework and better enshrine the power of supervisory boards in legislation, while reducing the scope for undue intervention in SOEs. However, it is worth noting that the draft law has undergone multiple revisions over the years. Moreover, an important sub-set of the economically-important SOEs remain carved out from applicability of the draft law. At the time writing, the provisions of the draft law were still under discussion in government and may be subject to further modification.

11.3. Independence of boards

C. The state should let SOE boards exercise their responsibilities and should respect their independence.

The Law on State Property Management introduces the requirement for supervisory boards in SOEs to be comprised of a majority of independent members. As mentioned, currently only 8 out of the top 15 SOEs have boards which fulfill the requirement of the law, and the remainder are the focus of future reform efforts (see Table 6.1). Along with reforms in the top-15 SOEs, all state-owned banks fulfill the criteria for independent supervisory boards, which are regulated by the NBU. For the remainder of the portfolio, SOE governing bodies cannot be considered to operate independently of government shareholders and management, and, in most cases, company representatives are directly appointed by line ministers. The same is applicable for municipally-owned enterprises.

State representatives, when appointed on SOE boards where there are independent board members, are said to act independently from the state and have the same rights and obligations as other board members. While the 2016 amendment to the SOE law sought to eliminate written instructions on how to vote on the agenda, in practice the actual independence of the state representatives from the state is nominal, since they
can be dismissed and replaced at any time. However, concerns with conflicts of interest with certain state representatives have been raised (see Section 16).\footnote{147} The aforementioned draft law amending the corporate governance of SOEs, would aim to address some of the inconsistencies in the legal framework and better enshrine the independence and fiduciary duties of supervisory boards in legislation.\footnote{148}

11.4. Centralisation of the ownership function

D. The exercise of ownership rights should be clearly identified within the state administration. The exercise of ownership rights should be centralised in a single ownership entity, or, if this is not possible, carried out by a co-ordinating body. This “ownership entity” should have the capacity and competencies to effectively carry out its duties.

As noted in Section 5 under Part I, state ownership in Ukraine is fully decentralised, with over 80 entities exercising ownership rights. This excludes the ownership arrangements for entities held at the sub-national level (see Section 8 and Annex A). The Law on Management of Objects of State Property (Article 1) identifies that the exercise of ownership rights is assigned to the CMU and a long list of “authorized bodies” defined under Article 4 of the Law.\footnote{149}

According to this body of legislation, under the delegated authority of the Cabinet of Ministers (CMU), the Ministry for the Development of Economy, Trade and Agriculture (MDETA), the Ministry of Finance, and other line ministries are responsible for developing state policy in the field of state property management (see Table 5.1). However, all these entities also exercise shareholder rights in SOEs under their ownership, while simultaneously having a broader mandate to shape the institutional, legal and policy environment in which SOEs operate. Most of these disparate ownership entities combine multiple roles, including exercising ownership rights, formulating state policy and, at times, setting regulation. This results in a goal conflict and impairs their ability to effectively oversee their portfolios as an active and professional owner.

As described in Section 5, while the CMU has the overall responsibility for state property matters, it delegates many of the day-to-day responsibilities to the State

\footnote{147} The SOE law and CMU Resolution 142 clearly state that independent board members should be impartial and act in the company’s interests, which does not necessarily seem to be the case for state representatives (also mentioned in Section 16). However, Article 11 of the SOE law states that state representatives can independently make decisions.\footnote{148} The draft Law ex-6428 currently under discussion may stipulate fiduciary duties. The language as it currently appears would aim to establish: the obligation to act solely in the interests of the legal entity, in good faith and reasonably, within the powers conferred by the statute of the legal entity and the law, and in a manner that will achieve the goal of the legal entity, including avoiding conflict interests.\footnote{149} This list includes: the Cabinet of Ministers; the central executive body which ensures the formation and implementation of state policy in the field of management of state property (MDETA); ministries and other executive bodies and state collegial bodies (authorized ownership entities); State Property Fund of Ukraine; bodies that ensure the activities of the President of Ukraine, the Verkhovna Rada (parliament) of Ukraine and the Cabinet of Ministers of Ukraine; bodies that manage state property in accordance with the powers defined by certain laws; state business associations; state holding companies, other state economic organizations, state enterprise, institution, organization or business association, 100 percent of shares of which belong to the state or other business company, 100 percent of shares owned by the state; National Academy of Sciences of Ukraine, industrial academies of sciences.
Property Management Department of MDETA which is the main developer of draft acts of the Cabinet of Ministers on issues related to the exercise of ownership rights or state-ownership policies by the CMU. As elaborated in Section 5 and Table 5.1, MDETA has been the main driver behind establishing the overall remuneration policy, the dividend policy, and the Basic Principles (ownership policy), while setting the reform agenda and overseeing the development of corporate governance action plans for the top-15 SOEs.

MDETA also convenes (on behalf of the CMU) the nomination committee for the nomination of supervisory board members and executives of economically important SOEs. It centralises information on financial and economic activities of individual entities and publishes an online aggregate inventory of SOE financial information (ProZvit). The Ministry has also been the main hand behind draft legislation and policies bearing on corporate governance of SOEs, including draft law 6428, as well as the more recent draft corporate governance law (ex-6428) that is currently under discussion. Furthermore, MDETA spearheaded discussions and initiated plans for the reorganisation of ownership arrangements (National Wealth Fund) and developed the “triage” strategy behind the 2018 Privatisation Law. To support these various initiatives, MDETA has made use of de facto non-governmental support and advisory groups which are part of donor-funded “reform support architecture” aimed at strengthening government capacity to design and implement public sector reform (see Box 11.1).

**Box 11.1. Reform initiatives and advisory groups under MDETA**

In supporting reform initiatives, MDETA has made use of de facto non-governmental support and advisory groups that are part of donor-funded “reform support architecture”, which have sought to strengthen government capacity in designing and implementing public sector reform. These units, including the Reform Delivery Office (in the CMU) and Reform Support Teams (in the MDETA), which have brought relevant “pools” of expertise to the ministry, are often responsible for spearheading the reform process. In addition, the Strategic Advisory Group for Supporting Ukrainian Reforms has been involved in high-level advice and guidance to the political leadership. The experts, who are financially supported by IFIs and receive additional multi-donor support, are funded outside of the civil service remuneration framework, which allows MDETA to tap into a broader pool of local and international expertise. However, as noted in earlier OECD analysis, these bodies are of a consultative and advisory nature, and are not integrated into the fabric of existing institutions, thus their ability to influence political processes can be limited. Moreover, their dependence on IFIs and donor financing also means that they are vulnerable to change.

Source: (OECD, 2019).  

The actual ownership units in line Ministries are financed from the Ministry’s or the Agency’s budget assigned from within the state budget. The CMU reports that the remuneration of civil servants and the staffing of ownership units in individual ownership units are often not sufficient to carry out ownership functions (although resources vary from ministry to ministry), but recognize that this is a general

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150 In some cases funding is insufficient (such as in Ministry of Energy), but other ministries (such as Ministry of Finance) have better resources and staffing (including a unit dedicated to overseeing SOEs) and fewer non-financial SOEs to oversee.
challenge for the Ukrainian public administration (refer to Section 5.1.3 for further details on staffing across various line ministries).

While MDETA coordinates the broad based policy for SOE reform, it has no control over the actions and activities of other ownership entities, without the political support of the CMU. However, political support at the level of the CMU can be challenging depending on the level of political will across various line ministries and heads of government to undertake whole-of-government reform. MDETA and the Ministry of Finance do not appear to coordinate actions to identify key risks when drafting annual fiscal risk reports related to the broader SOE portfolio, or while devising a dividend policy and guidelines for assessing capital structure appropriateness (Ministry of Finance, 2021[223]). The Ministry of Finance is more focused in its role as focal point for corporate governance of state-owned banks (regulated by NBU). The central role of MDETA could be further strengthened to give more capacity and responsibility to coordinate ownership responsibilities from a whole-of-government perspective.

As mentioned, the previous government had developed concrete plans to establish a centralised holding (so-called National Wealth Fund), but the plans were put on hold by the current government, and the previously planned budget for its establishment was later removed from the 2020 State Budget. Future ownership arrangements are still under discussion, particularly in the framework for the development of the economic strategy until 2030, though no concrete plans have been shared with the assessment team. Moreover, there is no budget foreseen for the creation of the National Wealth Fund in 2021.

It also bears mentioning that the State Property Fund Ukraine (SPFU) is another key institution exercising ownership responsibility in Ukraine. Its main role is privatising SOEs, while remaining as an agency at arm’s length with its own budget, and separate from MDETA and other line Ministries (See Section 5 and Box 5.2). The SPFU is trying to build a better track record with small scale privatisation activity despite lacklustre results seeing through large scale privatisation (also see Section 9.6). It has recently undergone a significant restructuring to streamline its operations and introduced new draft legislation (draft law 4543) to build SPFU’s funding and thus capacities to see through large-scale privatisation. The draft law was passed in March 2021 (Verkhona Rada, 2020[224]).

11.5. Accountability of the ownership entity

E. The ownership entity should be held accountable to the relevant representative bodies and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

The accountability requirements of the ownership bodies (i.e. the line ministries) to the parliament are defined indirectly via the accountability of government ministers, and more generally of government to the parliament. There are, however, no specific

[151] Until recently, the Ministry of Finance was also responsible for the oversight of the two key state-owned transmission system operators. However, according to a new order issued by the government, these two TSOs will be transferred back to the Ministry of Energy, while the energy generation companies have since been transferred to the CMU to ensure the ownership arrangements meet the ownership unbundling requirements set out by the EUs Third Energy Package (CMU, 2021[48]).
requirements for the line ministries, nor the units within them that are responsible for SOEs, to report directly to parliament regarding the carrying out of their state ownership function. The activity of state and municipally-owned enterprises is externally audited by the State Audit Service under the direction of the CMU and the Ministry of Finance.\textsuperscript{152} It is responsible for implementing policy in state financial control and monitoring the efficiency of the use of public resources, while having broad legal and sanctioning powers. In addition, the Accounting Chamber under the supervision of the parliament controls the receipt of funds in the state budget and monitors their use (as outlined in more detail under Section 15.2).

CMU Resolution 832 (CMU, 2007\textsuperscript{[225]}) identifies accountability procedures for ownership entities, which requires quarterly and yearly reporting to the MDETA on the following areas:

- management effectiveness assessments
- indicators of financial and economic activity of business entities
- the state of implementation of financial plans by business entities and their solvency
- compliance with the law on the use and preservation of state property
- performance of duties by management entities in accordance with the legislation

A 2017 audit by the Accounting Chamber found that these statutory reporting mechanisms tend to be a “formality" with little impact on SOE corporate governance practices, as well as on managerial or strategic decisions pertaining to state property management (CMU, 2020\textsuperscript{[42]} (OECD, 2019\textsuperscript{[40]}).

According to Article 4 of the Law on State Property Fund, the SPFU is accountable to the President and should submit quarterly and annual reports to the President, the Verkhovna Rada as well as the CMU on its activities.

11.6. The state’s exercise of ownership rights

\textbf{F. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Its prime responsibilities include:}

\textbf{F.1. Being represented at the general shareholders meetings and effectively exercising voting rights;}

The rules and procedures guiding state representation in general meetings are defined in Article 11 of the Law on Management of Objects of State Property which provides that “the representative of the state at the general meeting and meetings of supervisory boards (member of the supervisory board) independently makes decisions on the agenda, except as provided by this law”.

The law stipulates that the state as a shareholder has the right to vote at the general meeting on significant transactions (i.e. the value of which represents 25 percent or more of the assets of the company according to the latest annual financial

\textsuperscript{152} MOEs can be audited only to the extent of use of funds from the state budget or if they have any state tax exemptions. However, if requested by municipalities, the use of funds from local budgets can also be audited.
The vote is carried out by a state representative at the general meeting solely on the basis of a power of attorney granted by the ownership entity. In companies of “strategic importance for the economy and security of the state” in which the state holds more than 10 percent of shares, the votes taken at the general meeting are based on the decision of the CMU. Voting in companies in which CMU directly exercises ownership rights is subject to a slightly different procedure, whereby an order of the CMU is required. A draft is developed and submitted by MDETA within 10 days from the application by the SOE or from receiving an order from the CMU to prepare a draft order. However, in certain SOEs (such as Naftogaz), the powers of the general meeting are exercised by the shareholder alone, as specified in its Charter (CMU, 2015[226]) (CMU, 2020[227]).

Moreover, CMU Resolution 678 establishes the procedure for voting by representatives of the state at the general meeting of the company. This procedure stipulates that SOEs issue an order approving the task for voting no later than 15 days before the date of the general meeting. For votes relating to the governing bodies of SOEs, the order shall be made four days before the date of the general meeting (CMU, 2014[228]).

The JSC Law requires holding an annual general shareholder meeting, though an extraordinary meeting can be held (Article 47) at the request of the board, any shareholder with more than 10% of voting shares, the auditor or in other cases established by the Charter.

It is worth noting that in any JSC with a sole shareholder, there is no legal requirement to convene a general meeting and voting is done through the procedures established above. It is however unclear how actively represented the state is at the general shareholders’ meetings of partially privatised state-owned companies and how frequently it exercises its voting rights.

F.2. [The state’s prime responsibilities include:] Establishing well-structured, merit-based and transparent board nomination processes in fully or majority-owned SOEs, actively participating in the nomination of all SOEs’ boards and contributing to board diversity;

In most SOEs, the Law on Management of Objects of State Property empowers the ownership entity to have the following responsibilities with regard to board nomination and practices:

- Approve relevant amendments to the company’s charter (envisioning a supervisory board and its powers);
- Approve a board nomination policy;

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153 If required, transactions worth over 25% of asset value may be approved by a state representative. However, in general, under both JSC and SOE laws transactions worth at least 10% of the asset value have to be approved by the supervisory board, though additional requirements may apply depending on the board composition and value of the transaction. If there is no supervisory board, the ownership entity approves the transactions.

154 Similarly to other JSCs, the general meeting in SOEs can vote on matters reserved for it by law and on any other matters, except for those reserved for the supervisory board. However, in SOEs, matters reserved for the supervisory board (especially in corporatised SOEs) may not always be clear (such as CEO appointments).

155 Previously, there was an issue with Ukrnafta, when the quorum requirement had to be changed/decreased to unblock decision-making by the shareholders’ meeting.
• Establish a nomination committee, which develops the selection criteria for the supervisory board members (which should comply with the framework established under the Law on Management of Objects of State Property and relevant secondary legislation) and, based on these criteria, places a public announcement of the vacancies (except in economically important SOEs)\textsuperscript{156}

• Launch a competitive selection for independent board members

• Propose state representatives on the supervisory board to be approved by the CMU in economically important SOEs (otherwise directly appointed by the ownership entity)

• Determine the terms of contract and remuneration for the board members within the framework set by the CMU (except in economically important SOEs)\textsuperscript{157}

• Evaluate performance results of the supervisory board members based on the key performance indicators (CMU, 2017\textsuperscript{[161]})

The procedures for board nomination were fundamentally overhauled following the amendments to the Law on Management of Objects of State Property in 2016. Overall, the nomination process in SOEs is governed by a set of three CMU Resolutions, namely Nos. 142, 143 and 777 (further elaborated in Section 6 and Annex D). In general, the CMU Resolution No. 143 is applicable to the appointment of state representatives (including in economically important SOEs), and Resolution No. 142 is applicable to the appointment of independent supervisory board members in most SOEs.

However, if SOEs are deemed economically important, then the same selection procedures are applicable to both independent supervisory board members and CEOs based on CMU Resolution No. 777. In other SOEs, the ownership entity may decide to use the same procedures as those for economically important SOEs (under CMU Resolution No. 777), but in practice, procedures under the CMU Resolution 142 would apply. Appointment procedures for state-owned banks are set out according to a separate procedure identified by Article 7 of the Law on Banks and Banking and CMU Resolution 267 (See Section 7.4). There are also a number of exceptions to the rules, particularly for SOEs operating in the defence sector.\textsuperscript{158}

For economically important SOEs, the ownership entity is responsible for announcing the competition, and should submit information regarding the SOE performance (such as financial statements), as well as draft selection criteria for independent board members to MDETA and CMU. To launch the competitive selection process, the ownership entity announces the vacancy (and, if it does not do so within 30 days, then the CMU and MDETA may initiate it).

Independent board members are appointed through a competitive selection process involving a nomination committee. In most SOEs, the ownership entity appoints the nomination committee which selects the candidate (see Annex D). In economically important SOEs, however, a permanent nomination commission has been

\textsuperscript{156} In economically important SOEs, the selection criteria are proposed by the permanent nomination committee.

\textsuperscript{157} In economically important SOEs, the material terms of contract and remuneration are proposed by the permanent nomination committee.

\textsuperscript{158} In addition, CMU Resolution No. 777 contains a long list specific SOEs excluded from its coverage. These include the selection in the defence sector (both supervisory board members and CEOs), Ukrzaliznytsia (CEO), Naftogaz and its subsidiaries (CEOs), the National Public Television and Radio Broadcasting (both supervisory board members and CEOs), and the State Space Agency, among others.
established, consisting of the Ministers or Deputy Ministers of MDETA, the Ministry of Finance, and the ownership entity, and four independent (non-governmental) experts with the right to an advisory vote (Box 11.2). There is a requirement for the committee to meet on a quarterly basis, although the regularity of its meetings is not always assured. It elects a committee chair and a deputy chair responsible for organising committee work and convening meetings. The members also elect a secretary (not a member of the committee) responsible for counting votes and announcing the results.

The main tasks of the nomination committee are as follows:

- Approving the selection and evaluation criteria for the candidates (and for the executive search consultants who participate in the selection process)
- Approving the vacancy announcement
- Determining the candidacy of an applicant and submitting conclusions to MDETA for approval
- Preparing recommendations on the essential terms of contract
- Approving the report on competitive selection of professional executive search consultants
- Approving the pool of reserve candidates that may replace the selected candidate in case the latter declines, does not get appointed, or resigns prematurely.

Executive search consultants also assist with the independent board member selection process, and their main tasks are as follows:

- Drafting requirements for applicants and vacancy announcements, along with selection and evaluation criteria, and pre-selecting candidates from the initial pool (subject to the nomination committee’s approval)
- Assessing the candidates approved by the nomination committee and submitting shortlisted candidates to the nomination committee
- Submitting a report assessing three to five individuals per vacancy, including detailed candidate reports.

Following the selection, the committee prepares conclusions and proposals for the approval of MDETA, which are submitted to the CMU. After the CMU’s decision, the selected candidate is formally appointed by the ownership entity and a contract should be concluded. If the CMU does not approve the candidate within one month, or if the appointment is terminated within ten months, the selection committee should prepare proposals for the approval of other shortlisted candidates. If there are no suitable candidates, the process may be re-launched.

Along with independent members, the state representatives are also appointed through a selection process in economically important SOEs. However, the process is much less rigorous, as it involves the ownership entity submitting names for the committee’s approval. If the committee does not support the candidacy, the ownership entity may propose another candidate. In case there is no agreement, MDETA may submit a draft decision for the CMU’s approval regarding the candidacy of a state representative to the supervisory board of the SOE (CMU, 2020[42]) (CMU, 2017[229]).

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[159] Formally, it is known as the Committee for the Appointment of Heads of Enterprises Especially Important for the Economy, commonly referred to as the “SOE Nomination Committee”.
In all other SOEs, the ownership entities may directly appoint state representatives to the supervisory board.

As noted in Section 6, these procedures have mostly been applied in economically important SOEs, such as Ukrenergo, Ukrzaliznytsia and Ukrposhta. The nomination of Naftogaz’s supervisory board members in 2017 and 2019 were exempt from these regulations by the CMU, and the appointments were done directly by the CMU without a transparent selection process.

The new procedures for board nomination, as per the process established in 2018, is a welcomed development to professionalise the board nomination process, while ensuring that suitable candidates, with the right skill sets and level of independence, are identified. However, it should be noted that over the course of 2020, the nomination committee has faced some setbacks, reportedly due to the remuneration caps set in response to the Covid-19 crisis (now revoked) and the change in government. Some stakeholders have questioned the rationale behind the delays and pointed to the disruptions caused to the work of boards. Moreover, one ownership entity cited concerns about potential undue interference in the work of the nomination committee exercised through politically connected individuals with vested interest.

While the framework for nomination has been established, no measures to encourage gender diversity on boards and senior management exist in Ukraine. However, according to the calculations of the assessment team, approximately one-fifth of the board members in SOEs are women.\textsuperscript{160}

Box 11.2. Nomination committee in economically important SOEs

For entities deemed economically important for the economy, the CMU has formed a nomination committee, and MDETA provides informational, organisational, and logistical support. The composition of the committee has changed over the years, and it currently consists of the following:

- Minister for the Development of Economy, Trade and Agriculture (who can be substituted by a Deputy Minister if the Minister is absent);
- Minister of Finance (who can be substituted by a Deputy Minister if the Minister is absent);
- Head or deputy head of the ownership entity;
- Four independent (non-governmental) experts (approved by the CMU).

Currently, the four independent members are: the IMF Resident Representative in Ukraine; the IFC Regional Manager for Ukraine, Belarus, and Moldova; the EBRD Managing Director for Eastern Europe and the Caucasus; and the Business Ombudsman.\textsuperscript{161}

\textsuperscript{160} On average, 25.5% of women sit on boards of the largest publicly listed companies in the OECD countries, ranging from 3.3% in Korea to 45% in Iceland. The ability of the board to ensure strategic guidance of the company depends in part on its composition, which should include directors with the right mix of background and competencies. The G20/OECD Principles also recognise the importance of bringing diversity to boards (OECD, 2019(339)).

\textsuperscript{161} It has been reported that the independent members may suspend their role on the Committee in view “recent examples of corporate governance practices being replaced by discretionary government decisions” which “calls into question the value of the Committee.” (Interfax, 2021(351))
Importantly, only the Ministers and the representative of the ownership entity have the right to vote on the committee. The independent members have an advisory vote: they can participate in the discussion and express their opinion, which is included in the minutes, but they have no formal vote.

The decision of the SOE nomination committee would be made in a secret or an absentee ballot (voting may take place through e-mail) and is based on the majority votes of the Committee’s members who are present and have the right to vote. In case of an equal distribution of votes, the representative of the ownership entity would cast a decisive vote. The minutes would be signed by the chair (or deputy chair) and would also include the opinions of independent experts, if applicable.

Once the results are submitted, the CMU takes the decision on the appointment of the proposed candidates, the contestants are notified, and the information becomes publicly available.

If the CMU were the ownership entity launching the selection process, the Committee would include (instead of the head or deputy head of the ownership entity) the Minister or Deputy Minister of the central executive body engaged in forming and implementing state policy in a given field. That is, if MDETA or the Ministry of Finance were the ownership entities, then the Committee would only include the Minister of Economy (or First Deputy), the Minister of Finance (or deputy), and four independent experts.

Source: (CMU, 2008[162]) (CMU, 2017[161])

F.3. [The state’s prime responsibilities include:] Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;

CMU Resolution 1052 establishes procedures for ownership entities to develop clear goals for SOEs, which should be used to evaluate supervisory boards of SOEs and their executive bodies (CMU, 2016[140]). In practice, the resolution does not contain any methodology on how to evaluate board effectiveness which is reportedly why the government intends to systematically develop “key performance indicators” (KPIs) for supervisory boards. The methodology for setting KPIs is reportedly to be developed by mid-2021 and therefore has not been seen by the assessment team, though according to the authorities, they are set based on the goals outlined in the ownership policy and strategic plan of the enterprise. KPIs have already been developed for some of the top-15 SOEs, but these are often expressed in basic terms and differ from one SOE to another (see Box 11.3) (MDETA, n.d.;[230]) The use of specific financial KPIs, especially when decoupled from the ownership policy, as a measure to evaluate supervisory board performance, is not consistent with internationally accepted best practices.

Box 11.3. KPIs for supervisory boards in selected SOEs

Ukrposhta

The key performance indicators of the supervisory board of Ukrposhta are set according to quantitative targets set for the company in terms of “Sales revenue”, “Productivity” and “Profitability” for the period 2020-25.
Ukrhydroenergo

The key performance indicators of the supervisory board of Ukrhydroenergo are set according to quantitative and qualitative targets (no timeline established):

- Ensuring the EBITDA margin of at least 25%.
- Ensuring the achievement of net income per share of the Company at the level of UAH 50 / share.
- Ensuring the coefficient of financial stability at the level of not less than 1.0.
- Implementation of the development strategy of PJSC "Ukrhydroenergo" and the investment plan of PJSC "Ukrhydroenergo" for the medium term, approved by the Ministry of Energy.
- Implementation of the plan for financing and development of the investment program at the level of not less than 85%.

Ukrainian Sea Ports Authority

The key performance indicators of the supervisory board of Ukrainian Sea Ports Authority are set according to quantitative and qualitative targets set for the company for the period from 2020-25 for the following areas:

- Supporting the adoption of the bill on corporatisation of Ukrainian Sea Ports Authority
- Number of branches (seaport administrations) on a network basis after corporatisation of SE "SPFU"
- Implementation of the corporate governance plan approved by the governing body
- Volume of trans-shipment per meter of berth length of SE "SPFU"
- Return on assets (RoA)
- The level of customer satisfaction of the enterprise

Boryspil International Airport

The key performance indicators of the supervisory board of Boryspil International Airport are set according to quantitative targets set for the company for the period from 2020-25 for the following areas:

- Ensuring the number of served passengers of Boryspil International Airport at the level not less than provided by the Concept of Development of Boryspil International Airport for the period up to 2045
- Ensuring an increase in sales revenue compared to the previous year
- Profitability

Ukrenergo

The key performance indicators of the supervisory board of Ukrenergo are set according to quantitative and qualitative targets set for the company until 2021 in the following areas:

- Financial stability (expressed as a ROA)
- Management of operating expenses
- Increasing investment attractiveness
- Ensuring the reliability of energy supply
- Implementation of the action plan for integration of the integrated energy system of Ukraine into ENTSO-E
- Promoting corporate social responsibility
- Conscientious exercise of powers and performance of duties of a member of the supervisory board and corporate governance
Until now, broad mandates and objectives for SOEs were only set through national and sectoral legislation, as well as within charters of individual state enterprises. They generally defined the predominant activities of an SOE and gave some indications regarding its main economic activity and, where relevant, public policy objectives. There is no legal requirement for SOEs engaged in competitive activities to achieve a minimum rate of return, although for a few supervisory boards targets have been set through the KPIs (see Box 11.3).

Moreover, most SOEs lack business plans made on the basis of a corporate strategy and risk assessment, which would be in line with the general ownership policy and goals set by the state for each enterprise. SOEs still use strategic development plans and financial plans, which are obsolete planning tools and do not allow flexibility for adjustments when this is necessary for achieving company objectives. Notably, the substance of the financial plans is more suited for a planned, cost-based economy, and its approval is a lengthy process involving the ownership entities, line ministries and, in some cases, the CMU and the regulators, which can result in significant delays. For example, Naftogaz’s financial plan for 2020 was approved only in December 2020 (CMU, 2020[231]). In addition, the power to approve financial plans may often be used as a leverage by the ownership entities (see Section 5 and Box 5.1). Furthermore, as outlined in Part I, dividend policy of the government is set at a 30% minimum rate, and actual rates are often based on the fiscal needs of the state in a given year, rather than on the financial condition of individual SOEs, their strategies or investment needs (see Section 4.3).

Apart from state-owned banks, the state as an owner has generally not consistently set financial targets, capital structure objectives and risk tolerance levels for the SOEs in its portfolio. This is also linked to overall lack of clear owner’s expectations communicated to individual SOEs, which and often weighty public policy objectives imposed on SOEs. While MDETA monitors the “effectiveness” of ownership entities in managing their portfolios (state property and SOEs), it displays data in an aggregate form per ownership entity measuring net profits, number of employees, amount of wage arrears, value of assets, etc. (MDETA, n.d.[230]). Moreover, while MDETA collects the data, it is unclear whether it also behaves as an active owner to follow up on the information reported. Plans are reportedly underway to improve capacity within the MDETA to collect, monitor and analyse data pertaining to the SOE sector and in view of calculating a risk indicator for each SOE.

F.4. [The state’s prime responsibilities include:] Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance,

162 However, the assessment team did not obtain access to the internal database or the processes of how the monitoring was used for further decision-making processes.
and oversee and monitor their compliance with applicable corporate governance standards;

Article 16 of the Law on Management of Objects of State Property and CMU Resolution 832 identify accountability procedures for ownership entities towards MDETA related to reporting systems (CMU, 2007). Ownership entities are required to submit information to MDETA on the financial and strategic development plans, and to disclose information on financial and economic activities of individual SOEs. (Audit practices are further detailed in Section 15). As noted under Recommendation E, the Accounting Chamber has found this process of information collection to be more of a formality than a systematic performance monitoring exercise, and noted in a 2017 audit that many recommendations on gaps in corporate governance practices have gone unaddressed despite this reporting process.

One area where MDETA has made some notable improvements, which has also had an impact on aggregate reporting, is with regard to information collected as part of reporting requirements. MDETA has established an internal register, known as Best Zvit, which is an automated electronic document management system in which financial information is aggregated for the whole portfolio of companies. Information on the financial statements of SOEs is made public through an online inventory called ProZvit.

MDETA also monitors compliance with the corporate governance action plans and the reforms plans the CMU has initiated for the top-15 SOEs, which are gradually being implemented. With the recent approval of a national Corporate Governance Code (see Sections 4.2 and 15.1), the NCSSM will require JSCs to “comply or explain” in their annual corporate governance reports. However, to date no systematic monitoring of compliance with the Code is required for SOEs.

F.5. [The state’s prime responsibilities include:] Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;

The 2016 amendments to the Law on Management of Objects of State Property have significantly improved the requirements for transparency and disclosure in SOEs. They are required to publish information concerning their strategic goals, quarterly and annual financial statements for the last three years, and (if applicable) budgeting of non-profit public policy objectives and sources of the funding, among other areas (see Section 15). The "Law on Amendments to Certain Legislative Acts of Ukraine Regarding Improvement of Business Conduct and Attraction of Investments by Securities" (Law 2210) which became effective as of January 2018, also contributed to improving the quality of information provided by companies. The law introduced requirements for the boards of JSCs (including in SOEs) to form committees (namely, remuneration, appointment, and audit committees), and additional requirements regarding disclosure of information, such as new rules for compiling of regular reports, their scope (extended) and procedures of approval.

As further described in Section 15, SOE reporting requirements are outlined in the Commercial Code of Ukraine and CMU Resolution No. 1067, along with other applicable laws depending on the SOE legal form (such as the JSC law). However, reporting and disclosure requirements and enforcement may vary depending on the

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163 SPFU is also responsible for maintaining the Unified Register.
SOE type and legal form. For enterprises of public interest, public joint-stock companies, and entities operating in the extractives sector, higher standards of transparency and disclosure apply. They are all required to publish their annual financial statements according to higher transparency and disclosure standards (IFRS), and further disclosure requirements may be introduced by NCSSM (also see Table 15.1 and Table 15.2) (Verkhovna Rada, 2006[233]).

The availability and accessibility of financial information, including audited statements of SOEs, is intermittent. While some of the key SOEs (namely those among top-15) issue audited financial statements, others either do not implement relevant policies or have recently started doing so (see Table 15.3). Certain SOEs, particularly in the defence sector, may not be subject to similar disclosure requirements due to state secrecy laws. The CMU has also published a resolution regarding “open data” requirements applicable to SOEs and MOEs, which are gradually being implemented (CMU, 2015[234]).

F.6. [The state’s prime responsibilities include:] When appropriate and permitted by the legal system and the state’s level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;

According to the Law on Management of Objects of State Property, the SOE ownership entity is responsible for commissioning and approving external audits. If a supervisory board is established, it elects an independent auditor subject to public procurement procedures. However, in public joint-stock companies, the general shareholder’s meeting needs to approve an independent auditor upon the recommendation of the supervisory board.

It should be further noted that in some SOEs, revision commissions still exist (see Section 16.10 and Box 16.3). The revision commissions are appointed by and remain accountable to the shareholder (ownership entity), and may optionally report to the supervisory board on the results of scheduled and unscheduled inspections. However, the revisions commissions are no longer considered to be up to internationally accepted corporate governance practices. Most of the top-15 SOEs are focusing on developing internal audit and control functions and subjecting SOEs to independent external audit. A draft law has been introduced in the parliament (No. 2493) to abolish the revision commissions.

The assessment team is not aware of any systematic dialogue between the company and external auditors, nor with state audit organs. In SOEs without supervisory boards, given the direct involvement of the owner/shareholder in appointment of the auditor, there may be, on a case-by-case basis, opportunities to engage in a dialogue on the company’s activity.

F.7. [The state’s prime responsibilities include:] Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

The ownership entity sets the annual remuneration of supervisory board members based on a methodology and limits identified under CMU regulation 668 (amended in February 2020).164 The calculation of remuneration is made based on two criteria (i)

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164 In addition, the NCSSM has issued Requirements for the Regulations on the Remuneration and Remuneration Report of supervisory board members and the executive body of a JSC (https://zakon.rada.gov.ua/laws/show/z1367-18#Text). These requirements set out main principles of remuneration policies for board members and key executives, such as guidelines on fixed and variable components, with the...
the average salary in the respective industry of the SOE; and (ii) the SOEs net annual income. (Methodology is further described in Box 11.4). In addition, board members receive “additional payments” for chairing. While remuneration policy has been developed, it is unclear whether it is based on market research.

The remuneration for supervisory board members is reviewed annually by the ownership entity, and the amount may be changed (CMU, 2017[235]). While the resolution in principle applies to all board members, actual remuneration across the supervisory board may differ. Notably, the laws on civil service and prevention of corruption prevent civil servants (as well as other state representatives not deemed civil servants, such as the chief or deputy chief of the President’s office) from being remunerated, as they cannot engage in any other paid activity as not all state representatives are civil servants (as further elaborated in Section 16) (CMU, 2020[42]). For example, government appointees in Naftogaz receive 75% of the fees that independent board members receive (Naftogaz Group, 2020[61]).

Moreover, with the current version of the Resolution (further described in Box 11.4), it is difficult to calculate the actual remuneration of a board member without having access to and being able to verify average monthly salaries, which requires knowing the classification of industries applied to specific SOEs by the State Statistics Service, as well as knowing the actual average monthly salaries in these industries. As a result, despite the availability of a framework, in practice there is a lack of transparency in how remuneration is set.

**Box 11.4. Board remuneration methodology**

The ownership entity sets the annual remuneration of supervisory board members based on the net annual income of the SOE from the sale of products, goods, or services. If the net annual income of the company falls within a certain range, the maximum amount of monthly remuneration is calculated by multiplying the average monthly salary in the industry in which the company operates by a constant indicated in a table for each specific salary range. For example, if the SOE’s net annual income from sales ranges between UAH 3 million and UAH 10 million, the average salary in the respective industry would need to be multiplied by 15 (as indicated in the table in the CMU Resolution) to determine the maximum amount of remuneration for the board member. Remuneration may also vary depending on the role of the board members (notably, the chair’s remuneration is higher). CMU Resolution No. 668 was amended in February 2020, which some observers consider to render it less transparent.

In its previous 2018 version, the remuneration ranges also depended on the SOE’s annual income ranges. However, the remuneration ranges were specified in absolute terms. For example, if the SOE’s net annual income ranged between UAH 3.164 million and UAH 9.492 million, the annual remuneration of a board member would be up to UAH 1.37 million (or around UAH 114,000 per month). The previous version of CMU Resolution No. 668 was very uneven across SOEs, as it was not rooted in peer comparisons or market research. There were also exceptions for MGU (Main Gas Pipelines of Ukraine), which set the annual remuneration of its supervisory board members at UAH 5.062 million (or around UAH 421,000 per month), although the company’s sales and assets were minimal.

Source: (CMU, 2017[235])
CEO remuneration policy is set out in CMU Resolution No. 859 (CMU, 1999[236]). The maximum salary depends on the SOE’s number of employees and is set based on a factor of the minimum wage of an employee within the SOE and a constant indicated in the salary range. The value of the constant is determined by a range of full-time employees and the value of assets or net income from the sale of goods and services. However, further components in determining the overall CEO salary may include efficiency indicators, the candidate’s qualifications and field of work. The CEO may also receive cash benefits in case of retirement and incentive pay. The conditions for remuneration, along with indicators and bonuses, are determined by the central executive bodies and ministries in co-ordination with MDETA. MDETA is also responsible for ensuring adherence to CMU Resolution No. 859, and, together with the Ministry of Finance, for amending the Standard Form Contract with the head of an SOE (CMU, 1999[236]). Moreover, it should be outlined that while there is no clear provision in the law empowering the CMU to establish restrictions on CEO salaries, this has been applicable in practice. Some of these provisions may also contradict with the JSC law, which states that the supervisory board should have an exclusive authority to define the remuneration for the CEOs and the executive board.

It’s worth noting that the issue of board and CEO remuneration has been a hot subject of public debate with the government being in favour of reducing remuneration levels. The remuneration levels have often been attacked in the media, especially after the Naftogaz supervisory board decided to pay the company’s management a 1% bonus from USD 2.9 billion paid to Ukraine from Gazprom following the Stockholm arbitration case.

In February 2020, the CMU set a maximum monthly salary for the heads of SOEs at UAH 1.25 million (approximately USD 44,600). It also tied the monthly remuneration of supervisory board members to the average salary in the industry in which the company operates (Economic Truth, 2020[237]) (CMU, 2020[192]). Importantly, the remuneration of the members of supervisory boards and management in SOEs (as well as in state-owned banks) was drastically reduced (to UAH 47,230 per month, and equivalent on 10 minimum monthly salaries) during the Covid-19 pandemic. The idea was initiated by the President in his public speech on April 10, and the law limiting supervisory board and management pay was promptly adopted by the Verkhovna Rada on April 13, followed by respective CMU decisions on April 29, 2020. These limitations were imposed starting on April 1, 2020, that is, with retrospective effect

These so-called “remuneration caps” were not well received by SOE supervisory boards and management, as well as the international community, given the indefinite

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165 For example, doctors of science and professors may receive higher remuneration. Moreover, the CEO may have a reduced bonus in case of a deterioration of the quality of work and certain violations, such as non-approval of the annual financial plan and the presence of wage arrears.

166 The resolution introduces further provisions for enterprises in Crimea and local executive bodies, which may need to be coordinated with the local authorities.

167 The Standard Form Contract was approved by the CMU Resolution No. 597, along with the efficiency indicators (CMU, 1995[311]).

168 The bonus was to be divided among a group of some 40 Naftogaz managers. Although the first part of the bonus was paid, the second part was not, despite the Naftogaz formal obligations to pay it.

169 According to a public statement by a member of parliament, the CMU also limited the annual remuneration of the members of Naftogaz’s supervisory board at UAH 2.9 million (approximately USD 103,600) in August 2020 (Economic Truth, 2020[219]). However, the latter’s salary caps have not been verified.
nature of the quarantine and potential risks it could involve with board member resignations. In particular, the limitations led to mounting pressure to cancel them. Ultimately, the situation resulted in several board member resignations in SOEs, including PrivatBank in August 2020 and Ukrzaliznytsia in September 2020 (Aslund, 2020) (Shevchenko, 2020). The cap for supervisory board members and executives limiting their remuneration to UAH 47,230 per month was eventually lifted in October 2020.

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170 The President convened an extraordinary meeting of the parliament on July 13, whose agenda was supposed to include the consideration of a draft law that was to lift the salary caps. However, the draft law was never discussed, and the limitations stayed as they were (Economic Truth, 2020). 
http://w1.c1.rada.gov.ua/pls/zweb2/wesproc4_1?pf5511=89225
Chapter 12. State-owned enterprises in the marketplace

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field with SOEs undertaking economic activities.

12.1. Separation of functions

A. There should be a clear separation between the state’s ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

As outlined earlier in this review, there is often a blurred separation between the state’s ownership, policy and regulatory functions under the decentralised state ownership arrangements in Ukraine. State ownership rights are exercised by over 80 different ownership entities (line ministries, CMU or other state bodies) who simultaneously undertake sectoral regulatory and/or policy functions. This lack of separation is cited in the Basic Principles (ownership policy) document as a challenge faced by the state in implementing effective oversight over its portfolio, citing “conflicts of interest”, and “vaguely delineated” functions between the CMU, line ministries and other state bodies." As such, the ownership policy notes "significant risks of inconsistencies between the goals set for business entities and lack of clear distinction between commercial and non-commercial functions" (CMU, 2018[211]).

In addition to the competition authority (AMCU), the four sectors of the economy where SOEs are dominant are regulated by functionally separate sectoral regulatory authorities. The NEURC regulates the energy and utilities sector utilities; the NCCIR regulates communication and information; NCSSM regulates the capital and financial markets; and the NBU regulates the banking and financial institutions. It should be noted that the independence of some regulatory bodies has come into question by the Constitutional Court. In 2019, the NEURC was transformed from an independent regulatory authority into a central executive body accountable to the parliament,
further to a ruling by the constitutional court which goes against international best practice standards and the European Energy Community acquis.

In other sectors, such as aviation and aerospace, rail and energy, line ministries concurrently exercise ownership rights, policy formation and/or regulatory functions. Some examples include:

- The newly established Ministry of Strategic Industries is concurrently responsible for policy formulation and regulation the defence, aviation and aerospace industries. The ministry is also expected to become the ownership entity of Ukroboronprom (if draft law 3822 is passed).
- The CMU, ownership entity of Naftogaz and other state-owned power generation companies, is responsible for approving the government’s overall policy in the energy sector (overall set by the Ministry of Energy) and setting public policy objectives for gas and electricity provision to regulated markets.
- The Ministry of Infrastructure is also heavily involved in regulating and policy-making in the rail, seaports and aviation sectors. While technically the ownership of the national rail company falls under the CMU, it has “delegated” performing of ownership responsibilities to the Ministry of Infrastructure. Amendments to the Law on Rail Transport that would seek to align and harmonise Ukrainian legislation with the EU norms are currently pending.

Most SOEs in Ukraine are used as vehicles for industrial, regional and sectoral policies, play a role in preserving public interest or national security, and are required to fulfil significant public policy obligations set by the state. Where government exercises concurrent functions, such as policy formation and ownership, some line ministries have established dedicated units or departments (such as MDETA, the Ministry of Finance and the Ministry of Infrastructure) to perform ownership functions.

A ruling made by the Constitutional Court (decision No. 5-p/2019 June 13, 2019), established that certain provisions of the law establishing the independence of the regulator were deemed unconstitutional and would expire end-2019. To address this potential impasse, on December 19, 2019, the Verkhovna Rada of Ukraine adopted an amendment to the Law “On Amendments to Some Legislative Acts of Ukraine on Ensuring Constitutional Principles in the Fields of Energy and Utilities.” The amendments have resulted in the transfer of NEURC to a permanent central executive body with special status, and have made it accountable to the Verkhovna Rada of Ukraine. The Law also transfers the rights to name NEURC’s leadership to the CMU (the candidates are nominated by the Competition Commission), while other amendments aimed to expand its powers in case of market dysfunction. Some observers view the change of NEURC’s status as temporary and necessary to operate in light of the Court’s decision. (See (OECD, EC, EBRD and ETF, 2020)).

Further guidance on the structure and governance of regulators may be found in 2012 OECD Recommendation of the Council on Regulatory Policy and Governance and related implementation guides.

The minimum criteria established by the Energy Community calls for the regulator to be (i) “independent from both industry interests and government”; (ii) its “own legal entity,” and, (iii) “have authority over its own budget and have sufficient resources to carry out its operations”.

CMU Resolution No. 819 (September 7, 2020) codifies the Ministry as “the main body in the system of central executive bodies, which ensures the formation and implementation of state industrial policy, state military-industrial policy, state policy in the sphere of state defence procurement, in the sphere of defence-industrial complex, in the aircraft industry and ensures the formation and implementation of state policy in the field of space activities.” In addition, it should be outlined that the Ministry of Defence is responsible for forming and implementing state defence policy, which may overlap with some of the functions with the Ministry of Strategic Industries. The Ministry of Defence is also going to be responsible for the State Defence Order (currently implemented by MDETA), which applies to Ukroboronprom.

The amendments would also help to eliminate some of the inherent conflicts of interest of the railway operator that currently runs both the infrastructure, passenger and freight/cargo rail.
However, considering that the ownership entities continue performing policymaking, ownership and regulatory functions, the risks of conflicts of interest remain high. In such cases, there is some degree of separation between public officials responsible for the ownership of SOEs and those focused on public policy. However, it is problematic that objectives for individual SOEs are set by the same units engaged in the development of sectorial policies. Furthermore, no safeguards have been put in place at the level of executive decision-making to ensure that key decisions requiring ministerial sign-off remain functionally separate. The only instance, to the knowledge of the assessment team, where this issue was initially resolved, was in the case of the two gas and electricity transmission system operators (“TSO”). The TSOs were “unbundled” from the Ministry of Energy and transferred to the Ministry of Finance to ensure they were fully separated from policy and regulatory functions and had different ownership entity (Ministry of Finance) from the state-owned entities involved in generation capacity (Ministry of Energy and CMU). However, the government recently issued a Resolution to work towards retransferring the TSOs to the Ministry of Energy, as other SOEs (such as Ukrhydroenergo and Energoatom) were transferred from the Ministry of Energy to the CMU (Interfax, 2021[241]) (CMU, 2021[45]).

The OECD previously identified that proper safeguards must be established in Ukraine’s SOE sector to ensure ownership responsibilities are separated at arm’s length from policy functions and that regulatory responsibilities are shifted to relevant independent regulatory authorities to avoid conflicts of interest (OECD, 2019[40]). The absence of a complete separation of ownership, policy and regulatory functions in a large majority of cases continue to constitute a departure from the SOE Guidelines.

Concerning municipal SOEs, separation of ownership and regulatory functions is generally only in place in situations where an independent regulator has been established and the markets have been sufficiently contested, as AMCU has jurisdiction over the sub-national level. As many municipal SOEs provide services of general economic interest in non-competitive (or non-contested) markets, such as public transportation (e.g. Lvivelectrotrans, which is a monopolist in the area of tram and trolleybus transportation in Lviv), health and utilities, no proper regulatory oversight has been established. Furthermore, as many MOEs operate without proper corporate governance, there is risk of undue influence exercised by ownership entities (often the executive units of city councils) in MOE day-to-day operations (Centre for Economic Strategy, 2020[181]).

12.2. Stakeholder rights

**B. Stakeholders and other interested parties, including creditors and competitors, should have access to efficient redress through unbiased legal or arbitration processes when they consider that their rights have been violated.**

As a general rule, SOEs’ stakeholders, including creditors and competitors, have access to the same means of redress, including legal or arbitration processes, as the stakeholders of private companies. Commercial disputes between SOEs can be settled through the court system or, if established via contract between the parties, arbitration, provided that a foreign element is in the contract (e.g. one of the parties is a foreign entity). This applies equally to SOEs held at the central and municipal levels of government. A number of possible exemptions to the above exist in cases where
an SOE’s assets must legally remain in state ownership, and are therefore exempt from bankruptcy, insolvency, fraudulent conveyance, reorganisation, moratoria and other similar laws relating to or affecting creditors’ rights generally and to general principles of equity.176

SOEs and MOEs undertaking “economic management rights” over “public state property” cannot, according to the Ukrainian authorities, be the subject of court injunctions, such as a court order to restore property to lenders. This is enumerated in the Commercial Code of Ukraine, the Bankruptcy Law and the Law on the Moratorium on the Forcible Sale of Property, the latter of which applies to core assets owned by the state enterprises; and assets owned by business entities in whose authorised capital the state holds a stake of no less than 25% (Kisil, 2019[242]). Creditors would not be able to access collateral in the case of non-payment, and enforcement of any judgment against such SOEs or MOE would be restricted according to Ukrainian law.177 Moreover, part of the fixed assets that SOEs operate based on “economic management rights” limits the possibility of their use as a collateral, thus prompting the need for state guarantees to obtain a loan.

In addition, Article 34 of the Law “On Enforcement Proceedings” contains an extensive list of grounds on which enforcement action against SOEs may be suspended. The list broadly covers the following entities: wholesale electricity supplier (on certain conditions); utilities indebted to Naftogaz, Ukrttransgaz, Gas of Ukraine and electricity suppliers (on certain conditions); rail assets in occupied territories; small and large scale privatisation assets; enterprises of national strategic or security interest if pertaining to a legal entity of an “aggressor or occupying” state; and coal mining companies (until January 2022). Moreover, it should be noted that according to a recent regulatory disclosure, “…these factors make judicial decisions in Ukraine difficult to predict and effective redress uncertain… Court orders are also not always enforced or followed by law enforcement institutions” (Naftogaz Group, 2019[243]).

12.3. Identifying the costs of public policy objectives

C. Where SOEs combine economic activities and public policy objectives, high standards of transparency and disclosure regarding their cost and revenue structures must be maintained, allowing for an attribution to main activity areas.

Article 263 of Ukraine’s Association Agreement with the European Union, which entered into force in August 2017, requires that undertakings providing economic activities should maintain separate accounts for competitive and non-competitive activities, and should maintain high standards of transparency and disclosure

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176 For example, in accordance with the requirements of Article 7 of the Law of Ukraine “On Pipeline Transport” the alienation and encumbrance of the fixed assets and shares of Naftogaz, shares of Naftogaz subsidiaries is subject to a temporary moratorium on enforcement against its fixed assets introduced by Ukrainian law in 2001. By virtue of the moratorium, enforcement against the fixed assets of Naftogaz arising in connection with, inter alia, (a) court judgments and arbitration awards or (b) bankruptcy proceedings, is currently prohibited. Pursuant to Article 7 of the Law of Ukraine “On Pipeline Transport”, privatisation of SOEs which carry out activities on transportation by main pipelines and storage in underground gas storage facilities is prohibited as they are in strategic industry sectors. The initiation of bankruptcy procedures against Naftogaz and such subsidiaries is prohibited as well.

177 For example, the Naftogaz bond prospectus states that “the State owns the oil and gas assets operated by Naftogaz and thus the enforcement of any judgment against Naftogaz by creditors thereof would be restricted under Ukrainian law.”
Moreover, the Commercial Code and CMU Resolution 1067 provide for disclosing non-commercial objectives, while the 2015 Strategy states that the accounting separation and methodologies should be developed by MDETA (CMU, 2015[126]). Through its advocacy efforts, AMCU considers that these principles are well-known to state aid grantors and recipients. However, in practice, most companies do not maintain separation of accounts and, as a result, grantors of state aid cannot verify whether beneficiaries cross-subsidise budget-funded activities towards economic activities. The AMCU considers more advocacy efforts are required.

The structural separation of activities is only mandatory when there is a requirement in legislation, which is the case for the companies operating as natural monopolies. For example, Article 33 of the Law “On the Electricity Market” requires the TSO to “keep separate records of expenses and income for the performance of PSOs to ensure the public interest in the functioning of the electricity market” (Verkhovna Rada, 2017[249]). The NEURC requires electricity producers that sell electricity at regulated prices as imposed by the CMU to “keep records of costs and revenue of licensed activities within the PSO framework to ensure the general public interest...” (OECD, 2020[69]). The draft amendment to the Law on Rail Transport would also call for clear PSO identification, though it is currently being considered.

In practice, structural separation is not always feasible nor an exact science, as PSOs may be implicit and not clearly mandated by the state-ownership entities as part of “owners’ expectations”, may be requested on an ad hoc basis, or may not be clearly identifiable due to opaque arrangements. For example, provision of natural gas at regulated prices to certain customer segments (such as vulnerable households) by Naftogaz passes through an opaque supply and distribution channel, misused by rent-seeking intermediaries that are involved in the “last mile” of the gas supply chain. Naftogaz estimates losses and foregone revenues due to this arrangement and through segmented financial reporting. However, due to a lack of transparency and accountability around consumer data by gas intermediaries, calculations remain estimations.

12.4. Funding of public policy objectives

**D. Costs related to public policy objectives should be funded by the state and disclosed.**

Funding arrangements for SOEs’ public policy objectives vary across ministries and SOEs, and can be direct or indirect in nature (more on state support measures are covered under Recommendation F). In general, State support to undertakings in Ukraine has been predominantly sectoral in character, with the largest share going to land and pipeline transport, arts and entertainment, air transport, sports and other industries, and prevalent at both the national and sub-national levels (AMCU, 2020[136]). These funding arrangements can include:

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178 Article 263 of the EU-Ukraine Association Agreement (Chapter 10) reproduces EU State Aid standards with regards to accounting separation and transparency requirements.

179 In some cases, PSOs may not be formalised and cross-subsidies may be introduced (for example, in the railway and electricity sectors), which is not considered as state aid and the state will provide no compensation.
- Direct subsidies or compensations from relevant budgets. These are often set out in specific sectorial legislation. For example, the Natural Gas Law assigns Naftogaz a PSO requirement to sell/supply gas to certain customer categories according to a regulated price compensated according to “economically justifiable costs.” However, the law does not define the PSO compensation mechanism (although it says that such mechanism should be developed by CMU) and hence has never been applied. The compensation mechanism and coverage of losses incurred by Naftogaz has been a contentious issue, and may result in a competitive disadvantage compared to private companies. In December 2020, Naftogaz received a compensation for PSO in the amount of UAH 32.2 billion (Economic Truth, December[246]).

- Some SOEs pursue non-commercial objectives that are either partially or fully financed from profits of their commercial activities. For example, PSO set by the CMU requires 50% of electricity generated by Energoatom and 35% by Ukrhydroenergo to be sold at a fixed rate (e.g. regulated price) to the Guaranteed Buyer through July 1, 2022, with no compensation mechanism. This was deemed by the international community to violate the principle of fair competition enshrined in the Law on Electricity Markets (OECD, 2020[69]).

- In regulated markets, tariffs fund the carrying out of PSOs. For example, the gas and electricity TSOs, as well as transmission and dispatch tariffs are set by the NEURC. In addition, certain entities, such as universal service providers and last resort suppliers, along with heating distribution companies, are required to supply energy at a fixed rate. In practice, and as noted earlier, some energy sector SOEs (e.g. Ukrenergo and Naftogaz) have suffered significant uncompensated losses for the provision of public-policy objectives through inadequate tariffs. (OECD, 2019[40]) (OECD, 2020[69]).

Other examples include cross-subsidies in certain sectors, particularly energy and transport. Notably, Ukrzaliznytsia compensates for lower tariffs imposed on passenger transport by charging higher fees for cargo transport (as outlined in Section 3.2). Similarly, regulated tariffs in the energy sector (particularly for household consumers) have been compensated by charging higher rates among non-regulated consumers. While steps have been taken to phase out cross-subsidies (particularly in the energy sector), they still occur in practice.

With regard to disclosure of costs related to public policy objectives, the EU-Ukraine Association Agreement requires financial relations between public authorities and public undertakings to be transparent, including both direct and indirect funding support (e.g. through the intermediary of public undertakings or financial institutions) and the use for the funding (European Commission, 2014[247]).

Law 1555-VII on State Aid and a set of sector-specific state aid compatibility criteria (refer to Section 4.3.2), and multiple clarifications and guidelines on state aid application are provided by AMCU, which establishes legal requirements for the application.

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180 In addition, in January 2021, the Cabinet of Ministers published Resolution No. 25 that limits the maximum gas price for households, mainly for the supplier of last resort (which applies only to Naftogaz and its subsidiaries). As such, it is expected that most gas suppliers will refuse to sell gas to households at a regulated price to avoid losses, and consumers will be automatically transferred to Naftogaz as a supplier of last resort.

181 The PSO for Energoatom was set initially at 90%, though this was later revised. (CMU, 2020[42])
identification, calculation and notification of state aid. AMCU regularly publishes data on state aid, differentiating between compatible and non-compatible state aid, and state support measures.

However, certain state support measures in a number of sectors (such as agriculture, investments in infrastructure through public procurement, and defense-industrial sector, among others) are exempt from notification. Moreover, despite statistics showing a gradual increase in the number of notifications since the law was enacted, there is a manifest reluctance by many central and municipal authorities to submit notifications regarding state aid, and official figures on state aid and support measures are likely to be grossly underestimated. (Marchenko Partners, 2019[248]) For this reason, the Government’s Priority Action Plan for 2021 (approved by the CMU in March 2021) has included plans to development a draft law to address issues of responsibility of by state aid providers for failure to submit notifications on provision of illegal and inadmissible state aid to the AMCU.

According to Article 90 of the Commercial Code, companies with 50% or more state-ownership (direct or indirect) are required to publish quarterly and annual financial statements for the last three years, which requires expenditures for non-commercial activities related to public policy and sources of funding to be disclosed. However, as discussed in Section 15, high standards of transparency and disclosure by SOEs and MOEs remain underdeveloped across the portfolio, and have a limited enforcement power. Most efforts to upgrade these practices are focused on the top-15 SOEs (see Table 15.3).

12.5. General application of laws and regulations

E. As a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations. Laws and regulations should not unduly discriminate between SOEs and their market competitors. SOEs’ legal form should allow creditors to press their claims and to initiate insolvency procedures.

Sector and market regulation

As noted in Part I, the existence of multiple SOE legal forms and categories results in a lack of uniformity and consistency in the applicability of laws to SOEs carrying out economic activities. Moreover, given that 86% of the Ukrainian SOE portfolio comprises of state unitary enterprises, their operational form in most cases would not follow corporate norms similar to joint-stock companies. Even for JSCs, special carve-outs relate to state aid and support measures, public service obligations, bankruptcy procedures, public procurement practices, electronic declarations, and asset

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182 AMCU has established a number of procedures and orders based on which state aid should be disclosed, including AMCU Orders No. 2-rp dated 04.03.2016 and No. 43-rp dated 28.12.2015. Stakeholders also have an opportunity to appeal to the AMCU regarding illegal state aid or improper use of state aid, as outlined under AMCU Order No. 8-rp dated 12.04.2016.

183 State support is a more general term, covering any type of public assistance to undertakings, whereas the notion of State aid is a specific sub-set of the overall concept of State support that can be identified as such only after a proper assessment according to the Law and formal decisions by the AMCU.
ownership may be applicable that could either provide undue advantage or disadvantage to SOEs compared to their market competitors.

While SOEs are not systematically exempt from competition law by virtue of their state ownership, there is rather weak enforcement which does not fully tackle anti-competitive behaviour. Both central and municipal SOEs have been the subject of several proceedings initiated by the AMCU for potential competition infringements, which allows it to actively advocate on sectoral regulation and policies that may influence better market competition and a more level playing field.\textsuperscript{184} Stakeholders observe that regulatory authorities are less “comfortable” taking up big cases due to influence of vested interests which are involved in “explicit or tacit collusion among market players”, and “where there may be strong political connections that enable lobbying for regulatory protection” (World Bank, 2019\textsuperscript{249}). Other challenges relate to a regulatory framework that is implemented in a discriminatory manner and is not very mature (especially in the network sectors). High levels of market concentration in key sectors split between SOEs and a certain number of “politically connected” firms that do not allow for the entry of would be competitors (World Bank, 2019\textsuperscript{249}).

**General laws and tax codes**

As elaborated in Part I, SOEs are generally subject to the same tax regime as privately-owned companies, as defined by various acts through the commercial, tax, and budget codes, as well as sector-specific laws that may be applicable. However, certain entities may benefit from tax exemptions or deferrals, particularly those engaged in investment programmes.

**Bankruptcy proceedings**

Compared to private companies, SOEs benefit from competitive advantages in this area. The Ukrainian Commercial Code and the Bankruptcy Code establishes that certain SOEs (mainly budgetary, or kazenne enterprises) cannot go bankrupt. Moreover, state monopolies may be established in a number of sectors, though a full list is not available. While there are on-going efforts to liberalise certain markets (including electricity, rail and gas, as well as the production of spirits), a recent analysis of entry and exit dynamics by the World Bank reveals “a persistent lack of contestability in Ukrainian markets.” This is partly due to the market structure prior to liberalisation, nascent regulation, weak enforcement and a certain degree of “regulatory protection” afforded to certain market players (World Bank, 2019\textsuperscript{249}).

As many SOEs operate in sectors of the economy which have been identified as strategic (e.g. gas, defence, etc.), they are simply too big or too important to fail (e.g. state-owned banks, vertically integrated oil and gas company). In addition, although there are efforts to reorganise state-owned coal mines, the available budget is spent on covering some of their outstanding costs (mainly wage arrears).\textsuperscript{185} As noted in Part I, the procedure for SOEs is focused on preventing their bankruptcy and restoring

\textsuperscript{184} In some cases, fines have been imposed for infringements on SOEs, including those in the top-15 for abusing dominant position, including Ukrzaliznytsia (imposing UAH 18 million in 2020), USPA (imposing 5.5 million in 2019), and Boryspil Airport (imposing UAH 12.7 million in 2017). Other SOEs have included Ukrsprt (UAH 33 million in 2018 and UAH 200 million in 2012) and the National Information System (UAH 7.8 million in 2018), among others.

\textsuperscript{185} According to the Ministry of Energy, the total wage arrears of state coal mining enterprises between 2015-2020 amounted to UAH 1.2 billion, including UAH 782.3 million for January-February 2021. As of March 2021, UAH 526 million was allocated to repay salaries, which is 40.2% of accrued salary (Boytsun et al., 2021\textsuperscript{[53]})
Some SOEs also benefit from “sectoral moratoria”, particularly those operating in energy, defence and transport sectors. For example, in October 2020, moratorium was imposed on the bankruptcy of water and heating companies, and, in May 2020, a draft law (No. 2390) was adopted in first reading that introduced a moratorium on bankruptcy of electricity suppliers (which also meant a de facto moratorium on Energorynok, a former wholesale electricity market operator). In addition, all pending enforcement proceedings and new bankruptcy proceedings are suspended for state-owned coal mines until 2022, and for defence SOEs without a sunset clause. It is also worth noting that out of all SOEs, only Ukroboronprom is allowed to enter restructuring in the bankruptcy proceedings. Moreover, forced sale and enforcement of the proceedings on real property, equipment and equity of SOEs (including those where the state owns over 25% of the share) has been disallowed. (This provision also applies to Ukrzaliznytsia’s assets located in the Donbass). Within the context of the Covid-19 pandemic, amendments were introduced to the Bankruptcy Code (728-IX) to suspend bankruptcy proceedings during the lockdown and 90 days after it ends.

12.6. Market consistent financing conditions

F. SOEs’ economic activities should face market consistent conditions regarding access to debt and equity finance. In particular:

F.1. SOEs’ relations with all financial institutions, as well as non-financial SOEs, should be based on purely commercial grounds.

Access to debt and equity financing

SOEs generally do not access market consistent conditions regarding access to debt and equity finance. The main sources of finance for Ukrainian SOEs are:

- Equity capital through capital injections by its state-owner, including the form of government bonds, and fixed assets revaluation reserve
- Bond issuance
- Borrowing primarily through state-owned financial institutions
- State-guaranteed borrowing through international financial institutions.

Raising capital in local and international financial markets proves to be difficult for SOEs given that most are at the early stages of establishing internationally-accepted corporate governance practices and standards of reporting and disclosure, while also ensuring high quality external independent audit and internal audit and control systems. One successful example is Naftogaz which issued Eurobonds in 2019,
although future issuance in 2020 and 2021 have been postponed due to international investors’ “concern about the political and operating environment in Ukraine” (Naftogaz Group, 2020[250]). Some of the state-owned banks have also issued Eurobonds.

All SOEs must obtain government approval to raise capital. This is partly due to the fact that there is a prohibition to pledge or sell assets as collateral due to restrictions on the sale of state property. As such, SOEs must obtain explicit guarantees from the CMU and the Ministry of Finance to meet guarantees or sureties requirements under loan agreements. This requirement extends to both short and long-term loans, as well as external (IFI) or internal borrowing. State guarantees are provided within the limits and areas defined by the law on the State Budget of Ukraine, and decided by the CMU to (i) ensure the fulfilment of debt obligations of SOE business entities; and (ii) ensure fulfilment of debt obligations of business entities falling under international treaties of Ukraine. The state budget for a given year may determine the limits for such obligations (for example, the Law “On the State Budget of Ukraine for 2020” limited guarantees to loans that finance investment projects) and finance programs for the defence and security sector (up to a certain threshold).

In most cases, guarantees granted by the government are used to secure loans from IFIs. The guarantees are considered as compatible state aid by the AMCU, as they are directed towards promoting economic development (especially in case of poor living standards or unemployment), implementing national development programmes, or resolving common social and economic disturbances. The AMCU has developed guidelines for the assessment of state aid provided in the form of guarantees. According to the guidelines, a state or municipal guarantee is a state aid measure and requires the consent of the AMCU unless all of the following conditions are satisfied:

- Borrower of the guaranteed loan is not in financial distress
- Guarantee secures no more than 80% of the principal amount of the loan
- Guarantee secures a specific transaction that is limited in terms of the amount and term
- Guarantee is issued on a market-based fee.

In terms of recapitalisations, the government avails itself of this option for SOEs, state-owned banks and MOEs. For SOEs, state capital injections are used largely to offset annual deficits (this was the case for Naftogaz until 2016); and for state-owned banks, the high level of non-performing loans have led to heavy needs for recapitalization for loan loss provisions. It should further be noted that the state has granted debt write-offs or offered advantageous debt restructuring schemes to certain categories of SOEs that have been unable to fulfil their debt commitments. This often applies to strategic, export oriented state-owned enterprises, which are considered indispensable for national security and defence (Holzler, 2015[251]).

Fiscal risks for the government are high if SOEs are unable to maintain their financial integrity. It has been estimated by IMF that for the largest 48 SOEs, the combined net debt represents around 19.4 % of GDP (2017). Ukraine is still developing tools to improve the assessment of fiscal risks and plans to expand its financial model, though major SOEs were included in its 2020 commitments to the IMF Stand-by Arrangement

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186 It is worth noting that CMU Resolution No. 809 dated June 15, 2011 and CMU Resolution No. 414, dated May 5, 1997 monitor compliance with regard to SOE financing, which include provisions regarding state guarantees on foreign loans.
Despite these potential moral hazards, no major changes have been reported to the assessment team to ensure market-consistent conditions for SOEs to access finance.

Provision of financing from state-owned financial institutions

As lending to SOEs is state guaranteed, state-owned banks have significant exposures to some of the largest SOEs in Ukraine. For example, 66% of Naftogaz’ debt portfolio (not including subsidiary loans) is made up of borrowing from state-owned financial institutions (Ukrgasbank, Ukreximbank and Oschadbank). Although state-owned banks are considered to provide financing on market terms (including through the interest rate offerings on loans), they can be used as vehicles through which to finance projects that are politically motivated.

SOEs’ relations with non-financial SOEs

As mentioned earlier, SOEs may be subject to ad hoc government decisions that require them to offer goods or services at preferential rates to other SOEs. For example, Naftogaz’s subsidiary Ukrgasvydobuvannya (UGV) has been on occasion required to supply fuel to Ukrzaliznytsia (state-owned railway company) as part of an interest-free lease. Similarly, CMU has obliged Naftogaz to supply gas to Odessa Port Plant despite debts owed by the company to Naftogaz, and in parallel restructured the debt of the latter for two years.\footnote{In February 2015, the CMU obliged Ukrgasvydobuvannya (UGV), a joint stock company wholly-owned by Naftogaz, to provide fuel to Ukrzaliznytsia (state-owned railway company). The fuel was provided as part of an interest-free lease. The respective resolution was executed in the form of a “protocol decision” which is not publicly available. Later in August 2015, the CMU adopted Ordinance imposing the similar obligations on UGV. The respective obligations were included into PSO imposed upon Naftogaz by CMU Resolution dated September 22, 2016 No. 658). On December 28, 2016, the CMU issued Ordinance No. 1018п, whereby the debt of Odessa Port Plant owed to Naftogaz was restructured for two years starting from April 1, 2017 (interest-free) (OECD, 2019[40]).}

SOEs may also have substantial debt arrears with one another, which is especially the case in the energy sector. These include debts of coal mines to electricity producers; debts in the electricity market between the Guaranteed Buyer and Ukrenergo; debts of the Guaranteed Buyer to the recipients of green tariff for electricity production; the unresolved debt of Energorynok to Ukrenergo; and debts of heating companies to Naftogaz (OECD, 2020[69]).\footnote{Ukrenergo’s appeal to collect UAH 1.68 billion in debt from Energorynok was recently overturned (Economic Truth, 2020[327]).}

F.2. [In particular:] SOEs’ economic activities should not benefit from any indirect financial support that confers an advantage over private competitors, such as preferential financing, tax arrears or preferential trade credits from other SOEs. SOEs’ economic activities should not receive inputs (such as energy, water or land) at prices or conditions more favourable than those available to private competitors.

It should be noted that SOEs may be subject to preferential access to: tax benefits (exemptions or deferrals); land or other inputs; state guarantees securing financial liabilities of SOEs; interest rate compensations for commercial borrowings; debt write-offs and penalties with regard to the social insurance payments; recapitalisation;
preferential lending; and public procurement, as further outlined in Section 4. (Holzler, 2015[251])

For example, the AMCU has received private complaints on unlawful state aid in the postal and transport sectors. In particular, one of the leading providers of express delivery parcels in Ukraine, namely Nova Poshta (“NP”), privately complained to the AMCU regarding its rival state-owned postal operator Ukrposhta. According to the information available, Ukrposhta benefits from exceptionally low cost for its rental of state-owned and communal premises, i.e. in the amount of UAH 1 per year (approx. EUR 0.03). This amount of rental payment, which is established for state-funded organisations, applies to Ukrposhta in view of its obligations of delivery of state-owned/generated and communal periodical literature (Redcliff Partners, 2018[253]).

At the municipal level, there is a high level of uncollected tax on sizeable land or real estate assets that are owed to the municipalities from MOEs operating in competitive markets with private companies (Centre for Economic Strategy, 2020[181]). In August 2019, the AMCU issued a decision (No 535-p), according to which discount on land taxes granted by Sumy City Counsel to MOEs providing services related to public transportation, electricity transmission, water intake and supply, ancillary maintenance of air transport, and sanatoriums and rehabilitation centres financed from the state and municipal budgets constituted compatible state aid. In addition, coal mining companies have been identified as a particular challenge, accounting for the highest levels of uncollected tax, although this is not related to the applicability of tax rules but rather to structural problems in that sector.

F.3. [In particular:] SOEs’ economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

There is no legal requirement for SOEs engaged in competitive activities to achieve a minimum rate of return (see profiles of top-15 SOEs in Section 3 for average ROE/ROA). SOEs are expected to generate profits or, for those that are not profitable, to reduce their losses. Individual SOEs’ financial objectives are established through their financial plans, strategic development plans and 3-5 year investment plans, approved by shareholding ministries and, for some large SOEs and natural monopolies, by the CMU. In some cases, the regulators (such as NEURC) are involved in approving investment plans for licensees and tariffs, which are part of the financial plan approval process. The strategic development plans and financial plans are obsolete planning tools which do not allow flexibility for adjustments when this is necessary for achieving company objectives (as outlined in Sections 5 and 11). Moreover, most SOEs lack business plans made on the basis of a corporate strategy and risk assessment, which would be in line with general ownership policy and goals set by the state for each enterprise.

One area where SOEs’ financial conditions differ significantly from those of private companies concerns dividend pay-out ratios. As outlined in Section 4.3, dividend policy of the government is set at a 30% minimum rate based on the company’s net profit. The exact dividend pay-out is a flat rate set by the CMU annually for the previous financial year and the decisions are not substantiated based on the situations of individual SOEs (with some exceptions). In most cases, the rate is based on the

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189 Centre for Economic Strategy documented that for the whole of 2019, the municipal enterprises of Dnipro, Slovyansk community and Mykolaiv paid symbolic amounts of income tax compared to private companies.
fiscal needs of the state in a given year, rather than the financial condition of individual SOEs, its strategy or investment needs. In addition, there is currently no requirement to pay dividends on a consolidated basis, and some of the SOEs continue to pay double dividends, as both parent and subsidiary companies submit payments. In some cases, subsidiaries of SOEs are specifically required to pay dividends directly into the state budget.

Discussions with individual SOEs and ownership entities indicate that there is little dialogue regarding the desired capital structure of SOEs. This is also linked to the overall lack of clear owner's expectations communicated to individual SOEs, with often weighty public policy objectives imposed on SOEs without either a clear separation of accounting or a transparent and competitively neutral compensation mechanism. Moreover, for MOEs, annual dividend pay-outs are similarly not benchmarked against industry standards or subject to any harmonised dividend policy.

12.7. Public procurement procedures

G. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

The Law on Public Procurement has been amended in line with the 2014 Association Agreement with the EU. It foresees that Ukraine should ensure its existing and future legislation on public procurement is gradually made compatible with the EU public procurement acquis.190 In addition, in 2016 Ukraine acceded to the WTO's General Procurement Agreement (GPA).191 The Law on Public Procurement establishes specific rules for the procurement of goods and services, and it applies strictly to majority-owned commercial SOEs that engage in certain activities where they may retain special and exclusive rights, including gas transportation and postal services. Most, if not all SOEs, meeting the above mentioned criteria, use the ProZorro marketplace as a platform for procurement as a means to ensure fair competition, transparency, and non-discrimination practices, while working to prevent corruption. SOEs as bidders would have a tender through the ProZorro platform, which does not discriminate among bidder types. Any business that feels its rights have been violated can file a complaint with the AMCU.

Still, there are cases where municipal enterprises in competitive industries receive direct orders from the city authorities and bypass tender processes, which contradicts the legislation on state aid and protection of economic competition (Centre for Economic Strategy, 2020[181]).192 Moreover, according to a recent study, some local

191 WTO Government procurement - The Agreement on Government Procurement (GPA); https://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm. The text of the Agreement establishes rules requiring that open, fair and transparent conditions of competition be ensured in government procurement. The fundamental aim of the GPA is to mutually open government procurement markets among its parties.
192 Centre for Economic Strategy cites an example from the Department of Construction and Housing of the Kyiv City State Administration which transferred the functions of the contracting authority for construction, reconstruction and repair of municipal property to four specialised municipal enterprises of the City Council without a tender. However, the law on local self-government implies that such services are performed or delegated according to the
authorities benefit from legal ambiguity as to the application of the procurement rules when contracting from MOEs, and only publish a contract report with the contractor, as opposed to opening a competitive tender on ProZorro, which would appear to be a violation of the Public Procurement Law. Finally, when competitive tenders are held, the incumbent MOEs are often not challenged by competitors due to the nature of the local markets and services of general economic interest (SGEI) that are expected of operators, which is the case in local transport (Centre for Economic Strategy, 2020[181]). For example, in Kharkiv, a state-owned municipal enterprise offers services to local authorities and municipal enterprises, including the municipally-run subway, with most purchases occurring on a non-competitive basis and outside of the ProZorro tender procedures (Yablonovsky, 2019[254]).

Exceptions to the transparency rules around public procurement apply to contracts of significant national importance or defence SOEs whose activities fall under the Law on State Secrets (IMF, 2016[255]). An upwards of 90% of procurement activity for defence purposes remains classified, including the registry for defence suppliers. However, the definition of “state secret” is considered to be broad and may apply to contracting by local authorities of many kinds of services that would normally be subject to competitive tender, such as security services (Centre for Economic Strategy, 2020[181]) (Yablonovsky, 2019[254]). This has given no opportunity to evaluate the treatment of SOEs as bidders or procurers in this sector. It is, moreover, considered as an area rife with corruption and lacking of accountability (allegedly, military and dual-use items are procured through single-source contracts resulting in excessive prices and poor quality goods) (DLA Piper, n.d.[256]). A Law of Ukraine On Defence Procurement was passed in 2020, which aims to establish an open electronic registry of suppliers and manufacturers, with potential to introduce significant transparency improvements around public procurement practices of SOEs in the defence sector (Verkhovna Rada, 2020[257]).

Procurement by SOEs continues to be an area where the highest number of corruption crimes take place, and recent OECD studies point to the need for significant improvements prevention and detection efforts targeting illegal supplier collusion (OECD, forthcoming[258]) (OECD, 2018[12]). It is understood by the assessment team that most of the illegal and anti-competitive activity taking place around public procurement relates to collusion between various private companies and the management of the SOEs procuring the goods. However, some of the SOEs have started improving the monitoring of their procurement practices, as outlined in their annual and sustainability reports.

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193 In many cities, the authorities establish their own utilities – "municipal guards" – which has come under investigation by AMCU due to the potential that local budget financing constitutes state aid (Yablonovsky, 2019[254]).

194 For example, according to the NABU reports the sector of infrastructure and transport is dominated by cases where works and services are purchased at artificially inflated prices. This is usually done through collusion between various private companies and the management of the SOEs procuring the goods.
Chapter 13. Equitable treatment of shareholders and other investors

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

13.1. Ensuring equitable treatment of shareholders

A. The state should strive toward full implementation of the OECD Principles of Corporate Governance when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:

A.1. The state and SOEs should ensure that all shareholders are treated equitably.

Under the current SOE legal and policy framework, the state as a sole shareholder may exercise corporate rights over SOEs without convening a general meeting. If other shareholders exist, the rules on convening and holding a general meeting, which are provided under the charter of a relevant SOE, come into play (Verkhovna Rada, 2006[122]; CMU, 2020[42]). Further provisions are outlined in the JSC law regarding equitable treatment of shareholders, which is applicable to corporatised SOEs. As mentioned in earlier sections, 86% of the SOEs in Ukraine are registered as state unitary enterprises, where the state is the sole owner. In other majority-owned SOEs (including those registered as JSCs), the share of state ownership and the presence of private shareholders varies.\(^{195}\) According to information provided by NCSSM, out of 158 state-owned corporatised entities, 47 are 100% state-owned (including those among the top-15 SOEs) and 49 have less than 50% state ownership. The remainder have minority (private) shareholders present, though information regarding their composition often remains limited (CMU, 2020[42]).\(^{196}\)

According to the JSC law, each ordinary share provides its owner with the same rights, namely participating in the general meeting, receiving dividends and payments in case of liquidation, and obtaining information regarding the company’s activities. Each

\(^{195}\) It is worth noting that the term “minority shareholder” is not defined within the Ukrainian legislation, and is referred to as either non-state or private shareholder.

\(^{196}\) However, it is worth noting that most of these companies are unlisted (not being admitted for public trading). Moreover, certain entities are registered as legal forms (such as open joint-stock companies) that no longer remain valid.
shareholder is granted one vote per share, except during cumulative voting. There are further specificities applicable to preferred shareholders (and depending on the class of preferred shares), particularly with regard to receiving guaranteed level dividends and voting rights, as elaborated below (see Recommendation A.4.). The charter of a company defines the amount and sequencing of dividend payments, and terms and conditions of converting shares into different classes or types (CMU, 2020[42]) (Verkhovna Rada, 2008[123]).

In addition to voting, legislative framework has been further developed to help protect the interests of minority shareholders. Notably, those owning 10% of the shares or more are able to (i) call a general meeting, (ii) appoint representatives to supervise the registration of shareholders, (iii) initiate an audit of a JSC, and (iv) bring a derivative suit. In addition, they can grant consents on transactions during the general meeting depending on the value of goods and services as a share of company’s assets (Table 13.1). Within two years of creating a JSC (except for re-organisation), any transaction worth over 10% of asset value of the company (or charter capital, if no annual financial statements are available) and where the founder of the company is involved should be granted by the general meeting, and information should be made publicly available. However there may be some exception, as the rule would not apply in the case of transactions subject to state regulated prices and tariffs. Moreover, as the decision on significant transactions should be taken by a majority vote, majority shareholder can de facto make a decision without the support of a minority shareholder (CMU, 2020[42]) (Verkhovna Rada, 2008[123]).

Table 13.1. Parties responsible for granting consent based on the value of goods and services of transactions

<table>
<thead>
<tr>
<th>Supervisory board</th>
<th>10%-25%</th>
<th>25%-50%</th>
<th>50%+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supervisory board</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supervisory board (with at least 1/3 independent directors)</td>
<td>X</td>
<td>X</td>
<td>X**</td>
</tr>
<tr>
<td>General meeting (on the proposal of SB), based on over 50% of the votes*</td>
<td>(X)</td>
<td>(X)</td>
<td>(X)</td>
</tr>
</tbody>
</table>

Note: transaction depends on the market value of goods or service as a share of value of company’s assets based on the latest annual financial statement. (X) means that the general meeting may decide if there is no independent supervisory board (or if the charter does not contain a respective provision). *It is worth noting that while an independent board can be present, general shareholders’ meeting is not deprived of its right to decide on the same matters. De facto, two bodies may be able to take these decisions. **Supervisory board of a public JSC and banks can decide on 50%+ transactions. However, supervisory board of a private JSC can take decisions regarding 50% or more in case where it has at least 1/3 independent directors and the charter empowers them to do so.

Source: Author’s compilation is based on the responses from the questionnaire and JSC law.

Moreover, in 2017 Ukraine adopted a law on squeeze-out and sell-out procedures to better align with the EU law. The shareholders have the right to require mandatory repurchase of ordinary shares if they vote against merger, accession, division,

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197 Cumulative voting is applicable during the selection of supervisory board members in JSCs. However, supervisory board member selection processes in SOEs are determined by the CMU and differ from general procedures outlined in the JSC law.

198 Other minority shareholders may be able to consolidate their shares to carry out these actions, though it is subject to interpretation.

199 Law of Ukraine No. 1983-VIII was introduced to bring Ukrainian takeover provisions in line with Directive 2004/25/EC and to meet requirements under the Association Agreement. The law also implemented provisions on the rights of minority shareholders regarding sell-out and squeeze-out procedures.
transformation, or change of company type, material or interested party transaction, change of charter capital or waiver of pre-emptive right to purchase newly issued shares (Conlon, Dovgan and Mainarovich, 2017[258]). As of March 2020, 317 JSCs overall in Ukraine had gone through these procedures. While most of the transactions concerned private companies, a number of state-owned and state-controlled companies also took part (NCSSM, 2020[260]).

In addition, Ukraine has established a mechanism for filing derivative claims to protect personal property or non-property rights, which may help protect shareholders’ interests. During the early 2000s, the mechanism was abused by filing a large number of lawsuits, which hindered the activities of SOEs. As such, the Supreme Court banned derivative suits in 2008, which remained on hold until relevant legislative amendments were re-introduced in 2016. Currently, the shareholders may bring derivative claims if they own 10% or more of the share capital (except preferred shares) or property.

However, derivative suits have remained very rare and ineffective, partly because all of the conditions of civil liability needed to be met to file a claim (including illegality, damages, causation and guilt). Following the introduction of the framework in 2016, the first derivative claim was settled three years later. Moreover, there is a lack of clarity as to whether the 10% threshold would allow minority shareholders to file class action lawsuits, as limiting it to a single owner creates a high barrier. Currently, draft law No. 2493 seeks to reduce the threshold to 5% and to allow class action suits.

A.2. [Concerning shareholder protection this includes:] SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.

According to the JSC law, shareholders have the right to access the company charter and articles of incorporation, regulations of corporate bodies, and governance principles. They may also access minutes of the general shareholders’ meeting, and meeting minutes and reports of the supervisory board, collegial executive body and the audit committee. Other components include information regarding controllers from the audit firm, annual financial statements, documents submitted to state authorities, prospectus for securities and special reports regarding legal requirements. Moreover, shareholders may access regulations and reports on the remuneration of board members and mechanisms for their setting (Verkhovna Rada, 2008[123]).

200 The registry of companies participating in squeeze-out procedures may be found here: https://www.csd.ua/index.php?option=com_easytable&view=easytable&id=48&itemid=342&lang=ua
201 The recommendation was provided in paragraph 51 of the Resolution of the Plenum of the Supreme Court of Ukraine № 13 of 24.10.2008 “On the practice of consideration of corporate disputes by courts”: companies outside the relationship of representation. On this basis, the commercial courts were to refuse the shareholders (participants) of the company to satisfy claims.
203 According to the ruling, a gas company (Company Gas Resource LLC) was to recover damages from the CEO, who failed to purchase a special permit necessary for the company’s activities (Yasinska, 2020[345]) (Kibenko, 2020[346]).
204 Regulations on information disclosure are monitored by the NCSSM (No. 2826 dated December 2013). In addition, the Ministry of Justice (No. 2180/24712 December 2013) regulates the composition, procedure and timing of information availability on the stock market.
All shareholders can also access information regarding the company's financial and economic activities. The corporate secretary (or the executive body) should provide access to information within 10 days upon request. Shareholders also have the right to familiarise themselves with documents on the company's premises, and receive additional information with consent of the executive body (or as elaborated in the charter).

In addition, shareholders (or representatives of relevant entities) are entitled to participate in general meetings, along with other invited representatives (such as auditors, union representatives and officials). Draft agendas and notices are circulated among all shareholders no later than 30 days prior to the meeting. Board room discussions are reflected in the meeting minutes, which may be classified as confidential and not be subject to disclosure to third parties. However, the company may be obligated to disclose board meeting minutes if requested by law enforcement bodies or members of parliament (which may be abused). JSCs are also subject to additional disclosure requirements under the NCSSM regulations, and other requirements may also applicable depending on the SOE legal form and type (as further elaborated in Section 15) (CMU, 2020[42] (Verkhovna Rada, 2008[123]). However, in practice minority shareholders have submitted complaints regarding failure to disclose information (for example, with regard to notices and agendas for general meetings).

It is also worth noting that a number of companies have mixed ownership arrangements, and as a result, transparency and disclosure practices may be unclear. For example, Naftogaz currently has (i) subsidiary (daughter) companies, (ii) companies where it owns either 100% shares (such as Ukrgasvydobuvannya) or more than 50% shares, and (iii) entities where it owns less than 50% shares, such as local gas distribution companies. Often, other shareholders in these companies (particularly in local gas distribution companies) are vested interests or politically connected persons, through their ownership remains non-transparent (OECD, 2019[40]). Their influence, however, may be felt through challenges in promoting reforms.

A.3. [Concerning shareholder protection this includes:] SOEs should develop an active policy of communication and consultation with all shareholders.

Apart from disclosure requirements elaborated in Section 15, currently there are no provisions in Ukraine requiring the development of a shareholder interaction policy, though recommendations are provided by the NCSSM and are outlined in the Corporate Governance Code. In addition, according to the JSC and SOE laws, supervisory boards in SOEs have an option to elect a corporate secretary responsible for interacting with shareholders and investors. Based on the recommendations, companies should develop and disclose a shareholder interaction policy (subject to the supervisory board’s approval) and create a shareholder relations department. They should also create a formal mechanism for investor relations, which will be used for responding to inquiries, facilitating participation during the general meeting, and providing minority shareholders with an opportunity to communicate their views with the supervisory board. While not all companies are able to create such departments, they have an option to introduce these responsibilities within the existing departments (such as public relations or legal departments).
A.4. [Concerning shareholder protection this includes:] The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.

In JSCs, all shareholders may participate during the general meeting and in taking decisions through voting. In general, voting is carried out by using ballots. However, if stipulated in the charter and if there are no more than 25 shareholders, decisions may be made by an absentee ballot (poll). Decisions of general meetings on majority of the issues put to vote are taken by a simple majority of votes of shareholders registered to participate, with each share counting as one vote (except in cumulative voting).\textsuperscript{205} (In private JSCs, the charter may provide for higher threshold on most of the matters.) There are no specific requirements regarding non-state shareholders and all shareholders vote the same way. However, the following decisions should be adopted by three-fourths of votes of registered shareholders, unless more votes are required by the charter:

- Amending the charter
- Cancelling repurchased shares
- Increasing or decreasing authorised capital
- Changing the type of JSC
- Issuing new issue or other securities, or changing of the share capital
- Deciding on the placement of securities
- Deciding on liquidation or demerger of the company

Comparably, the holders of preferred shares may vote only on the following issues (and other issues outlined in the charter):

- Liquidation of the company that envisages converting preferred shares of a given class into ordinary or preferred shares of another class
- Any amendments to the charter that would restrict the rights of preferred shareholders
- Any amendments to the charter regarding the placement of a new class of preferred shares, whose owners will have a higher priority in collecting dividends or receiving payments in case the company is liquidated, or increase the rights of shareholders
- Decrease in the size of authorised capital

However, besides the guaranteed level of dividends, “preferred shareholders” receive no other benefits, though the charter of a private JSC may allow preferred shareholders to vote on other issues as well. Decisions are adopted if more than three-fourths of preferred shareholders, who participated in voting on the issue, voted in favour (unless the charter of a company with 25 shareholders or less requires more votes) (CMU, 2020\textsuperscript{[122]}) (Verkhovna Rada, 2008\textsuperscript{[123]}).

A.5. [Concerning shareholder protection this includes:] Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.

\textsuperscript{205} Cumulative voting is applicable to electing members to the company’s body in joint-stock companies (not all SOE JSCs are public) and banks. Private JSCs can provide for election of supervisory board based on cumulative voting in their charters, though this is not mandatory. However, procedures for electing company’s body in joint-stock SOEs are determined by CMU Resolutions 142, 143 and 777, as applicable, as elaborated in Part I.
To promote equitable treatment of shareholders, transactions between the state and SOEs, and between SOEs, are expected to take place on the same terms as those between other market participants. In Ukrainian legislation, regulations regarding related party and interest-bearing transactions are outlined in the JSC law, which are applicable to corporatised SOEs (Box 13.1). Information regarding transactions between the state and the SOEs, as well as between SOEs are subject to disclosure, with some carve-outs applicable for intra-group transactions. Both supervisory and executive body members are responsible for disclosing information regarding transactions that involve company shares and derivatives, or transactions with related companies. In addition, employees and officials should inform anti-corruption officers or shareholders regarding any conflicts of interest (as further elaborated in Sections 15 and 16). Supervisory board must also engage an independent external auditor to verify that related party transactions are taking place under normal market conditions, which are subject to the board’s approval (this is not applicable to private JSCs, unless otherwise stated in the charter). Moreover, transactions that relate to public procurement allow SOEs to compete on an equal footing with the private companies. Entities, such as the AMCU and the State Audit Office, also monitor transactions between SOEs, the state and other interested parties (CMU, 2020). However, as these provisions apply mainly to JSCs, they may not be strictly applicable or enforced in other SOE legal forms (such as state unitary enterprises and LLCs). Despite the legal framework applicable to JSCs, transactions with related parties are performed on terms that would not necessarily be available to unrelated parties (Naftogaz Group, 2019).

**Box 13.1. Provisions regarding interested party transactions**

JSC law contains provisions regarding interested party transactions worth over 1% asset value of the company. The executive body of a JSC should submit draft transactions and explanation of interest to the supervisory board (or, in case of absence, to each shareholder) within five working days. Supervisory board must involve an independent auditor to evaluate the transaction (except in private JSCs, unless otherwise stated in the charter). Consent is determined by majority vote of the supervisory board members (those involved in the transaction are not eligible to vote). The general meeting decides on the transaction if (i) there is no supervisory board; (ii) if all board members are parties to the transaction; (iii) if the market value of the transaction exceeds 10% of asset value of the company; or (iv) if the supervisory board rejects to decide or does not decide within 30 days. The information regarding interested party transactions is subject to disclosure (except in private JSCs, unless otherwise stated in the charter). In some cases, these procedures may not be applicable, such as in repurchasing shares, liquidation of a JSC, or banking transactions that are regulated by the Law on Banks and Banking Activities.

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206 However, SOEs are currently not required to have specific policies regarding conflicts of interest.

207 It should be noted that parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Group companies that are ultimately controlled by the Government of Ukraine are considered as related parties under common control. In addition, related parties also include the members of the executive board and supervisory board, and close members of their families, as well as those entities over which the members of the executive board or their close family members are able to exercise a significant influence or in which they hold a significant share of voting right.

208 As mentioned in Sections 4 and 12, SOEs and MOEs remain some of the largest recipients of state aid. Other transactions may include debt write-offs between enterprises, such as the debts on the gas, heating and electricity markets between state-owned companies, which are subject to public service obligations.
13.2. Adherence to the corporate governance code

B. National corporate governance codes should be adhered to by all listed and, where practical, unlisted SOEs.

Corporatised SOEs in Ukraine must comply with corporate governance requirements under the JSC law, along with other laws and provisions (such as the SOE law and CMU Resolutions) as applicable. In addition, Ukraine adopted a Corporate Governance Code, which was updated in March 2020. The code seeks to improve and standardise corporate governance practices in Ukraine. It covers elements, including defining objectives, shareholders’ rights and the role of stakeholders, board responsibilities, relationship with the management, disclosure and transparency, internal controls and ethical standards, and corporate governance evaluations. While the code applies primarily to stock market participants, it provides guidance for unlisted companies and SOEs, and takes international standards into consideration (including the G20/OECD Principles of Corporate Governance and UNCTAD Guidance on good Practices in Corporate Governance Disclosure, among others) (CMU, 2020[42]).

As outlined in Part I, the code mainly has an advisory nature and acts as a reference point for JSCs (including corporatised SOEs). However, listed companies are required to explain how they implement the recommendations in the code, as well as any deviations, and to outline achievements of their corporate governance aims through other practices (NCSSM and UCGA, 2020[261]). Additional corporate governance requirements are applicable to the state-owned banks approved by the NBU. These include the Methodological Recommendations on the Organisation of Corporate Governance in Banks of Ukraine, which take into consideration the recommendations of the Basel Committee on Banking Supervision on corporate governance. While the recommendations are not strictly enforced, the NBU uses them to monitor and help improve corporate governance in each bank according to its Annual Bank Inspection Plan. The NBU’s recommendations based on its inspections are mandatory for the banks to implement.

13.3. Disclosure of public policy objectives

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

SOEs in Ukraine perform public policy objectives and special obligations that are often imposed through the CMU resolutions. For example, the CMU Resolution 483 dated

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209 In addition, certain SOEs have adopted individual corporate governance plans and codes, including Ukrzaliznytsia and Ukrhydroenergo.

210 In addition, Ukrainian Corporate Governance Academy has developed Recommendations on the Governance of SOEs: https://ucga.com.ua/policy/recommendations-governance-state-owned-enterprises-ukraine

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June 5, 2019 is applicable to electricity producing SOEs to sell electricity at below market levels. Similar provisions are applicable to SOEs across other sectors, including natural gas, postal services and communications. According to the JSC law, shareholders are to receive information regarding any developments, material, financial statements and reports submitted to state authorities, including on the performance of public policy objectives. Moreover, information regarding PSOs should be made available through the SOE websites (or through the website of the ownership entity), financial statements and reports, covering expenditures for non-commercial purposes and sources of funding. Information should also be provided through decisions issued by the government and regulatory bodies (Verkhovna Rada, 2003[5] (CMU, 2020[42]). While information regarding public policy objectives is disclosed among some of the top SOEs, there is limited clarity whether disclosure requirements are enforced on a broader scale (see Section 15). In addition, although information regarding PSO policies is available, methodologies regarding their development and amendment remain unclear.

13.4. Joint ventures and public private partnerships

D. When SOEs engage in co-operative projects such as joint ventures and public-private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner.

Until October 2019, SOEs were unable to engage in joint ventures and public-private partnerships (PPPs). Following legal and regulatory changes, SOEs may now initiate, evaluate and sign PPP contracts (if they are the holding entity), or obtain approval from their ownership entity or the CMU (Verkhovna Rada, 2006[12]). Currently, the Law on Public Private Partnership provides relevant framework and principles for the interaction of public-private partners on a contractual basis, and covers areas, including dispute settlement and guarantees of rights of private partners, as well as state support for implementing projects. Other areas include decision-making regarding the performance of PPPs and procedures for holding competitions in identifying private partners (CMU, 2020[42]) (Verkhovna Rada, 2010[262]). While secondary legislation to allow for the implementation of PPPs in SOEs is still underway, a number of SOEs have started participating in projects and joint ventures, particularly in infrastructure and defence sectors. However, information regarding dispute settlement and upholding contractual rights in the SOE sector remains limited.
The state ownership policy should fully recognise SOEs’ responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

14.1. Recognising and respecting stakeholders’ rights

A. Governments, the state ownership entities and SOEs themselves should recognise and respect stakeholders’ rights established by law or through mutual agreements.

Ukraine has introduced a policy framework with regard to protecting stakeholders’ rights, which are applicable to SOEs. These include laws and regulations to protect the environment, employees and human rights, and to introduce anti-corruption measures. A number of SOEs (including Naftogaz and Ukrenergo) have started adopting policies with regard to social and environmental protection, and anti-corruption programmes, while introducing due diligence mechanisms. In addition, both SOE and JSC laws stipulate that representatives of local self-government bodies, trade unions, and labour collectives that have established an agreement with the company may participate during supervisory board meetings. The responsibilities of the representatives, however, are not specified in the law, though in case of participation, they may cast an advisory vote (CMU, 2020[42]).

While there is limited clarity whether ownership entities are expected to develop policies related to the rights of stakeholders, the Basic Principles (ownership policy) outlines that the SOE governing bodies should:

- Create optimal conditions for work, development, and realise personnel potential
- Ensure non-discrimination in labour relations
- Promote energy efficiency
- Minimise harmful effects on the environment

However, as outlined in Section 10, the Basic Principles as a policy document is not easily accessible, and has weak legal power and poor enforceability.

211 Stakeholders are individuals or groups that have interests that are or could potentially be impacted by the activities of a company. For example, these may include communities at local, regional and national levels, workers and employees, and consumers, as well as NGOs, civil society organisations, host governments, industry peers, and business partners (OECD, 2018[324]).
Certain ownership entities (such as the SPFU) are expected to procure environmental audits (Verkhovna Rada, 2006[122]). Others, such as the Ministry of Social Policy, have outlined the importance of ensuring social responsibility of enterprises, albeit without further elaboration (Ministry of Social Policy, 2019[263]).

While there is currently no centralised policy document (other than the Concept Note on Socially Responsible Business, see Section 14.4) regarding the protection of stakeholder interests, the SOEs, as well as the government and the ownership entities, are expected to comply with legal and regulatory frameworks outlined below:

- **Environmental protection.** Ukraine has introduced environmental regulations to promote stakeholder protection. Along with broader regulations (including the Law on Environmental Protection), it has introduced additional codes (including subsoil and water codes) that are applicable to companies (including SOEs) in conducting their operations. In 2018, Ukraine introduced a Law on Environmental Impact Assessment (EIA) to prevent environmental damage, consider both public and private interests, and allow communities to voice their concerns with regard to potential impact of company operations on the environment. Prior to carrying out some of activities specified in the law, companies (including SOEs) are expected to prepare EIA reports in areas where they seek to implement their projects. The assessments should outline main activities, possible risks, and prospects for social and economic development. Following the assessment, companies are required to engage in consultations with communities and the government, and, once decision has been made, they may proceed with or discontinue their activities. The EIA report, along with relevant documents, should be submitted in a timely manner and be made publicly available through a unified registry (Verkhovna Rada, 2017[264]). Since its adoption, a number of SOEs have conducted EIAs, including Naftogaz, Energoatom, Ukrhydroenergo and Ukrenergo, among others. However, the overall process may have shortfalls, including a lack of standardisation and consolidation of EIA reporting, limited awareness and civil society participation.

- **Human rights.** Ukraine has introduced instruments on internationally recognised human rights outlined in the International Bill of Human Rights, as well as ILO conventions and standards. It has established an office of the parliament Commissioner for Human Rights to ensure the observance of the constitutional human and citizen rights and freedoms, and to allow citizens to appeal to the commissioner in case of infringements (OECD, 2016[265]). The country also introduced a National Human Rights Strategy in 2015 to improve the observance and enforcement of human rights in Ukraine, and an action plan for

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212 The activities are outlined in the EIA law and are divided in two categories, covering energy-related (hydrocarbons exploration, thermal plant operation, installations), metallurgy and chemical production, infrastructure work (construction of airports, railways, roads and dams) and utilities (including waste management). However, the rationale for having two categories or specific distinctions between them is not clear.

213 Specifically, companies are expected to provide new EIA reports with each new activity, regardless of whether an activity may be conducted in the same region of previous operations. This may create confusion among relevant stakeholders.

214 During the onset of Covid-19, public hearings were cancelled and only written submissions were allowed, thus not allowing for a meaningful exchange with stakeholders regarding on-going activities.

215 Notably, these include the Universal Declaration of Human Rights and the main instruments through which it has been codified, namely the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights. Ukraine has also ratified 69 ILO International Labour Standards (Conventions).
implementation. However, certain human rights challenges can be observed in some SOEs (particularly in the mining sector), as well as entities located in non-government controlled areas.

- **Employment and labour rights.** Ukraine’s Labour Code has been the main legal basis for employer-employee relations. Along with outlining labour rights, it contains provisions regarding collective agreements, trade unions, employee contracts, occupational health and female employment, among others. In recent years, a number of changes have been introduced, including prohibiting discrimination based on sexual orientation (OECD, 2016[265])(Verkhovna Rada, 1971[266]). In addition, the rights of trade unions and associations are outlined in the Constitution and in other normative acts. The unions may conduct inspections, demand information from companies and communicate with employees. Employees belonging to trade unions may exercise powers, including collective bargaining and disciplinary action (Verkhovna Rada, 1999[267]). Moreover, Ukraine has introduced sector-specific legislation regarding occupational safety measures, particularly in nuclear and hydrocarbons sectors, and the operation of specialised equipment, which apply strictly to SOEs engaged in these sectors. Nevertheless, there have been challenges in upholding labour rights (including non-payment of wages) among SOEs in recent years, which have resulted in strikes (mainly in the mining sector).

- **Consumer, creditor and investor protection.** The Law on Consumer Protection outlines provisions to protect consumer rights and ensure product safety, quality, and accessibility of reliable and timely information. It also includes elements covering warranties and credit transactions (Verkhovna Rada, 1991[268]). Ukraine has developed legislation to protect creditors’ rights and a bankruptcy code, with the latter containing specific provisions on SOEs which do not fully protect creditors’ rights.216 Moreover, in 2015 Ukraine adopted a law to protect the rights of investors, including the submission of derivative claims, while ensuring information availability prior to transactions and on a quarterly and annual basis (in JSCs) (further details are outlined in Section 13). The country has also introduced alternative ways of paying dividends (including through a depository system or directly to shareholders) and improved procedures for determining market value of securities (PARD, n.d.[269]) (Verkhovna Rada, 2015[270]).

- **Anti-corruption framework.** Ukraine has developed anti-corruption programmes and legislation regarding whistleblower protection, which should be adopted in SOEs (as further outlined below, also see Section 4.5). In 2019, Verkhovna Rada introduced amendments to the Law on Prevention of Corruption that defined whistleblowers and established communication channels through the National Agency for Prevention of Corruption (NAPC). Whistleblowers are also expected to receive guarantees and labour rights, and legal protection and assistance.217 They are to remain anonymous and they may receive reward for their co-operation (Verkhovna Rada, 2019[271]). In case of appeal, the NAPC is expected to represent the interests of whistleblowers, while other entities, including NABU and state bodies, may get involved during the investigation. In complying with relevant regulations, a number of SOEs have developed anti-corruption programmes and established communication channels, including hotlines and online platforms, and

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217 Notably, provisions under the Law on Ensuring the Safety of Persons Participating in Criminal Proceedings may be applicable to whistleblowers.
have organised reception days. However, in practice the effectiveness of these programmes and measures often remains limited (OECD, 2018[12]). Moreover, as mentioned in Section 4.5, a draft law was passed in Verkhovna Rada (No. 3450) that would have weakened whistleblower protection and restrict their rights. However, the draft law was not signed by the President (Verkhovna Rada, 2020[272]) (TI Ukraine, 2021[153]). Currently, Ukraine is working towards adopting an anti-corruption strategy between 2021-2025 (NAPC, 2021[273]).

Along with the established framework, since 2017, Ukraine has been an adherent to the OECD Declaration on International Investment and Multinational Enterprise and has established a National Contact Point (NCP) under MDETA as part of a complaints mechanism. However, the institutional framework remains nascent and activities (including awareness raising regarding OECD RBC instruments) remain to be initiated. Moreover, the Business Ombudsman Council (established in 2015) is a channel for companies to report unfair business practices. However, over 70% of the cases are submitted by small and medium-sized enterprises, mostly concerning tax issues and complaints against law enforcement, customs, the Ministry of Justice and state regulators (Strikun, 2020[274]). Overall, while steps have been taken among some of the SOEs to comply with legal and regulatory requirements in protecting the rights of stakeholders (particularly among top-15 SOEs), there is a lack of centralised and unified effort from the state in ensuring that SOEs engage in responsible conduct.

14.2. Reporting on stakeholder relations

B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labour, creditors and affected communities.

Ukraine has established disclosure requirements under the Law on Accounting and Financial Reporting, as well as through guidelines introduced by the Ministry of Finance and CMU resolutions (see Section 15). Legislation regarding the requirements to submit non-financial (management) reports remains to be streamlined. In general, enterprises (except for budgetary institutions, micro-enterprises and small enterprises) are expected to submit annual reports with their annual financial statements. If they submit consolidated financial statements, they are required to issue consolidated reports. However, medium-sized enterprises may not reflect non-financial information regarding their operations (CMU, 2000[275]). Stricter requirements regarding the submission of non-financial reports are applicable to state-owned banks (as defined by the NBU) and companies operating in the extractives sector (as defined under the EITI law).

According to the Law on Accounting and Financial Reporting, and subsequent recommendations issued by the Ministry of Finance, annual reports are expected to cover both financial and non-financial information (Ministry of Finance, 2018[276]).

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218 According to the Law on Accounting and Financial Reporting, enterprises of public interest, public joint-stock companies, businesses operating in the extractives sector, and entities determined by the CMU should prepare financial statements and consolidated statements based on IFRS. Others may determine the extent to which preparing financial statements (including consolidated statements) is applicable. Enterprises of public interest (except those not issuing securities), public joint-stock companies, natural monopolies and entities in extractives sector are required to publish annual financial statements by April 30 following the reporting period, along with an auditor’s report. Large non-issuing and medium-sized companies should publish annual financial statements together with the auditor’s report on their website no later than June 1 the year following the reporting period.
Although coverage areas are not exhaustive, the reports are recommended to include the following information:

- Organisational structure and description of the enterprise
- Results of enterprise’s activities
- Liquidity and liabilities
- Environmental issues
- Social issues and personnel policy
- Risks
- Research and innovation
- Financial investments
- Developmental prospects
- Corporate governance structure

A small number of SOEs (among the top-15) have adopted non-financial and sustainability reporting standards (e.g., Global Reporting Initiative Standard). Moreover, the SOEs have started adhering to relevant ISO environmental, labour and governance requirements, while working towards meeting the recommendations under OECD SOE and MNE Guidelines. Large enterprises (500 or more employees) are recommended to include non-financial key performance indicators to monitor the impact of their operations, including social (such as human and labour rights, and community relations), environmental and anti-corruption aspects. They may also outline risks affiliated with their business relationships, products or services, and their efforts in mitigating adverse impacts (CMU, 2020).[42]

Overall, non-financial reporting remains nascent and varies between companies, though key SOEs have improved their reporting and disclosure practices in recent years. For example, Naftogaz, Ukrenergo and Energoatom have been consistently issuing non-financial reports. Ukhydroenergo has also improved its disclosure practices and, along with annual reports, has recently started issuing sustainability reports. While reports are available in some of the other top-15 SOEs, their publication is often delayed. Other companies, such as Boryspil International Airport and Polygraph Combine Ukraina, also cite the importance of having corporate social responsibility programmes and adhering to international standards on responsible conduct, though it is unclear whether they issue non-financial reports (see Table 15.3).

14.3. Internal controls, ethics and compliance programmes

C. The boards of SOEs should develop, implement, monitor and communicate internal controls, ethics and compliance programmes or measures, including those which contribute to preventing fraud and corruption. They should be based on country

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219 Certain SOEs are also looking to comply with relevant EU directives (2014/34), requirements under the US Securities and Exchange Commission, SDGs, Stakeholder Interaction Standard (AA1000SES) and International Standard for Integrated Reporting. Moreover, as an adherent to the Declaration on Multinational Enterprises, Ukraine has committed to meeting certain requirements, including high levels of transparency and disclosure.

220 KPIs for environmental issues may depend on the sector of operation. However, some KPIs may cover water use, waste management, greenhouse gas emissions, pollution and energy consumption. Social and personnel policy indicators may cover areas, such as the total number of employees, equal employment opportunities, diversity, and staff training and education.
norms, in conformity with international commitments and apply to the SOE and its subsidiaries.

The SOE law requires supervisory boards (where formed) in SOEs to establish so-called “anti-corruption policies” which are applicable to SOEs of all legal forms. The JSC law further stipulates that the nominations (appointments) committee is expected to develop a code of ethics to regulate issues on conflicts of interest, confidentiality, fair business conduct, and the protection and proper use of the company’s assets, while providing information regarding violations of legal requirements or ethical standards (Verkhovna Rada, 2008[123]).

While the supervisory board is responsible for forming an anti-corruption policy, the programme is established and implemented by the CEO according to the Law on Prevention of Corruption. As outlined in Part I of this review, anti-corruption programme must be set up in majority-owned SOEs and municipal enterprises that have over 50 employees, more than UAH 70 million gross income from the sale of products (goods and services), or over UAH 20 million in costs of purchasing goods and services. Other SOEs that do not meet the relevant thresholds are responsible for establishing anti-corruption units. However, under the existing framework, the CEO’s functions may overlap with those of the supervisory board members if there is need to have a compliance programme (including an anti-corruption programme) subordinated to the latter. Notably, an anti-corruption officer (also known as commissioner or compliance officer), who is responsible for managing and implementing the anti-corruption programme, is appointed and dismissed by the CEO (in case of dismissal, NAPC’s approval is required).

According to the Law on Prevention of Corruption, anti-corruption programme should outline anti-corruption measures, scope, standards and methods for implementation. In particular, it should elaborate on the following procedures:

- Regular reporting of the Commissioner to the state-owner or other shareholders of legal entity or the CEO (at least once a year)
- Supervising, controlling and monitoring compliance within the anti-corruption programme in the SOE, and evaluating implementation results
- Informing the Commissioner regarding conflicts of interest and ways to resolve them
- Conducting individual consultations regarding the application of anti-corruption standards
- Applying disciplinary measures (such as informing relevant bodies and conducting investigations)
- Ensuring confidentiality and protection of the informant
- Periodic trainings in preventing and combatting corruption
- Making changes to the programme

In addition, the NAPC has developed a methodology for the assessment of corruption risks for public authorities, and procedures for preparing anti-corruption programmes for its approval (NAPC, 2016[277]; NAPC, 2017[278]).

While compliance framework has been developed and measures are partly implemented, SOEs continue to witness high levels of corruption, particularly in energy and defence sectors, and the effectiveness of anti-corruption programmes is questionable. The NAPC lacks the resources, capacity and mandate to monitor
implementation of anti-corruption programmes across the entire SOE portfolio. There is also a lack of clarity regarding whether ownership entities are involved in ensuring the effectiveness of anti-corruption programmes, and assessing their alignment with the state’s expectations with regard to integrity and anti-corruption. Moreover, as the commissioner of the anti-corruption programme is appointed by the CEO, there may be conflicts of interest in monitoring and detecting corruption at management levels.

As documented by a recent OECD study, “the NAPC has not received any cases where whistleblowers have been directed to them for protection and cooperation by individual SOEs. This contrast with levels of detected and perceived corruption in the sector creates impression that reporting channels are not functioning as they should” (OECD, 2018[12]).

It should be noted that only a handful of SOEs (mostly among top-15) in Ukraine have developed risk management systems which include a coherent and comprehensive set of internal controls, ethics and compliance measures. These also include mechanisms to combat corruption within the SOEs and to protect whistleblowers. Despite their existence in certain SOEs, internal controls, as well as ethics and compliance programmes, may not be properly functional. Earlier OECD reviews point to the need to enhance internal controls that include compliance, risk management and audit functions with an independent reporting line to the supervisory board. Furthermore, strong and responsible state ownership is essential to effectively mitigate these risks (OECD, 2020[69]).

14.4. Responsible business conduct

D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.

Similarly to private companies, SOEs should work towards minimising risks and observing high standards of responsible business conduct, including on issues related to the environment, employees, public health and safety, and human rights. In Ukraine, the concept of responsible business conduct (RBC) remains nascent, although relevant regulations and policies have been introduced. The country has also adopted the Concept for Implementing State Policy to Promote the Development of Socially Responsible Business in Ukraine until 2030 and an action plan. According to the Concept, companies (including SOEs) will be expected to protect consumer interests and avoid unfair practices, while launching awareness-raising campaigns to promote responsible conduct. As mentioned, Ukraine became an adherent to the Declaration on International Investment and Multinational Enterprises in 2017 and the OECD MNE Guidelines, and has established a National Contact Point. Relevant RBC and corporate social responsibility standards are also expected to be implemented at the level of supervisory boards and executive bodies. According to the Law on Management of Objects of State Property, the supervisory board of unitary SOEs is responsible for developing corporate social responsibility programmes and for ensuring sustainability of the company’s activities (CMU, 2020[279]).

RBC-related principles and standards, including due diligence mechanisms, have been introduced in a number of SOEs at supervisory and management board levels. For example, Naftogaz has established a Committee on Health, Safety, Environment and Reserves, which is responsible for developing a health, safety and environment
strategy, policies, plans and risk assessment mechanisms. The company has also created an integrated management unit that monitors RBC-related risks, and has adopted relevant environmental, social (including health and safety), and anti-corruption policies. Along with communicating risks, Naftogaz discloses relevant indicators and adheres to Global Reporting Initiative (Naftogaz Group, 2020[61]).

Similar standards, due diligence and disclosure mechanisms have been introduced in other SOEs, including Ukrenergo. A number of SOEs have also established corporate social responsibility units that are responsible for implementing sustainability projects. In particular, Naftogaz and its subsidiaries report that they provide contributions to local communities where they operate, while Ukrhydroenergo engages in cross-border collaboration to ensure the sustainability of water reservoirs (Naftogaz Group, 2020[61]).

On a broader scale, most of the SOEs have yet to adopt RBC policies and introduce due diligence mechanisms. Along with a lack of clarity regarding the meaning of RBC, relevant practices are often limited to company operations, and lack implementation throughout business relationships or supply chains. In addition, certain sectors experience particularly high levels of RBC-related challenges. Notably, state-owned coal mines have high levels of emissions, while their activities and unsustainable mine closures have contributed to excessive water and land pollution. Moreover, workers in state-owned mines often face non-payment of their wages and face health and occupational safety risks, while measures to minimise hazards remain limited (ILO, 2018[280]) (ILO, 2018[281]).

14.5. Financing political activities

E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions.

According to the questionnaire, Ukrainian SOEs are not engaged in financing political activities. The Law on Political Parties prohibits contributions to support political parties by state and municipal enterprises, institutions and organisations, and legal entities where at least 10% of authorised capital or voting rights, directly or indirectly, belong to the state and local governments (CMU, 2020[42]). However, there may be indirect mechanisms for financing or supporting political activities, especially at municipal level.  

221 Global Reporting Initiative is a standards organisation for businesses, governments and other organisations to outline and communicate issues related to human rights, corruption and environment, among others. https://www.globalreporting.org/about-gri/mission-history/

222 However, some SOEs have started working towards introducing RBC in their supply chain through procurement practices and by carrying out “know your counterparty” (KYC) tests.

223 For example, Ukrposhta had been asked on a previous occasion to distribute political propaganda (OPORA, 2020[328]). Moreover, in municipalities, local council members are often CEOs of MOEs, which can provide opportunities for indirect financing of political activities.
Chapter 15. Disclosure and transparency

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

15.1. Disclosure standards and practices

A. SOEs should report material financial and non-financial information on the enterprise in line with high quality internationally recognised standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. With due regard to enterprise capacity and size, examples of such information include:

Disclosure practices

SOE reporting requirements are outlined in the Commercial Code of Ukraine and CMU Resolution No. 1067, along with other applicable laws depending on the SOE legal form (such as the JSC law). The SOEs are required to publish information regarding their activities on their website or that of their ownership entity. Information disclosed by the SOEs should include company objectives, quarterly and annual financial statements, charter of the enterprise (current and previous editions) and ownership structure. SOEs should also disclose biographical information and qualifications of supervisory board and executive body members, along with their annual reports and remuneration (Table 15.1). Other information should include decisions of the general meeting of the shareholder and ownership entity regarding the enterprise, risk factors, and information on agreements and contractual obligations in which the company is engaged. Moreover, expenditures on non-commercial policies (such as PSOs) should be covered in their financial statements, while state aid and the use of public funds should be disclosed to relevant authorities and made publicly available (see Sections 4 and 12). In practice, however, there is a lack of compliance with disclosure and reporting requirements, which is an area difficult to monitor considering the large SOE portfolio.

Table 15.1. Disclosure requirements in Ukrainian SOEs

<table>
<thead>
<tr>
<th>Information</th>
<th>Frequency of publication</th>
<th>Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOE objectives and the state of their achievement</td>
<td>Annual</td>
<td>Simultaneously with annual financial statements</td>
</tr>
<tr>
<td>Quarterly financial statements, including expenditures for non-commercial purposes and sources of funding</td>
<td>Quarterly</td>
<td>No later than last day of the month following the reporting quarter</td>
</tr>
<tr>
<td>Information</td>
<td>Frequency of publication</td>
<td>Deadline</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>--------------------------</td>
<td>--------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Annual financial statements of the enterprise (for the previous 3 years), including any expenditures for non-commercial purposes and sources of funding</td>
<td>Annual</td>
<td>April 30 or June 1 following the reporting year (as further elaborated in Table 15.2)</td>
</tr>
<tr>
<td>Audited financial statements (for previous 3 years)</td>
<td>Annual</td>
<td>April 30 or June 1 following the reporting year (as further elaborated in Table 15.2)</td>
</tr>
<tr>
<td>Charter of the enterprise (Previous versions of the charter to remain available)</td>
<td>Upon registration</td>
<td>Within 10 calendar days (5 in public JSCs) from the date of registration</td>
</tr>
<tr>
<td>Ownership structure</td>
<td>Annual</td>
<td>Simultaneously with annual financial statements</td>
</tr>
<tr>
<td>Biographical information and professional qualifications of management board members</td>
<td>Annual</td>
<td>Simultaneously with the annual financial statement and if information is to be updated (If a new CEO/executive body is elected, then 10 calendar days within the decision on appointment, or within 5 working days for issuers of securities)</td>
</tr>
<tr>
<td>Biographical information and professional qualifications of supervisory board members, including principles of their selection and information regarding their membership on boards of other entities if they are independent members</td>
<td>Annual</td>
<td>Simultaneously with the annual financial statement and if information is to be updated (If a new board member is elected, then within 10 calendar days of the decision on appointment, or within 5 working days for the issuers of securities)</td>
</tr>
<tr>
<td>Annual reports of the supervisory board and the executive body</td>
<td>Annual</td>
<td>Simultaneously with annual financial statements</td>
</tr>
<tr>
<td>Structure, principles of formation and the amount of remuneration for the members of the management and supervisory boards, including any compensation packages and benefits</td>
<td>Annual</td>
<td>Simultaneously with annual financial statements</td>
</tr>
<tr>
<td>Decisions of the ownership entity regarding the enterprise, business partnership, and decisions of the general meeting of the shareholders</td>
<td>After the decision is issued</td>
<td>Within 10 calendar days of the decision</td>
</tr>
<tr>
<td>Description of significant anticipated risk factors that may affect SOE operations and measures to manage such risks</td>
<td>Annual</td>
<td>Simultaneously with annual financial statements</td>
</tr>
<tr>
<td>Information on agreements and contracts subject to disclosure</td>
<td>After contract is concluded</td>
<td>Within 10 calendar days from the date of concluding the contract</td>
</tr>
<tr>
<td>Information on SOE operations and obligations arising as a result of public-private partnership</td>
<td>After the transaction</td>
<td>Within 10 calendar days from the date of concluding the contract</td>
</tr>
</tbody>
</table>

Source: (CMU, 2016\[24\]) (Verkhovna Rada, 2003\[5\])

Reporting and disclosure requirements may also vary depending on the SOE type. Enterprises of public interest (except for large SOEs that are non-issuers of securities), public joint-stock companies, natural monopolies and entities operating in the extractives sector are required to publish their annual financial statements and consolidated statements, together with the auditor’s report, on their website by April 30. Large non-issuer companies, medium-sized companies, and financial institutions belonging to micro and small enterprises are required to publish their annual financial statements and auditor’s reports no later than June 1 of the year following the reporting period. Depending on their legal form, other reporting requirements may be applicable. For example, joint-stock companies are subject to disclosing notices of general meetings and draft agendas, along with their transactions on derivatives and securities, information regarding their (preferred) shares and dividends, and other material determined by NCSSM (CMU, 2020\[42\]) (Verkhovna Rada, 2006\[233\]).

In addition, companies operating in the extractives sector are required to provide information to the Ministry of Energy within the EITI framework. The information may cover company activities, audited reports, list of special permits and subsoil use, and
products that are extracted and sold. These provisions are strictly applicable to Naftogaz, which is required to comply with high levels of transparency and accountability, and inform stakeholders regarding socially significant aspects. Similar requirements are applicable to state-owned coal companies and information may be partly accessed through the EITI reports. However, information is often not fully disclosed or easily accessible, and the publication of the reports is often delayed.

15.1.1. Financial reporting standards

General framework regarding reporting standards in Ukraine is outlined in the Law on Accounting and Financial Reporting and orders of the Ministry of Finance. These requirements apply to all forms of ownership, including SOEs that are required to submit financial statements. Along with national reporting requirements, certain companies (including SOEs) must submit statements according to IFRS, notably:

- Enterprises of public interest, public joint stock companies, issuers of securities that are listed on stock exchanges or for which public offer has been made, large enterprises,
- Business entities operating in the extractive industries
- Enterprises engaged in financial services (other than insurance and pension provision), private pension funds, ancillary activities in the field of financial services and insurance (except for ancillary activities in the field of insurance and pension provision)

In addition, CMU may define SOEs working in specific sectors that should submit statements according to IFRS.

According to Law on Accounting and Financial Reporting, entities that are required to comply with IFRS should submit their financial statements in a single electronic format based on the international taxonomy standards. A single window system for IFRS is currently being prepared for launch in Ukraine, although taxonomies for banking and insurance were previously developed with EU support. The system is to be operated by the NCSSM and, once developed, qualifying SOEs will be expected to prepare and submit their financial statements in eXtensible Business Reporting Language (XBRL) format.

Along with preparing their statements in line with IFRS, the aforesaid SOEs are also subject to mandatory audit requirements, as further outlined below in Section 15.2 and Table 15.2. Certain SOEs may also be required to have their financial statements independently audited based on the book value of their assets. All other entities (other than budgetary institutions) may determine the applicability of IFRS voluntarily. In

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224 Other information includes the number of employees, government subsidies, agreements related to the extractive industries, payments for social and charitable purposes, transportation costs, revenue from oil and gas transportation, annual reports on taxes and other payments.

225 Further steps to improve disclosure practices include the adoption of CMU Resolution No. 419 of February 28, 2000 on submitting financial statements (and subsequent amendments); guidelines on submitting financial statements, consolidated statements and management reports issued by the Ministry of Finance; and amendments to national accounting regulations and standards, among others.

226 According to the Law on Accounting and Financial Reporting, “large enterprises” are those that meet at least two of the following criteria: (i) employ over 250 individuals, (ii) have a book value of over EUR 20 million, or (iii) have a net income of EUR 40 million.
addition, MDETA has developed a template that SOEs may use to submit their financial plans and statements (MDETA, n.d.[282]).

However, the availability and accessibility of financial information, including audited statements of SOEs, is intermittent. While some of the key SOEs (namely those among the top-15) issue audited financial statements, others still need to do so (or have only recently started doing so). Certain SOEs, particularly in the defence sector, may not be subject to similar disclosure requirements due to state secrecy laws. In addition, information on large company groups and holdings are unevenly reported. While some holding companies provide consolidated reports (such as Naftogaz), subsidiaries may also issue financial and non-financial information separately (CMU, 2020[42]). Specific disclosure practices in top-15 SOEs are outlined in Table 15.3.

More broadly, information regarding individual SOEs in public registers is often self-reported, and the quality and robustness of the financial information may be uneven across the sample depending on the extent to which individual SOEs have implemented corporate governance reforms.

Table 15.2. Summary of financial reporting requirements in SOEs by type

<table>
<thead>
<tr>
<th>Enterprise type</th>
<th>Financial statements</th>
<th>Mandatory IFRS reporting</th>
<th>Auditor's report</th>
<th>Disclosure</th>
<th>Reporting deadline 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprises of public interest 6</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>April 30</td>
</tr>
<tr>
<td>Public joint stock companies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>April 30</td>
</tr>
<tr>
<td>Natural monopolies</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>April 30</td>
</tr>
<tr>
<td>Companies operating in the extractives sector</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>April 30</td>
</tr>
<tr>
<td>Large enterprises (non-issuers of securities) 3</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes 4</td>
<td>June 1</td>
</tr>
<tr>
<td>Holding companies 1</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>April 30</td>
</tr>
<tr>
<td>State-owned banks</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>April 30</td>
</tr>
<tr>
<td>Financial institutions belonging to micro and small enterprises</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>June 1</td>
</tr>
<tr>
<td>Other SOEs (including medium-sized enterprises)</td>
<td>Yes</td>
<td>Yes 5</td>
<td>Yes</td>
<td>Yes</td>
<td>June 1</td>
</tr>
</tbody>
</table>

1 Consolidated statements to be submitted by holding companies where two of the following conditions are met: book value is below EUR 4 million, net income is below EUR 8 million, and number of employees is below 50 individuals. They are required to prepare and submit consolidated financial statements in accordance with national accounting standards or IFRS.

2 Deadlines for audited statements are together with financial statements.

3 Large enterprises are entities that meet at least two of the following criteria: (i) employ over 250 individuals, (ii) have a book value of over EUR 20 million, or (iii) have a net income of EUR 40 million.

4 Applicable only if determined by the CMU based on the company’s book value of assets.

5 Applicable to enterprises engaged in certain economic activities as determined by the Cabinet of Ministers of Ukraine.

6 Enterprises of public interest include issuers of securities admitted to trading on stock market (or if a public offer has been made), banks, insurers, private pension funds, other financial institutions (except other financial institutions and non-governmental pension funds belonging to micro-enterprises and small enterprises) and large enterprises, as defined above.

The Law on Audit of Financial Reporting and Audit Activities imposes mandatory audit requirements, *inter alia*, on SOEs that are registered as public JSCs, that are “enterprises of public interest”, natural monopolies, or operate in extractive industries, and that are micro and small financial institutions. In addition, large SOEs, including unitary enterprises, may be required to have their financial statements independently audited according to the Law on Management of Objects of State Property, based on the book value of their assets. External independent auditors for SOEs are selected on a competitive basis, usually subject to public procurement procedures.
Source: Author’s compilation is based on the Law on Accounting and Financial Reporting, the Law on Auditing, and CMU resolution No. 419 (CMU, 2000[275])

Table 15.3. Disclosure and reporting practices in top-15 SOEs

<table>
<thead>
<tr>
<th>MGU</th>
<th>GTSOU</th>
<th>Ukrzaliznytsia</th>
<th>Enterprom</th>
<th>Nadvagaz</th>
<th>Ukrenergo</th>
<th>Ukroboronprom</th>
<th>Uchydroenergo</th>
<th>USPA</th>
<th>SFSC</th>
<th>Ukrospora</th>
<th>Boycip IA</th>
<th>Agrarian Fund</th>
<th>USATSE</th>
<th>PK Ukraina</th>
<th>Automobile Roads of Ukraine</th>
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</thead>
<tbody>
<tr>
<td>+/Y</td>
<td>+/Y</td>
<td>+/Y</td>
<td>+/Y</td>
<td>+/Y</td>
<td>–/N</td>
<td>+/Y</td>
<td>+/Y</td>
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</tbody>
</table>

Notes:

1 This row reports (a) whether the SOE discloses the accounting standards it uses, and (b) whether the financial reporting according to these standards is disclosed. “+” means that the SOE discloses the accounting standards used, and “–” means that it does not. “Y” stands for “yes” (when financial reporting according to the declared standards is disclosed), and “N” stands for “no” (when not disclosed). For example, “+/Y” means that both the accounting standards used are disclosed and the respective financial reporting is available, etc. All to 15 SOEs, except Ukroboronprom, use the International Financial Reporting Standards (IFRS). Ukroboronprom said publicly that it would use the IFRS, but no such reporting is available yet.

2 This row reports disclosure of (a) enterprise objectives, and (b) the fulfillment of these objectives. “Y” stands for “yes” (when respective information is disclosed), and “N” stands for “no” (when not disclosed). “Y/N” means that specific objectives and fulfillment are disclosed, “Y/N” means that objectives are disclosed, but the fulfillment of these objectives are not, “N/N” means when neither the objectives nor their fulfillment are disclosed.

3 This row reports disclosure of (a) financial results, and (b) operating results. “Y” stands for “yes” (when respective information is disclosed), and “N” stands for “no” (when not disclosed). “Y/N” means that both financial and operating results are disclosed, “Y/N” means that financial results are disclosed, but operating results are not, etc.
All top 15 SOEs, except Ukroboronprom, are either 100% owned by the state or state unitary enterprises. Ukroboronprom is a State Concern. This row shows whether the SOE discloses the government agency that acts as its ownership entity (for JSCs and LLCs) or exercises control over the respective SOE (for state unitary enterprises and Ukroboronprom).

This row reports disclosure of (a) the applicable corporate governance code/policy, and (b) reporting on its implementation. "Y" stands for "yes" (when respective information is disclosed), and "N" stands for "no" (when not disclosed). For example, "Y/N" means that both the applicable corporate governance code/policy and reporting on its implementation are disclosed, "Y/N" means that the applicable corporate governance code/policy is disclosed, but the status of its implementation is not, etc.

"0" means that no information on the board remuneration is disclosed, "1" means that the SOE discloses the remuneration principles or policy, but not the size of the remuneration, "2" means that the SOE discloses the size of the total board remuneration, but not the remuneration for individual board members, and "3" means that the SOE discloses the size of the remuneration for individual board members. "NB" means that the SOE has no supervisory board. Ukroboronprom has a supervisory board whose members cannot be remunerated by law.

"0" means no disclosure on material transactions with the state and other related entities, "1" means the information is disclosed only on Smida website, "2" means the information is disclosed on both: SOE website and Smida.

A.1. [Examples of such information include:] A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity).

Ukrainian SOEs are required to disclose their objectives and achievements annually on their websites (or on the website of their ownership entity) and in their annual reports. However, not all SOEs are in compliance with this requirement. Moreover, there is a lack of clarity and uniformity in SOE objective-setting, which may vary between enterprises depending on the sector of operation. For example, Boryspil International Airport’s objectives include becoming a leading hub airport in Eastern Europe and expanding connections. Energoatom, on the other hand, is tasked with ensuring safety of operating nuclear plants, while transmission system operators are to work towards integrating into European networks and promoting energy security.

A.2. [Examples of such information include:] Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives.

Along with their financial and operating results, Ukrainian SOEs are expected to disclose costs and funding arrangements for non-commercial objectives (including PSOs). Non-commercial spending and sources of financing should be disclosed in the SOE quarterly and annual financial statements. State aid and support measures in achieving services of general economic interest should be reported and disclosed to the AMCU and the Treasury. As noted earlier, not all SOEs are separating accounts for commercial and non-commercial activities, and the methodologies for compensating PSOs are often unclear.

A.3. [Examples of such information include:] The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes.

According to the Commercial Code, SOEs in Ukraine are required to disclose information regarding their corporate governance policies in their charters. Information contained in the charters should include the company name, purpose and activities,
size and procedure for forming authorised capital and other funds, and distribution of profits and losses. It should also list management bodies, competences, and conditions on reorganising and liquidating the business entity, along with other elements. JSC law provides additional disclosure requirements that are applicable to corporatised SOEs. Notably, the charters should contain information regarding nominal value and total value of shares, amount of dividends, procedures for converting preferred shares, and the rights of shareholders. The law also sets conditions for publishing and disclosing additional documents regarding their corporate governance, which need to be submitted to NCSSM. While key SOEs have been working towards ensuring disclosure of their corporate governance policies in recent years (particularly JSCs), information disclosure regarding SOEs on a broader scale is often not enforced.

A.4. [Examples of such information include:] The remuneration of board members and key executives.

In Ukraine, SOEs are required to disclose information regarding remuneration of supervisory board members and executives. According to the Commercial Code and CMU Resolution No. 1067, state unitary enterprises and majority-owned SOEs must disclose information regarding the structure, methodology and amount of remuneration for both supervisory and executive board members. Information should also cover compensation packages, benefits and dismissal pay, and should be disclosed annually with financial statements. In addition, procedures for setting remuneration for supervisory board members and CEOs are disclosed through CMU resolutions and outlined in internal company documents.

In practice, however, information regarding supervisory board member remuneration may not be easily accessible (see Table 15.3). A draft law (No. 3952) that was passed in first reading would strengthen disclosure requirements regarding remuneration of members of the governing bodies of SOEs (except in state-owned banks). This would include, both executive and non-executive directors, as well as board members and top executives of SOEs (including those holding temporary positions) where the state is majority or full owner.

A.5. [Examples of such information include:] Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board.

SOE board member qualifications and selection processes are established by SOE and JSC laws, and CMU resolutions, the applicability of which may vary depending on the SOE legal form and type. When available, SOE charters (particularly in corporatised SOEs) contain information regarding the requirements for composition of the company’s bodies and their competences, establishment, election and dismissal of members, and decision-making.

According to the Commercial Code and the CMU Resolution No. 1067, SOEs are required to publish information, including supervisory board member biographical information, professional qualifications, principles for their selection, membership on boards of other businesses, and the independence of board members. In case of an appointment of a new member, information should be updated within 10 days (or 5 days for issuers of securities) (CMU, 2016[214]). Both supervisory and executive boards are also required to publish annual reports regarding their activities, which can be issued as stand-alone documents or integrated into SOE annual reports. Supervisory
board members in banks and public JSCs are required to provide the following information:

- Assessment of composition, structure and activities of the supervisory board, including procedures for decision-making and indication of how their role has impacted the company’s financial and economic activities.
- Assessment of competence and effectiveness of each member of the board (including information of his/her activities as an official of other legal entities or other paid and pro bono activities)
- Assessment of activities and competences of the board’s committees, including composition, functional powers, number of meetings, and issues dealt with. Audit committee should separately indicate its conclusions, including the independence of external audit
- Assessment of supervisory board’s implementation of relevant goals

In practice, some of the top-15 SOEs (such as Naftogaz, Ukrzaliznytsia, Ukrenergo and USPA) ensure the availability of the aforesaid information on the company’s website and through their non-financial reports. Similar disclosure requirements are also applicable to MOEs under the Commercial Code, though in practice information is often unavailable.

A.6. [Examples of such information include:] Any material foreseeable risk factors and measures taken to manage such risks.

According to the Commercial Code of Ukraine and CMU Resolution 1067, companies must disclose anticipated risk factors that could affect their operations and results, as well as measures to manage these risks. Information should be disclosed in financial statements and updated on the website. While risk factors are outlined by some SOEs in their annual reports, most do not follow internationally-accepted corporate disclosure standards in the area of risk management. Board-level risk committees and risk management functions remain to be developed in most SOEs.

A.7. [Examples of such information include:] Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships.

Ukrainian SOEs may receive state aid and support measures through state bodies or as outlined in CMU resolutions, the state budget, and international treaties to fulfil debt obligations. State aid should be reported to AMCU, which assesses notifications, collects and analyses the information, and determines whether measures are considered to be compatible or incompatible state aid. Decisions regarding state aid and support measures are subject to disclosure on the AMCU and treasury websites. SOEs engaged in public-private partnerships (PPPs) are also expected to disclose information regarding their contractual arrangements (including financial

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228 JSC law does not specify which goals are to be met and how these goals are set.
229 For example, according to the 2020 State Budget, SOEs could receive guarantees to cover loans for investment projects and to improve defence and security of the state (up to UAH 10 million). Other entities include state-owned coal mines, which have received significant support measures in repaying wage arrears.
and non-financial elements), as well as relevant transactions within 10 days of occurrence (as applicable).

However, as outlined in the previous sections, many forms of state aid often go unreported according to the AMCU, as state aid grantors (particularly at municipal level) often fail to disclose relevant information. In addition, there is a lack of clarity regarding the characterisation of state aid (particularly with regard to tax benefits) (AMCU, 2020[136]). As part of addressing these challenges, a draft law is currently being developed to further streamline Ukraine’s law on state aid with EU legislation. One of the provisions in the draft law includes an obligation for both the provider and recipient of state aid to reimburse any illegally received state aid.

A.8. [Examples of such information include:] Any material transactions with the state and other related entities.

Under the Commercial Code, state unitary enterprises are required to disclose all of their operations and liabilities with (i) the state and/or municipal budget, (ii) the state and/or municipal institutions, enterprises and organizations, and (iii) financial and non-financial contractual liabilities, arising from public private partnerships.231 The disclosure should be made available on the official webpage of the state unitary enterprise or the relevant managing body. According to CMU Resolution 1067, the same requirement is applicable to 100%-owned SOEs or entities with over 50% or more participatory interest from the state. Additional requirements may be applicable under the JSC law, while the Law on Transparency of Usage of Public Funds requires the SOE to disclose contractual liabilities.232 In practice, top-15 SOEs often do not fulfil this requirement (see Table 15.3), and there is no clarity as to whether transactions are disclosed on a broader scale.

In addition to transactions with the state, Ukraine has developed legal framework regarding related party transactions, which is defined under accounting regulations issued by the Ministry of Finance. These rules are applicable to all enterprises, organisations and entities regardless of their ownership that follow reporting under the national standard.

Related parties include enterprises under the control or significant influence of other persons; enterprises and individuals that directly (or indirectly) exercise control over the enterprise or affect its activities; or close family members of individuals (Ministry of Finance, 2001[283]). The list of related parties is determined by companies taking into account the essence of the relationship and legal form, and may include the following:

- Joint ventures and participants in relevant activities
- Investor enterprises or affiliated enterprises
- Enterprises and individuals that exercise control or have a significant influence over the enterprise
- Close family members (or other related individuals) engaged in the enterprise
- CEO and others belonging to senior management

These requirements are not applicable to companies that prepare financial statements based on IFRS, where other relevant conditions are applicable. In addition, provisions

231 Commercial Code also provides for a procedure for approving of material commercial liabilities of SOEs.
232 The information should be disclosed through https://spending.gov.ua.
regarding related party transactions outlined in the JSC law are applicable to corporatised SOEs. For example, Naftogaz has a more elaborate definition of related parties, where the attention is directed at the nature of the relationship. According to its Eurobond prospectus, related parties include those if one party may control another party, or can exercise significant influence or joint control over another party in making financial and operational decisions.

Groups, such as Naftogaz, which are ultimately controlled by the Government of Ukraine, and all state-controlled entities, may be considered as related parties under common control. However, in some transactions, the state may not always be considered a related entity. In addition, related parties include the members of the executive board and supervisory board, and close members of their families, as well as those entities over which the members of the executive board or their close family members are able to exercise a significant influence or in which they hold a significant share of voting rights.

Financial statements should outline the nature of related party transactions, including types and volumes, methodology for assessing assets and liabilities, and amounts receivable and payable from the transactions. If one party controls (or is controlled by) another related party, information about their relationship should be disclosed regardless of whether transactions take place. Moreover, notes in the financial statements should elaborate on any payments received from the entity by management personnel, including current, long-term, or dismissal payments, and post-employment benefits, as well as share-based payments and loans. For group companies, business relationships between parent company and other companies of the group are not generally considered to be related. Provisions regarding interested party transactions and the role of supervisory board members are outlined in Section 13 (CMU, 2020[42]).

In practice, some of the recent examples include GTSO, which has continued to elaborate on its transactions with Ukrtransgaz as the former was unbundled from the latter. In addition, Naftogaz’s 2019 consolidated report focused on transactions with entities that are owned, controlled, or influenced by the state, including the state-owned banks (Oschadbank, Ukreximbank, and Ukrgasbank), heat generating companies, and regional gas distribution companies.

A.9. [Examples of such information include:] Any relevant issues relating to employees and other stakeholders.

As outlined in Section 14, enterprises are expected to issue non-financial reports, together with their annual financial statements, as part of communicating relevant issues related to employees and stakeholders. Budgetary institutions, along with micro, small and medium-sized enterprises may be exempt from submitting non-financial information. Non-financial reports are expected to cover environmental, social and corporate governance issues, along with risks, performance indicators, and

233 For example, NBU’s regulations do not interpret a loan from a state-owned bank to an SOE a related-party lending, though SOEs have reported these transactions. Similarly, the AMCU has no established rules that interpret transactions with the state as transactions with related entities.


235 Micro and small enterprises are exempted from submitting an annual (management) report, and medium-sized enterprises have the right not to reflect non-financial information in the annual report. https://zakon.rada.gov.ua/laws/show/996-14#Text; https://zakon.rada.gov.ua/laws/show/419-2000-%D0%BF#n12.
company policies. As mentioned above, additional regulations apply to entities engaged in the extractives sector, where information disclosure is subject to following the EITI standard, and in national banks, where procedures are regulated by the NBU. Non-financial reports, along with annual financial statements and audited reports, must be published on the company’s website. In practice, only a small number of SOEs in Ukraine disclose financial and non-financial information. However, certain SOEs have developed internal policies and procedures, and stakeholder interaction policies to communicate relevant information, as needed.

15.2. External audit of financial statements

B. SOEs’ annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit.

15.2.1. Independent audit in SOEs

According to the current policy framework, not all SOEs are required to have mandatory annual audits of their financial and economic activities. However, the Law on Accounting and Financial Reporting imposes mandatory independent audit requirements, *inter alia*, on SOEs that are registered as public JSCs, that are “enterprises of public interest” or natural monopolies, that operate in extractive industries, and that are micro and small financial institutions. External independent auditors for SOEs are selected on a competitive basis, usually subject to public procurement procedures. Deadlines for audits are together with the finalisation of financial statements. The law also elaborates on the audit standards applicable to SOEs, as elaborated in Box 15.1 (Verkhovna Rada, 2017).

In addition, the amendments to the Law on Management of Objects of State Property in 2016 clarified that SOE financial statements may be subject to mandatory independent audit. The criteria for selecting an independent auditor, as well as identifying SOEs subject to mandatory audits should be determined by the CMU depending on the book value of their assets. Similar provisions apply to MOEs, where the local council determines the criteria for selecting independent auditors and assigning companies subject to mandatory independent audits (Verkhovna Rada, 2016). Further requirements with regard to independent audit have been introduced and may be applicable to SOEs depending on their legal form, such as joint-stock companies (Verkhovna Rada, 2017).

Within the current framework, if the SOE has no supervisory board (which is the case for most SOEs) – according to the Law on Management of Objects of State Property – the SOE ownership entity is responsible for commissioning independent audits. If a supervisory board is established, the selection is done by the board, and the

236 Enterprises of public interest include entities (issuers of securities) whose securities are traded on stock exchanges, banks and other financial institutions (except for financial institutions and non-state pension funds that are considered micro and small enterprises), as well as “large enterprises”. According to the Law on Accounting and Financial Reporting, “large enterprises” are those that meet at least two of the following criteria: (i) employ over 250 individuals, (ii) have a book value of over EUR 20 million, or (iii) have a net income of EUR 40 million.

237 In 2015, the government introduced mandatory independent audits for 146 SOEs, while simultaneously working to improve internal and independent auditing processes in individual SOEs (MDETA, 2015).
ownership entity approves independent auditors upon the submission of the supervisory board. However, there are discrepancies in the law regarding the selection of an independent auditor. According to the JSC law, independent auditors should be elected by the supervisory board in private JSCs and by the general shareholders meeting in public JSCs. At the same time, according to the more recent Law on Audit of Financial Reporting and Audit Activities, independent auditors are elected by the general shareholders meeting (meaning the ownership entity in the case of SOEs). In either case, the supervisory board, if established, sets the terms of agreement with and the remuneration of the audit firm, reviews the external auditor’s reports and approves the measures to be implemented. If no supervisory board is formed, then these measures are approved by the ownership entity (CMU, 2020).

Despite these reporting requirements, there are still numerous challenges in this area. Notably, the process is nascent and the statements of many large SOEs go unaudited. For others, it may be difficult to retrieve financial and non-financial information despite stipulations of the law, and discrepancies may be present depending on the accounting standards that are applied.

Box 15.1. Audit standards in Ukraine

Audit standards applicable to Ukrainian SOEs are outlined in the Law on Audit of Financial Reporting and Audit Activities to avoid conflicts of interest and ensure independence of auditors. Auditors (and their family members and close relatives) are not allowed to be officials of audited entities two years following an audit, and restrictions are applied regarding their ownership and disposal of securities. Managers and shareholders of the company are also prohibited from interfering with the auditor or any activities pertaining to external audit. Notably, the auditor would have no rights to provide the enterprise with other services, such as tax reporting, consulting, management, legal assistance, assessment, or other services related to attracting financing, distributing profits, and developing an investment strategy.

Prior to engaging their services, companies are expected to ensure that auditors meet relevant requirements to avoid conflicts of interest, carry out due diligence and risk assessment, assess the adequacy of staff and compliance with relevant tasks, and meet legal and transparency requirements. Statements on the independence of external experts are subject to disclosure, along with issuing a transparency report and information regarding independent practices. Quality checks are carried out by the Quality Assurance Inspectorate of Public Oversight Audit Authority and the Audit Chamber Quality Control Committee of Ukraine’s Audit Chamber. Violations may lead to excluding the auditor from the registry and losing rights to conduct audits, with up to a 7-year statute of limitations for misdemeanours.

Source: (Verkhovna Rada, 2017)

15.2.2. State audit functions in SOEs

Along with independent audit, Ukraine has established the State Audit Service (SAS) that performs state audit functions over SOEs. As an entity under the direction of the

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238 In addition, Ukraine has developed specific independence requirements for the appointment of an external auditor. Namely, they may not be officials of an audited entity for another two years, and may not own shares of the SOEs. The auditors may not prepare tax reports and financial statements, and engage in consulting services with the audited entity. Violations of some of these requirements may lead to penalties.
CMU and the Ministry of Finance, SAS implements policy in state financial control and analyses the efficiency of the use of financial resources by public entities. During the early 2000s, SAS was established as a central audit department, and it was later transformed into State Financial Inspection. After reorganisation, it acquired its current form in 2015. Some of its specific roles include conducting audit and monitoring procurement practices of entities receiving funds from the State Budget, including ministries, executive bodies, and enterprises. It also exercises control over the use of financial resources and assets, savings, budgetary needs, and regulatory compliance with respect to elements, such as financial reporting and ensuring timely repayment of loans received under state guarantees (CMU, 2020[42]) (State Audit Service, 2017[285]).

While performing audit functions, the SAS has broad legal and sanctioning powers, including ensuring compliance with law, filing motions and imposing penalties in case of violations. It may also provide recommendations to the CMU and other ministries regarding policy and legislative improvements (CMU, 2020[42]) (OECD, 2019[40]). Previous OECD studies analysing its functions noted its presence directly in the offices of the SOE, its involvement in the day-to-day SOE operations, and its potential for duplicating internal audit functions (where they exist), though certain functions have been limited.239 However, SAS continues to ensure the participation of its representatives in audit commissions of majority-owned SOEs (see Section 16.10). Some of the functions performed by the SAS have led to perverse outcomes and forged opportunities for corruption. In some cases, its auditors have been suspected of engaging in SOE blackmail, while the agency was perceived as the “number one scare of the SOE management” (OECD, 2019[40]) (OECD, 2018[12]). Some of its recent reports include the assessment of the use of budget funds for the state-owned coal mines and the construction of the Odessa International Airport, as well as sector-wide assessments, including the effectiveness of corporate rights management in the oil and gas sectors (CMU, 2020[42]).

In addition, Ukraine’s Accounting Chamber, a supreme audit institution that is organisationally, functionally and financially independent, also has the power to audit individual SOEs and their ownership entities. It has been established under the supervision of the Verkhovna Rada, with a remit to control the receipt of funds in the State Budget of Ukraine (including from SOEs) and to monitor their use. In addition, the Chamber provides external control over the use of public funds through audit, analyses, and other control measures, produces quarterly and annual reports, and conducts both performance audits and an overall economic assessment regarding the efficiency of use and disposal of state property. Its analyses regarding the use of budget funds may also include conclusions and policy recommendations (Verkhovna Rada, 2019[208]). For example, in 2019, the Chamber conducted an audit of the effectiveness of ProZorro, while providing recommendations regarding the improvement of ownership functions and corporate governance practices in SOEs. However, the frequency and intervals of the audits conducted by the Chamber have remained unknown. Moreover, some of the functions of the Chamber and SAS overlap, and, similarly to the latter, the Chamber has also been criticised for exercising pressure on SOEs. Lastly, the Chamber’s evaluation reports have been criticised by

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239 Some of SAS’s powers included verifying and signing contracts and payments exceeding UAH 100,000 for goods and UAH 1 million for services, though it no longer performs this function. Currently, the procedures for the SAS are detailed under the CMU Resolution No. 252 dated March 27, 2019.
the government for lacking economic and financial analysis, and for missing key recommendations (CMU, 2020[42]).

15.3. Aggregate annual reporting

C. The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

SOEs in Ukraine are expected to publish information regarding their activities on their websites, which may be otherwise published on the portal of the ownership entity. The ownership entities should also communicate information with MDETA and the CMU, which is aggregated in a unified portal managed by the SPFU. Other entities, including the State Statistics Service of Ukraine, also collect and compute data with regard to the SOE sector. In practice, however, there have been challenges in ensuring information availability and communication, as well as discrepancies across different portals.

To improve information collection, MDETA has developed an internal register, known as Best Zvit, which is an automated electronic document management system. Ownership entities are expected to complete electronic reports based on the procedures approved by MDETA and the Ministry of Finance. While inputting the information received, MDETA also cross-checks information with other registers. Although the internal register is not disclosed, the ministry discloses aggregated information and efficiency measures regarding the SOE sector as a whole through its website (CMU, 2020[150]).

In addition to improving internal reporting on SOE performance, Ukraine has taken steps towards information disclosure on the sector and on individual SOEs. With the onset of SOE reforms in 2014-2015, MDETA began publishing an aggregate report on state ownership. The report focused on the top-100 economically important SOEs, and it was issued annually on the Ministry’s website. It contained information regarding the financial data and the performance of individual entities in key sectors of the economy, and information on key corporate governance challenges and developments. (OECD, 2019[40]). While these narrative reports were published between 2014-2018, they have been discontinued. However, in July 2019, MDETA introduced ProZvit, a database that aggregates financial indicators for centrally-owned SOEs (from financial year 2016). Information can be searched by ownership entity, industry, and SOE, and can be aggregated by sector.

While ProZvit is still being updated and contains discrepancies, it has been a valuable reference point. It also demonstrates a positive step towards centralising information regarding the SOE sector, and working to ensure data availability and transparency. The Ministry of Finance and MDETA issued a joint decree to mandate reporting into the database for all SOEs and promote uniformity, which entered into force in 2019 (MDETA and Ministry of Finance, 2018[286]). However, as figures often remain self-reported by SOEs, there may be challenges in ensuring accuracy of the information provided. MDETA is reportedly taking steps to improve the accuracy of information, while also considering to re-issue a narrative aggregate report. These actions will aim

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240 The platform was developed by MDETA, in partnership with the electronic auction portal Prozorro.sales, as well as Transparency International Ukraine and the German Society for International Co-operation (GIZ).
to feature aggregate financial data on SOE performance and risks, as well as entail an update and/or further development of the methodology for key financial indicators to develop an information panel to assess SOE performance.
Chapter 16. Responsibilities of the boards of state-owned enterprises

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

16.1. Board mandate and responsibility for enterprise performance

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise’s performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably.

As outlined in Part I, a supervisory board must be established in all public JSCs and private JSCs with 10 or more shareholders, and in majority-owned SOEs where (i) the value of total assets (or authorised capital in a new SOE) exceeds 2 billion or (ii) net income exceeds UAH 1.5 billion. In SOEs, both state representatives and independent board members should be appointed, with the latter representing majority. However, practices and requirements vary depending on the SOE legal form and type. Notably:

- In state unitary enterprises, there should be between 5 and 11 board members (with an independent majority), and the term of office is limited to three years. An independent member of the supervisory board may not serve for more than three consecutive terms.
- In state-owned banks, there should be nine supervisory board members (6 independent and 3 state representatives). The term of office for board members is limited to three years and to two consecutive terms.
- In JSCs board members may be appointed for a term no longer than three years (which may be renewed) and there should be at least five individuals on the board in a public joint-stock company (without explicit requirements regarding private JSCs). In majority-owned SOEs that are corporatised, at least one-third (and at least two) of the board members should be independent. In practice, however, there is an independent majority to comply with the requirements under the Law on Management of Objects of State Property.

There is currently no concept of a “shadow director” or a system for replacing directors in the current framework. Despite these requirements, supervisory boards remain to
be set up in some of the top-15 SOEs, and, in some cases, independent board members need to be appointed (see Table 6.1).

The SOE governing bodies are organised in the form of two-tier boards with a separate supervisory board and a separate executive body.\(^{241}\) The executive body may consist of either (i) a single person (such as a general director or a CEO), (ii) or a collegiate body (such as a management board), the head of which would be equivalent to a CEO. While specific tasks of the supervisory board members may vary based on the legal form of the enterprise, the sector and provisions under the company’s charter, their functions broadly include the following:

- Approving draft strategy, draft annual financial plans, and other draft decisions, along with governance related issues \(^{242}\)
- Approving the market value of property and deciding on placing and repurchasing of securities (except for shares)
- Deciding on temporary removal and appointment of the CEO, and appointing and terminating powers of the CEO, along with determining the terms of contract, and setting remuneration as well as monitoring compliance with the terms of the contract (however, in practice and according to secondary legislation, the board’s powers are limited in performing these functions)
- Setting up an internal audit unit, approving procedures to conduct audit, and appointing and terminating the powers of the head of internal audit
- Selecting an independent auditor, determining the terms of agreement and payment for its services, and selecting a property appraiser
- Ensuring that conflicts of interest of CEOs and supervisory board members are prevented, detected and settled, including those related to misuse of assets and related-party transactions
- Ensuring effective management and risk management of the company, and resolving other issues based on the charter and relevant laws that fall within its powers
- Preparing the supervisory board’s annual activity report, along with an evaluation of the work carried out by the supervisory board members and quality of corporate governance
- Developing anti-corruption and corporate social responsibility policies, and approving the codes of business ethics
- Consenting to significant transactions, typically worth between 10-25% of the company assets (which may be over 25% in JSCs). They may also engage in acquiring redemption of shares and ensuring information disclosure (CMU, 2020[42]; Verkhovna Rada, 2006[122]).

Additional requirements and functions may be introduced for supervisory board members in JSCs based on the JSC law. Moreover, certain laws and regulations (such as the JSC law) mandate that all supervisory board members act in the interests of the company and comply with relevant requirements and provisions of the charter.

\(^{241}\) Draft Law No. 2493 dated November 25, 2019, which has passed the first reading in the parliament, proposes to allow establishing one-tier boards in joint-stock companies, which may impact their structure moving forward. However, one-tier boards may not be established in enterprises of public interest, including among some of the top-15 SOEs.

\(^{242}\) In SOEs where the government has sought to introduce governance standards based on the OECD SOE Guidelines, the board members may have the ability to approve the strategies and company plans.
In case of non-compliance, sanctions may be imposed, including contract termination or financial, administrative, disciplinary, civil or criminal liabilities.

The Law on Management of Objects of State Property and the CMU Resolution No. 142 specify that the independent board members should be guided by the interests of the SOE, with no specific references regarding state representatives. Officials of the bodies of a JSC are also liable to the company for damages caused by their actions (or inactions). Moreover, following an external auditor’s conclusions on the results of the audit and proposals for consideration at the general meeting, liabilities may be brought against the board members.

Under the existing framework, board meetings must take place no less than once a quarter, although in practice, they are much more frequent. Unscheduled meetings may be convened at the request of any supervisory board member, the ownership entity, or the SOE’s executive body (or as otherwise stated in the charter). Over half of the board members need to be present in the meeting to constitute a quorum. Board decisions are normally taken by a majority vote, although the charter may set a higher requirement in JSCs.\(^{243}\) If the results over the course of two years reveal that the SOE no longer meets the original criteria for establishing a supervisory board, the ownership entity may decide on continuing its functioning or abolishing the board (CMU, 2017\(^{[161]}\)).

Despite the introduction of the aforesaid framework, the extent of the supervisory board’s ability to exercise its powers has been subject to debate and resulted in controversies (Box 16.1). Moreover, supervisory boards have been unable to perform key functions, including approving the company’s strategic documents (such as financial plans) and appointing CEOs, stemming largely from the contradictions in the existing legal framework. Previously, Ukraine sought to introduce additional legislative amendments (including a draft law commonly known as “draft law 6428”) to address inconsistencies in the legal framework and better enshrine the power of supervisory boards in legislation. While the initial efforts were put on hold, a draft law that is currently being developed would likely aim to address some of these shortcomings. However, as the draft is currently being developed, it is not yet clear how these inconsistencies would be addressed.

### Box 16.1. Corporate governance challenges related to the role of supervisory board members

Despite the establishment of supervisory boards with a majority of independent members, contradictory provisions within the legislative framework have contributed to limiting their powers. While the Law on Joint-Stock Companies reserves to the supervisory board the power to appoint and dismiss the head of an SOE (a CEO), other legislation may involve the ownership entity or the CMU in this process. In particular, if the SOE is under the ownership of the CMU, the latter appoints and dismisses the CEO. The Law on Management of Objects of State Property and CMU Resolutions are also ambiguous on this issue. (At times, the Law on the Cabinet of Ministers of Ukraine is also invoked, as it says that the heads of SOEs under the CMU are appointed by the CMU.)

\(^{243}\) Upon the supervisory board’s request, other company officials may be present during the meeting. The supervisory board should also maintain copies of their meeting minutes. Information deemed confidential in performing their functions may be recorded in a separate document with restricted access. Meeting minutes in JSCs should be executed with five days after the board meeting, although the law envisages no sanction for not complying with this requirement. In state unitary enterprises, their decisions should be communicated to the CEO and the ownership entity the day after the meeting though no formal requirements for maintaining minutes are set.
Moreover, the role of supervisory boards in approving the company’s strategic documents (such as financial plans) has remained limited. While Ukraine has sought to introduce additional legislative amendments (including a draft law commonly known as “6428”) to improve the legislative framework, these efforts have remained on hold.

Overall, the legal framework for the appointment of CEOs in uneven and inconsistent, and it may depend on the legal form of the SOE, its ownership entity, and special laws:

- In Ukrainian Sea Ports Authority’s (USPA) supervisory board is elaborated in the company charters, and the board has the power to appoint and dismiss the CEO (USPA is a state unitary enterprise held by the Ministry of Infrastructure)
- In Ukrzaliznytsia (a JSC held by the CMU), the powers to appoint and dismiss the CEO are reserved for the CMU according to the Law on Establishing a General-Purpose Joint-Stock Rail Company (4442-VI)
- In Naftogaz (a JSC held by the CMU), these powers have been contested between the CMU and the supervisory board due to the discrepancies between the Law on Joint-Stock Companies, the Law on Management of Objects of State Property and CMU Resolutions
- In Ukrenergo (a JSC held by the Ministry of Finance), the process was less clear in practice. Specifically, the ownership entity delegated power to the supervisory board through the company charter, but then the issue was whether the nomination process would be governed by the secondary legislation designed for SOEs (CMU Resolutions Nos. 777, 142, and 143 implying the involvement of SOE nomination committee) or organised by the supervisory board.

The inconsistencies within the current legislative framework and in practice have rendered the powers of the supervisory boards susceptible to abrupt changes. For example, in March 2019, the Government of Ukraine introduced a resolution that amended the charter of Naftogaz. These amendments stripped the supervisory board of some of its key powers, such as the responsibilities for approving financial plans and significant transactions of Naftogaz’s wholly-owned subsidiaries, asserted the CMU’s powers to appoint and dismiss the CEO, and introduced ambiguities regarding the company’s ownership of assets.

In 2020, the charter was further amended to grant supervisory board members powers to appoint and dismiss the CEO, albeit requiring the ownership entity’s approval. However, in April 2021, these procedures were circumvented as the government dismissed the supervisory board and the CEO of Naftogaz, appointed then acting Minister of Energy as the new CEO, and subsequently re-appointed the board members. The CMU also amended Resolution No. 777 to exclude its applicability in selecting the CEO of Naftogaz. In response, all board members of Naftogaz submitted notices regarding their early termination of powers effective mid-May 2021.

Source: (OECD, 2020[69]) (Ministry of Infrastructure, 2020[287]) (Naftogaz Group, 2021[68]) (CMU, 2021[67]) (CMU, 2021[160])

16.2. Setting strategy and supervising management

B. SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government. They should have the power to appoint and remove the CEO. They should set executive remuneration levels that are in the long term interest of the enterprise.
While supervisory boards in Ukraine have been granted certain powers, such as setting up internal audits and approving transactions, certain core functions remain limited. They may only approve draft strategic documents (including draft financial plans and company strategies), as the ownership entities or other government bodies (including the CMU and the regulators) approve final versions. In addition, while the supervisory board is involved in CEO selection, the ownership entity or the CMU may be required to provide final consent depending on the SOE legal form and type, as well as the powers granted to the supervisory board in company charters.

Procedures for appointing management in SOEs is outlined in the SOE Law and the CMU Resolutions (further elaborated under Annex D). According to the Law on Management of Objects of State Property, the supervisory board in a state unitary enterprise should decide on the removal and appointment of CEOs (including temporary CEOs), and setting the terms of contract and remuneration. In addition, the JSC law also stipulates that the CEO should be elected by the supervisory board and that the charters may not transfer this authority to the shareholder. However, secondary legislation presents contradictions to these provisions. According to the CMU Resolution 777 (as well as certain provisions under the Law on Management of Objects of State Property) the ownership entities or the CMU need to approve CEO appointments, particularly in strategic or economically important SOEs, unless otherwise indicated in individual company statutes.

In certain cases, supervisory board members are empowered to appoint CEOs. For example, according to the Law on Banks and Banking, the supervisory board in state-owned banks may design the process for appointing and dismissing the CEOs, and may select the candidate (though subject to the NBU’s approval). They are also responsible for developing and approving internal regulations, though the bank’s development strategy is subject to the CMU’s approval. In addition, charters of certain SOEs (such as USPA) specify that supervisory board members have the right to appoint the CEO. However, charters and internal documents are vulnerable to change (for example, the amendments to the Naftogaz charter in 2019 that significantly limited the rights of board members). Moreover, regardless of the supervisory board’s right to appoint and dismiss the executive body, the overall process of CEO appointment has often witnessed undue political influence, which has stemmed mainly from contradictions in the existing framework (as further elaborated in Box 16.1).

CEOs in SOEs are appointed based on a competitive selection process, though it varies depending on the SOE type (as further elaborated in Annex D). According to the general framework, the ownership entity (or, the supervisory board if stated in the charter) is responsible for launching the competitive process, including the appointment of a selection committee and approving the candidate. However, the procedure is more rigorous in SOEs deemed economically important, where CEOs

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244 However, as outlined in Section 15, the role of supervisory board members in selecting external auditors may vary depending on the SOE type. In state unitary enterprises, supervisory board members may select external auditors. In public JSCs, the general meeting is responsible for approving the supervisory board’s selection, though practices vary in private JSCs.

245 Enterprises deemed especially important for the economy (or economically important SOEs) are defined in CMU Resolutions No. 142 and 143. These are enterprises whose asset value, according to the latest financial statements, exceeds UAH 2 billion or whose annual net profit exceeds UAH 1.5 billion. Procedure specific to the SOEs that are strategically important applies to those where their asset value exceeds UAH 20 million or their annual net income exceeds UAH 200 million. Criteria for defining “enterprises of strategic importance for the economy and security of the state” (hereinafter, strategically important SOEs) are set by CMU Resolution No. 999. Based on these criteria, CMU Resolution No. 83 establishes a specific list of strategical SOEs.
are selected by a permanent nomination committee consisting of the Ministers (or Deputy Ministers) of MDETA, the Ministry of Finance and the ownership entity, with an advisory vote from international organisations (IMF, EBRD and IFC) and the business ombudsman (see Box 11.2). The process also involves hiring an independent executive search company to assist with the selection. However, the selected candidate is to be approved by the CMU (in both strategically or economically important SOEs).

Considering that CEO appointment may be a lengthy process, temporary or “acting” CEOs may be appointed in the meantime (as outlined in Section 6). Although their appointment should be the responsibility of board members, in practice the ownership entities become involved in the process. However, temporary appointments are often used as the means of circumventing the nomination procedure and with the ownership entity more susceptible exercising undue influence. At the time of writing, more than half of the top-15 SOEs had acting CEOs (along with other acting executive body members), as reflected in Table 6.1 and the SOE profiles in Section 3. Moreover, the competitive selection process is currently not applicable to Ukroboronprom, as the President directly appoints the CEO, who, in turn, appoints the heads of its affiliated companies.

According to the Law on Management of Objects of State Property, the supervisory board in SOEs should be able to set remuneration for CEOs. Similarly, the JSC law states that setting remuneration for the CEO should fall within the exclusive competence of the supervisory board. However, the contracts are usually established between the CEOs and the ownership entities. Moreover, as outlined in Section 11.6, executive remuneration is subject to the caps imposed by the CMU and must fall within a specified range that takes assets (or net income) of the company and the average number of employees into consideration. While the specific methodology of its application in practice remains unclear, there is also no evidence as to whether the current remuneration caps take market-based pricing in a given sector into consideration. The ability of the CMU to impose salary caps may also contribute to unpredictability. Notably, the imposition of heavy salary caps during Covid-19 pandemic had reportedly rendered it challenging to attract qualified candidates for executive positions in SOEs, and a number of CEOs considered leaving their posts.246

The draft legislation on corporate governance that is being developed seeks to address some of the aforesaid shortcomings, including further empowering supervisory board members and clarifying the framework for setting remuneration. While the draft has been commented on by the international community, including the OECD and EBRD (see Box 9.1), alignment of provisions with the spirit of the SOE Guidelines still remains to be assessed, especially in view of the carve outs established for some SOEs (particularly those under the ownership of the CMU).

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246 It is also worth noting that management/CEOs evaluation is linked to the conditions set in their contracts. Typical contract for CEOs (under Regulation 597 (02-08-1995)) suggests that CEO reports quarterly on the performance based on the indicators set in the contract. In case of mismanagement, additional reporting may be required.
16.3. Board composition and exercise of objective and independent judgement

C. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.

Procedures for board member appointments depend largely on the SOE legal form and type. As outlined in Sections 6 and 11, CMU Resolution 142 details nomination processes for independent board members in most SOEs, while Resolution 777 details selection procedures for board members in SOEs that are economically important. The key difference is that in economically important SOEs, the nomination process is the same as CEO selection. Namely, the candidates are identified by an executive search company and assessed through the nomination committee consisting of the Ministers (or Deputy Ministers) of MDETA, the Ministry of Finance, and the ownership entity, along with independent experts selected by the CMU. Moreover, while in most of the SOEs the ownership entity confirms appointments, in economically important SOEs the CMU approves the selected candidates.

Unlike the appointment of independent board members, the selection criteria and process for state representatives is more basic, where candidates may be appointed by ownership entities. In SOEs that are deemed economically important, the candidates need to be approved by the nomination committee (as outlined in CMU Resolution No. 143). The process of appointing directors, however, varies depending on the SOE sector of operation, including in state-owned banks (which is further elaborated in Section 7). Each of the three state representatives are appointed by the President, the CMU, and Verkhovna Rada, and independent board members are appointed through a competitive selection procedure, which is similar to the process in economically important SOEs. In addition, Ukroboronprom has five supervisory board members, three of whom are appointed by the President and two by the CMU without a competitive or a transparent process.

Some of the qualifications for supervisory board members are outlined in the SOE and JSC laws, as well as applicable CMU resolutions, though additional requirements may be set by the ownership entities. In general, board members must meet relevant higher education requirements, professional skills and knowledge, work experience, and other characteristics, while having no outstanding criminal record. In addition, independent board members are required to demonstrate integrity, impartiality and impeccable reputation (see Box 16.2 regarding qualifications for state representatives). Additional requirements are applicable in the banking sector, where at least half of the board members are expected to have educational and professional background in banking or financial sectors, and further requirements may be set by the NBU.

Along with general requirements, competences, and personal and professional qualities, the composition of the boards is expected to be diverse, though there are

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247 In an economically important company, the ownership entity submits information for consideration to the appointment committee, through which the nomination committee makes a decision to the CMU. If the nomination committee does not decide on it, the ownership entity may appeal again. In case of disagreement, the MDETA should submit respective candidates for CMU approval, after which a candidate should be selected by the ownership entity.

248 In SOEs engaged in economic activities, it is advisable that they be recruited from the private sector, which can help make boards more business-oriented. Their expertise could also include qualifications related to the SOE’s specific obligations and policy objectives (CMU, 2020[42]).
no details regarding specific requirements to promote diversity. Moreover, board members should not have conflicts of interest (which is stricter in state-owned banks) and should not be appointed in competing companies. However, the existence of conflicts of interest has previously stalled the appointment of supervisory board members or, in case of their existence, has allowed board members to recuse themselves during board meetings, as further elaborated in 16.5.

There are a number of provisions outlining the termination of board members’ powers, including their own initiative (two week notice is required), or at the initiative of the ownership entity as outlined in the charter in state unitary enterprises. Board members’ powers may also be terminated in case they are unable to fulfill their duties (due to health reasons), in case of a court sentence, death or incapacity. In addition, independent directors who no longer meet the requirements are to resign by submitting a written notice. At the same time, however, in JSCs the shareholder may terminate powers of the supervisory board members without a cause, which has contributed to premature dismissals and subsequently resulted in lawsuits.249

Formally, the decision of an ownership entity or shareholder is required to initiate the selection of replacement of a supervisory board member, though the powers of those who resigned shall be deemed terminated after two weeks or on a given day (before the decision is in place). As such, in some cases, board seats may still appear to be filled when de facto the board member has submitted resignation and not fulfilled any of his/her board duties, which can be a challenge for the functioning of boards.

In state-owned banks, conditions leading up to the termination of powers for supervisory board members are outlined in the law, covering aspects such as non-implementation of the strategy and non-compliance with relevant requirements, and if requested by at least five supervisory board members or the NBU. Depending on the specific circumstances, the CMU may be involved in the termination process of the board members in state-owned banks.250 In addition, state representatives in SOEs may be recalled by entities responsible for their appointment, though reasons are often unclear. While it may be due to conflicts of interest, they are often recalled with a change in government.

The draft corporate governance law seeks to introduce provisions regarding the termination of the powers of supervisory board members and the simultaneous election of new members. Some of the grounds could include non-compliance with relevant qualifications, at the request of majority members, and improper performance of duties, among others. However, the draft law is currently being revised and it is unclear whether these provisions will be adopted.

249 In May 2020, the Ministry of Finance dismissed the chair of Ukrainian gas transmission system operator Main Gas Pipelines of Ukraine (MGU). The decision was made due to allegations regarding improper organisation of the work of the company’s supervisory board. The chair’s dismissal brought about concerns in the international community, as it demonstrated signs of political interference within the company. In December 2020, the court decided that the dismissal was unlawful. In addition, while the Ministry of Energy prematurely terminated the powers of the chair of the supervisory board of Ukrhydroenergo, following a court’s decision the chair’s powers were reinstated in February 2020. (Unian, 2020[335]). In April 2021, the CMU temporarily terminated the powers of the board of Naftogaz and dismissed the CEO, and, after the appointment of a new CEO, the same board members were re-appointed (CMU, 2021[67]).

250 Notably, the CMU may get involved if the powers of a supervisory board member are being terminated due to non-implementation of a strategy, CMU’s repeated disapproval of the strategy, determination of non-compliance with relevant requirements under the law, and at the request of other supervisory board members or the NBU. The CMU may not get involved in other cases, including entry into force of a court sentence or a decision, and submission of a personal statement to terminate powers (Law on Banks and Banking, Article 7).
Box 16.2. Appointment and remuneration of state representatives in SOEs

According to the CMU, state representatives appointed to the supervisory boards should demonstrate (i) higher education and professional skills, (ii) full legal capacity, and (iii) clean criminal record. Additional criteria may be introduced by an ownership entity. Moreover, supervisory board members in an SOE should not serve as officials in competing companies. While state representatives may be appointed by ownership entities in most SOEs, they need to be approved by the nomination committee upon the recommendation of the ownership entity in economically important SOEs. Moreover, the powers of the state representative may be revoked at any point by the ownership entity.

In addition, certain limits may be introduced in appointing state representatives. People’s deputies, members of CMU, and heads of central and local executive bodies may not combine their official activities with other work (except teaching, scientific or creative work), or be supervisory board members in an enterprise to make profit. Similarly, the Law on Prevention of Corruption prohibits certain participants from being on boards to make profit, except when representing state interests in an SOE. Moreover, even though CMU members are prevented from being appointed to supervisory boards, deputy ministers may serve as state representatives.

However, there are ambiguities as to whether civil servants may receive remuneration for serving on the SOE boards. Certain laws, including the Law on Civil Service and the Law on Prevention of Corruption, place restrictions on civil servants (as well as other state representatives who are not considered civil servants) from engaging in paid activities. However, some state representatives may not technically qualify as civil servants and receive full remuneration for serving on the supervisory board.

Source: (CMU, 2020[42]) (Verkhovna Rada, 2014[152]) (CMU, 2017[161]).

However, there are often difficulties to attract or retain qualified candidates for the position of supervisory board members, as some recent resignations have demonstrated. Certain international board members have cited political pressure, undue political interference in boards and sometimes corruption in law enforcement bodies (including the threat of criminal cases being initiated to impose pressure on the candidates) as examples of challenges associated in working on the supervisory boards of Ukrainian SOEs. More recently, COVID-19-related remuneration caps (now revoked) on supervisory board members introduced significant challenges in attracting and retaining qualified individuals.

16.4. Independent board members

D. Independent board members, where applicable, should be free of any material interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardise their exercise of objective judgement.

Under the current framework, independent supervisory board members should be appointed in SOEs, though specific requirements differ based on the SOE legal form. According to the Law on Management of Objects of State Property, majority of the board members should be independent. This provision is stricter compared to the requirements applicable in other joint-stock companies, where at least one-third (and
at least two) of the members should be independent. Although there is no clarity regarding which law would be applicable in corporatised SOEs, in practice the provisions under the Law on Management of Objects of State Property prevail. To date, 8 out of top-15 SOEs in Ukraine have established supervisory boards with independent members (see Table 6.1).

Requirements also vary in other forms and sectors of operation. For example, in state-owned banks, six out of nine directors are to be independent. However, independent board members are not appointed in defence SOEs, and there are no specific requirements in MOEs. While SOEs earmarked for privatisation must also fulfil requirements to have independent directors, the situation is slightly different. Board appointments are often stalled or contested in courts, which results in an impediment to the privatisation process.

Under the JSC law, an independent director is defined as a member who is not influenced by others in decision-making process in performing his or her duties. The Law on Management of Objects of State Property (SOE law), however, does not define an independent supervisory board member as such, but provides an independence criteria for the board members. According to the SOE law, the following individuals are not eligible for the competitive selection:

- Any official who has been employed in the state unitary enterprise (including subsidiary, branch and subdivisions) for a term of five years or less before the start of the competitive selection (or any other employee with a term of less than three years)
- An individual who is affiliated with the enterprise, its shareholder, or its subsidiary, or who has received income from the enterprise (except for being remunerated for performing supervisory board member functions)
- The owner of corporate rights of the state unitary enterprise, a civil servant, or a state representative
- Any person that has been an auditor of the state unitary enterprise for a period less than three years prior to the launch of the competitive selection (this also applies to individuals engaged in audits of the entity, subdivision, or representative office)
- An individual with economic or civil relations with the state unitary enterprise, or its subsidiary, branch, representative, or subdivision, or a head or member of the executive division with such relationships
- An independent board member in the supervisory board in the state enterprise that has served for three consecutive terms
- A person that is a close affiliate with any of the aforesaid individuals (as defined under the Law on Prevention of Corruption)

However, depending on the SOE type, further requirements may be imposed to ensure that the supervisory board member is considered to be independent. For example, joint-stock companies would also exclude shareholders and owners of over 5% or more of the authorised capital of the entity, or if they receive any additional income from the company (or its affiliates) exceeding 5% of their remuneration (Verkhovna Rada, 2006[122]) (Verkhovna Rada, 2008[123]).

In addition to the aforesaid requirements, CMU Resolution No. 142 states that independent members should have full civil capacity and demonstrate education and work experience that would be relevant in performing their functions. They should not
hold elected or other official positions, have no outstanding criminal record, and demonstrate impartiality, integrity and impeccable reputation, while meeting other requirements determined by the selection committee (CMU, 2020[42]) (CMU, 2017[161]).

The candidates are screened during the selection procedure to ensure they meet the aforesaid criteria. However, if a shareholder considers that an independent board member that has been appointed does not meet these requirements, a lawsuit may be filed against them (CMU, 2020[42]). Moreover, the NBU has the power to disqualify candidates in state-owned banks.

16.5. Mechanisms to prevent conflicts of interest

E. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.

The Law on Prevention of Corruption provides a general framework for preventing conflicts of interest which is applicable to SOEs. Conflicts of interest are defined as follows:

- Potential conflicts of interest: individuals performing official or representative powers where their private interests may affect the objectivity or impartiality of decision
- Real conflicts of interest: a contradiction between private interests of individuals and their representative powers, which affects impartial decision-making
- Private interest: any property or non-property interest of an individual, including due to personal, family, friendly, or other extracurricular relations with individuals or legal entities, including those in connection with membership or activity in public, political, religious or other organisations

In case of any conflicts, supervisory board and NAPC should be notified. In settling conflicts of interest in SOEs, some measures may include restricting access to information, constraining decision-making powers, or, if need be, dismissing individuals from their positions. Relevant decisions are to be recorded in the meeting minutes (Verkhovna Rada, 2014[152]).

The regulations are stricter in the state-owned banks, where individuals are not allowed to be appointed as supervisory board members in case of conflicts of interest, with the NBU exercising the power to disqualify candidates/appointees.

Further provisions to prevent conflicts of interest are outlined in the SOE and JSC laws. Notably, individuals who are founders, shareholders, CEOs, or members of the supervisory board are not allowed to be CEOs or supervisory board members in SOEs within the same or related markets. Restrictions are also put in place in case of related party transactions, as further outlined in Section 13. Moreover, conflicts of interest are expected to be settled through supervisory boards, and, where applicable, by the appointments committees, while applying relevant laws and regulations, as well as internal documents and codes of ethics.
In practice, however, individuals may be appointed as board members and serve in executive positions in other SOEs, and, at times, in SOEs in related markets. While the board members should recuse themselves to avoid conflicts of interests, potential risks remain present. Moreover, additional risks may be present through state representatives, as there is a lack of clarity as to whether their decisions are taken independently of the state or the ownership entity’s interest (though it is worth mentioning that Ukraine has abolished voting instructions). Further issues have been raised due to the involvement of “satellite companies” that usually win tenders and do businesses with SOEs, or close affiliates (including family members) of board members in tenders, as certain SOEs have been criticised for such practices (OECD, 2018[12]) (Golovnev, 2020[286]).

Ukraine previously introduced e-declaration requirements for supervisory board members of SOEs, thus allowing the NAPC to monitor potential conflicts of interest. These requirements, however, were declared to be unconstitutional in October 2020 and all investigations were closed. In December 2020, the parliament reinstated the law, albeit a less effective version, and the previous investigations that were closed due to the ruling could not be resumed based on the evidence that had already been gathered (also see Section 4.5).

16.6. Role and responsibilities of the Chair

F. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.

The chair’s powers are elaborated in the SOE and JSC laws, as well as in secondary legislation. Currently, there are two-tier boards in Ukraine, which separates the roles of the chair of the supervisory board and the CEO. According to the Law on Management of Objects of State Property and the CMU Resolution 142, any member of the supervisory board may be elected as chair in a majority-owned SOE through a simple majority vote, and may be re-elected. However, practices may differ among SOEs. For example, according to Article 7 of the Law on Banks and Banking, the chair of the supervisory board must be elected from among its independent members, and JSCs may have additional provisions outlined in the charter.

Broadly, the chair’s role consists of conducting meetings and organising the work of the supervisory boards, though his or her powers may be framed further by the charter and other internal documents. The chair and each board member has a single vote, and the decision is made by a simple majority. In case of equal distribution of votes, the chair’s vote becomes decisive in state unitary enterprises (CMU Res. 142), though in JSCs, provisions regarding a casting vote should be outlined in the charter.

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251 In a previous occasion, the NBU rejected the candidacy for an independent board member for Oschadbank, who was also serving on the board of another SOE to which the bank had extended loans. In SOEs, including Naftogaz, Ukrtransnafta and MGU, among others, board members have recused themselves.

252 The requirements to submit e-declarations previously applied to both Ukrainian and foreign nationals, and this caused controversy, including from G7 Ambassadors, who urged Ukraine to cancel these requirements. Notably, these requirements violated international laws and commitments, and risked deterring Ukraine from recruiting and retaining qualified international supervisory board members (OECD, 2019[40]). The requirement was later cancelled for foreign nationals serving as independent directors.
addition, the chair’s responsibilities in JSCs are similar, though other elements include opening the general meeting and making proposals on the appointment of a corporate secretary (who is elected by the board), among others (CMU, 2017[161]) (Verkhovna Rada, 2008[123]).

While notionally the chair of the supervisory board acts as the main contact point between the ownership entity and the company, earlier OECD reviews have noted challenges associated with a lack of regular and consistent dialogue between the owner and the supervisory board.

16.7. Employee representation

G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

According to the SOE law, representatives of local self-government bodies and trade unions, or other bodies authorised by labour collectives, that have signed a collective agreement on behalf of the labour collective, may participate in the meeting of the supervisory board of an SOE. In JSCs, they may participate at the invitation of the supervisory board and may have the right to an advisory vote. The responsibilities of these individuals or training to perform relevant duties, however, are not specified (Verkhovna Rada, 2008[123]) (Verkhovna Rada, 2006[122]).

16.8. Board committees

H. SOE boards should consider setting up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

Requirements to establish committees in supervisory boards are outlined in the JSC law (for corporatised SOEs) and CMU Resolution 142 (for state unitary enterprises). In a handful of SOEs where the supervisory boards have been established, there are committees on audit, appointments and remuneration, which are chaired by independent directors. The board may also form other committees (including either permanent or temporary committees), if needed. Their powers should be determined based on the provisions under the charter and relevant regulations. Overall, the committees should have an independent majority and be chaired by and independent supervisory board member. However, further requirements are applicable in state-owned banks, where supervisory boards should also set up a risk committee\textsuperscript{254} and

\textsuperscript{253} Note that CEOs often sign contracts with supervisory board members on behalf of the ownership entity.

\textsuperscript{254} Ukrainian banks are required to establish permanent risk management units responsible for implementing internal regulations and risk management procedures in accordance with the risk management strategies and policies determined by the bank’s supervisory board. The risk management unit should be accountable to the supervisory board and separate from the internal audit unit. To manage risks, banks are also generally required to form permanent committees, including credit committee and asset and liabilities management committee as part of the unit (Verkhovna Rada, 2000[124]).
the members of the audit committee should consist exclusively of independent members (CMU, 2017[161]) (Verkhovna Rada, 2000[124]) (Verkhovna Rada, 2008[123]).

In addition, it is worth noting that specific requirements regarding committees are further outlined in the JSC law, including setting up appointments, remuneration and audit committees (committees on appointments and remuneration may be merged). Appointments committee is responsible for evaluating the structure, size and composition of the executive body and participating in recruitments, while developing ethics plans to avoid conflicts of interest, informing of any violations, and conducting trainings. Remuneration committee develops and reviews remuneration policy and submits proposals to the supervisory board regarding the remuneration of executive board members. Other elements include developing KPIs and incentive schemes for individuals performing managerial functions (Verkhovna Rada, 2008[123]).

Audit committee in JSCs organises internal audit, reviews its effectiveness, and provides recommendations on appointing or dismissing heads of internal audits. The committee may also provide recommendations regarding an independent auditor, while monitoring their independence and objectivity. Unlike other committees, the audit committee should have unrestricted access to information regarding the company’s financial activities and the information submitted to the independent auditor. It also reports on its activities twice a year, compared to other committees reporting once a year regarding their composition, meetings and activities. Following the approval of the supervisory board, information should be made public within three working days. However, it is worth noting that while these regulations under the JSC law are applicable only to corporatised SOEs, requirements may vary in other SOE legal forms (Verkhovna Rada, 2008[123]).

In practice, some of the key SOEs have taken steps towards establishing committees and meeting requirements under relevant laws. Notably, Ukrenergo has established committees on audit, appointments and remuneration, and investment and strategy, consisting of at least three and majority independent board members, and chaired by independent board members. Similarly, Naftogaz has created five committees on audit and risk, ethics and compliance, nomination and remuneration, strategy, and health, safety, environment and reserves, while meeting relevant requirements on composition. However, the structure and efficiency of the committees may vary between companies depending on the SOE legal form. Their work may also be impacted due to delays in filling empty board seats. Moreover, only a small number of SOEs have initiated the establishment of risk management committees and units, though functions may be integrated within other committees (such as audit committee) (note that requirements are to be established in this regard).

16.9. Annual performance evaluation

I. SOE boards should, under the Chair’s oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

According to the SOE law, supervisory board members are expected to prepare annual reports covering their activities, evaluation of the work of their members and the quality of corporate governance. JSC law elaborates further on the content of the

Requirements for committees in SOEs are outlined in the SOE law and the CMU Resolution no. 142. However, provisions are not as specific as those outlined in the JSC law.
annual reports of the supervisory board members, which are mandatory for public JSCs and banks, and voluntary for private JSCs (see Section 15). Until now, supervisory board member evaluation has been carried out in a formalistic way, during which the shareholder acknowledges the activities of supervisory board at an annual shareholders’ meeting and outlines whether or not the board’s performance was satisfactory. In practice, certain SOEs (including Ukrenergo, MGU and Boryspil International Airport) have started issuing so-called supervisory board reports, while others may disclose information in their annual reports. In general most supervisory boards in Ukraine, apart from state-owned banks, have not established board self-evaluation mechanisms. The self-evaluation by state-owned banks focus on the effectiveness of the board as a whole, its committees, and each board member, and involve the use performance agreements. Moreover, Ukreximbank has developed a self-evaluation methodology for supervisory board members which is in line with internationally accepted practices.

In addition, ownership entities have started setting “key performance indicators” (KPIs) for supervisory board members in companies, including Ukrosposta, Ukhrvdroenergo, USPA, the Boryspil International Airport, Ukrenergo, Polygraph Combine Ukraine and Automobile Roads of Ukraine. While there is currently no specific methodology for setting the KPIs for supervisory boards, relevant provisions are outlined in charters and ownership strategies (also see Section 11 and Box 11.3). For example, according to the CMU resolution that approved a revised ownership policy of Naftogaz, MDETA is expected to develop KPIs for its supervisory board members (CMU, 2020). In addition, Naftogaz’s ownership policy states that the KPIs for board members are expected to be established jointly by the ownership entity and the board members. KPIs are currently being developed for board members in other top-15 SOEs, and relevant documents are expected to be disclosed by mid-2021.

In state-owned banks, the Ministry of Finance is currently working on an assessment methodology to evaluate the performance of the supervisory board. According to the Law on Banks and Banking, the Ministry is responsible for annually assessing the implementation of the strategy in each bank and analysing whether targets have been met. Within this context, the assessment methodology is expected to outline the effectiveness of the supervisory boards in performing oversight functions and in implementing the strategy. The Ministry is expected to hire an external expert who will analyse the functioning of the board’s activities collectively, and, following the assessment and the Ministry’s decision, the CMU (as the ownership entity) should make a decision regarding the board’s collective performance.

However, there are concerns with regard to the establishment of KPIs for supervisory boards of non-financial SOEs due to the possible use of such KPIs as grounds for undue dismissal of individual board members, especially in the absence of a clearly articulated ownership policy, objectives and owners’ expectations for individual SOEs. Moreover, it is not clear whether the KPIs are to be established for the board as a collegial body or for individual board members. The draft law on corporate governance that is currently under development seeks to anchor application of KPIs for board

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256 Methodological recommendations have been outlined by the National Bank of Ukraine (NBU, 2018).

257 CMU Resolution No. 1052 details requirements for clear goals in SOEs to improve supervision over the supervisory board, the company, and the executive body (CMU, 2016). However, the adoption of separate indicators to evaluate board members individually are currently being discussed. Ownership entities have already issued specific tasks collectively for boards, such as Naftogaz (CMU, 2017).
members, and it is understood that this will be further linked to the goals set by the ownership policy and strategic plan of the SOE. However, to date, no methodology has been shared with the assessment team. Board evaluation tools should be carefully considered, applied to the board as a collegial body, and developed based on internationally-accepted best practices. The practices established for state-owned banks appears to be quite advanced and may serve as a useful model to emulate for the rest of the portfolio. Ultimately, board evaluation should be based on objective criteria and built upon clear owners’ expectations communicated to the entire board. The evaluation should not serve as input for undue dismissals.

16.10. Internal audit

J. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

The establishment of an internal audit function is not mandatory as a matter of law in Ukrainian SOEs, though requirements vary depending on the SOE legal form and type. If a supervisory board exists, it may establish an internal audit function. If there is no supervisory board, there are no strict rules regarding the functioning of internal audit.

Under the existing framework, the supervisory board is responsible for developing and approving the procedures for performing an internal audit function, appointing and dismissing the head of internal audit, and setting the terms and conditions of employment agreements of the internal audit staff, including remuneration. The head of internal audit should report to the supervisory board’s audit committee. Moreover, according to the Law on Management of Objects of State Property, ownership entity may launch unscheduled audits in case the CEO of an SOE changes, although the mechanisms for such an audit and the involvement of the supervisory board in this process have not been elaborated.

However, internal audit functions have not been fully implemented in majority of the SOEs, and quality and composition may vary between SOEs. Naftogaz has developed an internal audit plan, along with relevant objectives and procedures for appointing an auditor. Similarly, Ukrenergo and Boryspil International Airport introduced internal audit functions in 2019. However, in some cases, there have been significant time gaps between the set-up of audit committees and units, and the start of their activities. In addition, Energoatom has reportedly established an internal control system, including a directorate for control and audit work that inspects the company’s financial and economic activities. However, as the company is not corporatised and as it does not have a supervisory board, the audit unit is accountable to the CEO. As a supervisory board should be created in Energoatom and as it is expected to be corporatised, its audit function and reporting lines are expected to change.

Moreover, while internal audit usually reports to the supervisory board (where it exists), practices may differ in some SOEs. Notably, in 2020 Ukrposhta set up an internal audit department, which reports to the supervisory board on most matters.

258 It is worth noting that the requirements for setting up an internal audit unit are clearer and more specific in the JSC law applicable to corporatised SOEs, compared to the SOE law.
However, the audit department reports to the CEO of the company on administrative and personnel issues that do not require a decision from the supervisory board. In addition, considering that the GTSO currently has no supervisory board, its internal audit unit reports to the supervisory board of the MGU, its ownership entity. Moreover, Ukroboronprom has no audit function for the time being (CMU, 2020[150]).

Despite the establishment of internal audit functions, revision commissions (see Box 16.3) still exist in certain SOEs.259 For example, while Ukhydroenergo has established an audit committee in the supervisory board and a system of internal controls, its revision commission remains in place and reports to the ownership entity. Other SOEs with revision commissions include State Food and Grain Corporation, Sea Ports Authority, Ukrzaliznytsia, UkSATSE and Automobile Roads of Ukraine, among others, though they no longer exist in other top-15 SOEs and state-owned banks.260 Currently, a draft law is being considered in the parliament (No. 2493) that would abolish the revision commissions.

Box 16.3. Revision commissions in Ukrainian SOEs

The provisions regarding the set-up of revision commissions are outlined in the JSC and SOE laws, and secondary legislation. These commissions are responsible for exercising control over financial and economic activities over SOEs. Although their functions have changed over the years and their influence has been reduced, the commissions may still have a significant impact on SOE operations.

Revision commissions are appointed by and remain accountable to the shareholder (ownership entity), and may optionally report to the supervisory board on the results of scheduled and unscheduled inspections. While their composition is determined by the charter, the commission must contain at least three members, and, in certain circumstances, the representatives of the SPFU, SAS, and State Tax Administration. Members of the supervisory board or the executive body, the corporate secretary, and other company officials may not be appointed to the commission. Their term of office is limited to five years, though their powers may be terminated earlier as determined by the general meeting or as stated in the charter.

Some of the key functions of the revision commission include the following:
- Checking the status of the implementation of the financial plan and economic activities
- Verifying compliance with the company’s charter (including the use of reserve funds)
- Checking timelines and completeness of settlements with the budget, dividend payments, and repayment of loans
- Analysing the company’s financial condition and compliance with accounting
- Submitting reports on the results of the inspection to the general meeting and providing recommendations as needed
- Providing recommendations on the selection of an independent auditor

259 SOEs may still have revision commissions, or temporary committees to conduct special audit of financial and economic activities of an SOE (Box 16.3). These commissions may be set up for a period of no longer than five years, during which they may make proposals regarding the agenda to the general meeting and demand convening extraordinary meetings, along with having a right to an advisory vote. The members of the commission may also participate in supervisory board and executive body meetings, if specified in the law, charter, or other regulations. Access to information may be provided (though with specified limits) and based on the results, the commission could prepare an opinion regarding the financial and economic activities, relevant statements and procedures, or violations. However, these commissions have often been ineffective and served as an additional instrument for intervention.

260 The CMU recently appointed a revision commission in Ukrzaliznytsia consisting of the representatives of the State Audit Service, Ministry of Infrastructure, MDETA, SPFU and the State Tax Service (Interfax Ukraine, 2021[332])
• Convening an extraordinary general meeting in case of threats to the company’s interests through detection of abuses by company officials

The revision commission may also request information from the company, demand the convening of executive body and supervisory board meetings, request explanations and involve independent specialists at the company’s expense, as needed. The commission members may also make proposals to the agenda of the general meeting and, along with drawing conclusions from the inspections, to exercise control over addressing violations.

The commission may conduct special inspections if decided by the shareholder, supervisory board, the executive board, or on its own initiative, at the SOE’s expense. The final results and conclusions should be approved by the general meeting, and contain information on scheduled and unscheduled inspections, proposals to address violations, and completeness of financial statements. The results are not subject to public disclosure, and they may be submitted only to the executive and supervisory boards, as well as the SPFU, the ownership entity and the initiator of the audit. Commission members may also receive additional incentives at the SOE’s expense.

Source: (SPFU, 2009[289]) (SPFU, 2007[290]) (Verkhovna Rada, 2008[123]) (Verkhovna Rada, 2006[122])
Part III. Conclusions and recommendations
Chapter 17. Conclusions and recommendations

In the last six years, Ukraine has taken several steps toward reforming corporate governance in the largest SOEs and aligning its practices with the OECD SOE Guidelines. Some of the achievements in this period include the adoption of the 2016 amendments to the Law on Management of Objects of State Property, which introduced provisions requiring a majority of independent directors on supervisory boards of SOEs and more robust transparency and disclosure. In 2015, Ukraine issued its first annual aggregate report of the top-100 SOEs. While the report was eventually phased out, the government recently established a publicly available online inventory (ProZvit), with financial indicators for the centrally-owned SOEs, which is a step towards better transparency. Ukraine has also established a government-led nomination committee and competitive selection procedures for independent board member and CEO appointments in economically important SOEs – though its consistent use remains to be seen. In the last year, Ukraine has prioritised the implementation of corporate governance reforms in the top-15 SOEs, with the stated aim to align practices with the SOE Guidelines. Significant steps have also been taken to upgrade corporate governance in state-owned banks.

At the same time, corporate governance reforms remain nascent and fragile. On the one hand, previous governments’ reform efforts have at times been patchy, often left unfinished and in some cases even reversed. Many legal requirements and established policy frameworks are not implemented or circumvented. Eighty-six per cent of the 3,300 centrally-owned SOEs still operate in the legal form of state unitary enterprise. The absence of a comprehensive ownership policy and decentralised ownership arrangements, with over 80 central executive bodies exercising ownership rights, result in diverging governance approaches and goal conflicts for individual SOEs, and an unclear role for the relevant ownership entities. Allowing ministries and other state institutions to perform ownership, policymaking and regulatory functions concurrently represents an additional source of conflict of interest. A slew of exceptions and overlapping provisions apply to the current legal framework and allow for conflicting interpretations of the law – and these exceptions create opportunities for undue interference in SOEs. For example, these regulations strip supervisory boards of their most important powers, such as appointing CEOs and approving strategies. Further focus on implementation by the state as a shareholder and by individual SOEs is necessary, in particular with regard to establishing fit-for-purpose independent supervisory boards, professional management, functioning systems of internal controls and audit, systematic external independent audit and widespread adoption of IFRS.

Moreover, despite gradual progress in the past, shifting priorities partly due to the Covid-19-induced crisis have led to reform stagnation and setbacks, resulting in board member resignation and stalled legislative proposals. The review highlights broad concerns about long-term political willingness and ability to implement the SOE Guidelines. This is further compounded by lack of transparency and stakeholder
consultation around key government decisions and policies. Lack of leadership and of a long-term stable policy framework, together with weak enforcement powers of regulatory authorities and law enforcement bodies, aggravate the risk of policymakers and vested interests making politically-motivated decisions at the expense of SOEs' performance. Going forward, strong leadership and tone from the top, together with a clearer long-term ownership policy, will be necessary to see through and implement holistic reforms.

To address some of these challenges, this review identifies a number of near and long-term priorities (non-exhaustive) to help Ukraine better align its practices with the SOE Guidelines. Ukrainian authorities are encouraged to continue working with the OECD in view of supporting their implementation.

17.1. Near-term priorities

Address inconsistencies in legal and regulatory frameworks. The Law on Management of Objects of State Property (SOE law) provides a general corporate governance framework for SOEs. However, additional laws and secondary legislation may be applicable to SOEs depending on their legal form, type and sector of operation. This allows for a slew of exceptions, conflicting interpretations and contradictions. Ukraine needs to introduce amendments to the current legal framework for the corporate governance of SOEs to align it with the OECD Guidelines. The amended legal framework should aim to, _inter alia:_

- Elucidate and clearly delineate the role of state as owner, in both its exercise of shareholder rights and its broader ownership functions, from the roles and responsibilities of supervisory boards which should be in line with the SOE Guidelines (e.g. CEO appointment, dismissal and remuneration, setting the strategy, approving key corporate documents, etc.)
- Rectify contradictions between various laws (including the SOE Law and the JSC Law) and regulations (Resolutions of the Cabinet of Ministers), establish a clear hierarchy of application, and eliminate exceptions, while avoiding carve-outs for specific sectors (e.g. defence) and individual SOEs
- Abolish “key performance indicators” for the supervisory board and ensure boards are evaluated based on self-evaluation and external independent evaluation, addressing the board as a collegial body, and based on clear and transparent criteria, including their ability to meet broad objectives and mandates based on long-term value set by the ownership entity
- Establish clear grounds for early termination of powers of the supervisory board members, which should be decoupled from the board evaluation process.

Continue corporate governance reforms in the top-15 SOEs. The implementation of CMU Protocol Decisions No. 26 and No. 62 is lagging and additional focus is particularly important around board and CEO appointment practices. The ownership entities should ensure full transparency around board and CEO appointment and dismissals, which should reflect well-structured, uniform, transparent and merit-based procedures. The ownership entity should ensure supervisory boards are composed of majority independent directors and empowered to exercise independent and objective judgement, shielded from undue political interference, and have the necessary autonomy to carry out their work. Powers to appoint and dismiss the CEOs should be vested with the supervisory board. The ownership entity should refrain from the
common use of “acting” CEOs which circumvents the nomination procedures. The ownership entities should strive to attract and retain suitable, qualified and reputable board and management profiles, and implement a remuneration policy to achieve that goal. Ukraine may wish to consider measures that enhance gender diversity on boards and in senior management.

**Implement best practices in transparency and disclosure in economically important SOEs, and upgrade financial and non-financial reporting.** The ownership entity should develop a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information. This disclosure policy should be systematically implemented by SOEs, actively monitored by MDETA and should foresee penalties towards SOEs in cases of non-compliance. In particular, economically important SOEs should consistently establish internal audit units that report directly to the supervisory board, and whose activities are monitored by the board audit committee chaired by an independent board member, avoiding any state interference. The selection of an independent auditor should be made by the board according to established procedures. Boards should be held accountable for ensuring that qualifying SOEs systematically issue their financial statements based on internationally accepted accounting and auditing standards. The revision commissions should be abolished. Ownership entities should maintain dialogue with state audit institutions and external independent auditors, and take appropriate measures in response to audit findings. For SOEs with public policy objectives, the supreme audit institution may also assess the adequacy of risk management and integrity measures established to achieve said policy objectives. In this vein, ownership entities should ensure that costs of public policy goals if assigned to SOEs are properly compensated, while ensuring clear separation of costs of public policy goal implementation from costs of commercial activity.

**Develop a comprehensive ownership policy with clear rationales for ownership.** The current Basic Principles (ownership policy) should be formalised and further developed to consider trades-offs between shareholder value, long-term investment capacity, public service obligations and other public policy goals. The ownership policy should reflect whole-of-government policies and priorities, and establish linkages with the existing government sectoral strategies (such as the so-called “triage” process and Principles for Strategic Reform of the Public Banking Sector) and obligations set out in relevant sectorial legislation. The policy should be based on a sufficiently long time horizon to allow governing bodies of the company to develop a corporate strategy and establish goals which are in the long-term interests of the company and the shareholder, and subject them to recurrent review. It should serve as a basis from which ownership entities establish rationales of state ownership, as well as broad mandates and objectives for individual SOEs that should be understood and discussed with the board. This should be taken into account by SOEs for the purposes of their strategic and financial planning. The ownership policy should be subject to political accountability and stakeholder consultation before approval. The policy should be based on a legal framework to ensure its enforceability and be made publicly available.

The state should ensure that the governance of SOEs is carried out in a transparent and accountable manner. The government should establish clear policies which are made transparent and subject to accountability. Key policy documents, such as those pertaining to the reform of the top-15 SOEs or the Basic Principles (ownership policy),
should undergo appropriate consultation procedures with stakeholders, and be subject to appropriate procedures of political accountability. Such policy documents should be published and made available to the general public.

*Reintroduce annual aggregate reporting, while upgrading the ProZvit platform.* Future efforts should be focused on ensuring high quality data, and updating and streamlining the ProZvit platform, while minimising discrepancies and duplication with other existing sources (such as the SPFU’s unified portal). Moreover, MDETA should reintroduce the annual narrative aggregate reporting with regard to all SOE portfolios (or at least economically important SOEs), which would help strengthen the accountability of the state as a shareholder and serve as a key disclosure tool.

*Professionalisation of state-ownership functions, as a means to fight corruption, and avoid undue political interference and unnecessary day-to-day intervention in SOEs, with the ultimate aim of enhancing SOE efficiency and profitability.* To address concerns about day-to-day intervention and undue political influence, ownership entities should take action to professionalise ownership practices. This includes discontinuing the use of outdated planning documents (such as the financial plan) which can act as a source of irregular practices. The Government should ensure that ownership entities set and monitor the implementation of broad mandates and objectives for SOEs, which are based on clear financial and non-financial targets, capital structure objectives (including flexible dividend policies) and risk tolerance levels. Ownership entities should maintain on-going and active dialogue with the board on draft key strategic documents to come to an agreement on what is realistic, achievable and aligned with the shareholder’s expectations. Two-way accountability and institutionalising dialogue between the state and board will be a key aspect to professionalising state ownership. Care should be taken to avoid that the state excessively intervenes in the process or that such dialogue is used as a means for potential political interference.

### 17.2. Long-term priorities

*Establish a centralised ownership coordination entity.* A strong, independent and professionally staffed agency should be established to ensure that the ownership entity function is carried out on a whole-of-government basis. This entity should (i) exercise full ownership rights in at least a sub-set of economically important SOEs; while (ii) coordinating the rest of the SOE portfolio. This entity would need to have the powers, capacity and competency to exercise ownership rights, alone or in concert with other parts of government involved in state-ownership. The ownership entity should be assigned to a part of the public administration that does not have concurrent responsibility for policy planning, regulation, or public policy objectives. It should be overseen by a senior government minister and be accountable to relevant legislative bodies. The ownership entity should enjoy a degree of budgetary autonomy and be adequately resourced to allow it the flexibility to recruit, remunerate and retain necessary expertise. The ownership entity should be shielded from undue political interference and corruption.

*Ensuring a level playing field with private companies.* To avoid distorting competition, public service obligation frameworks should be clarified and improved, with a clear compensation methodology established. Ownership entities should systematically notify the Anti-Monopoly Committee of Ukraine (AMCU) prior to extending state aid
and support measures to SOEs and MOEs, and should be subject to enforcement action by the AMCU in case of illegal state aid. To this end, the AMCU should be further empowered to carry out its functions. SOEs should be required to maintain separate accounts for commercial and non-commercial activities to ensure competitively neutral compensation for carrying out public service obligations. The government should review the bankruptcy rules and moratoria applicable to SOEs and MOEs, while eliminating the unconditional (in terms of duration and amount) use of state guarantees for SOEs and MOEs to access finance. The government should require SOEs to access finance on commercial terms, which, among other things, means that they should be able to pledge their assets. In turn, boards and management should have the right incentives for sound financial management. To this end, the Ministry of Finance should strengthen its fiscal risk monitoring system, for example by publishing quarterly reports on fiscal risk assessments of SOEs and risk mitigation measures (with NBU for the state-owned banks), as well as ensuring that all SOEs start to have their annual financial statements audited by external independent auditors.

*Continue strengthening anti-corruption frameworks applicable to SOEs.* The state should apply high standards of conduct, promote integrity and ensure clarity in its expectations for promoting anti-corruption efforts. It should ensure that anti-corruption institutions, including NABU, SAPO and the High Anti-Corruption Court, are sufficiently resourced, staffed and empowered to conduct investigations. The boards of SOEs should be required to ensure that the companies implement high standards of disclosure and transparency, especially in area of procurement, and develop an integrated risk management system, guided by risk management committees. In parallel, boards should improve internal controls, ethics and compliance measures in line with the SOE Guidelines. There should be a high level of integrity in governing bodies of SOEs, and supervisory boards or CEO candidates should not have perceived/potential or actual conflicts of interests.

*See through reform of the remainder of the SOE portfolio in line with the ownership policy and fully centralise ownership.* Full corporatisation of state unitary enterprises (that is, their transformation into joint stock companies, limited or additional liability companies), should be undertaken for the remainder of the portfolio (including municipally-owned enterprises), unless they are identified for liquidation, and as determined by the comprehensive ownership policy. Central SOEs to remain in state ownership should be consolidated under one centralised ownership coordination entity in accordance with the best practices outlined by the SOE Guidelines.
Annex A. Methodological note on data analysis

Annex A.1. Data compilation and assessment

In assessing the Ukrainian SOE sector, this report has considered and analysed data from various sources. This includes data received from the Ukrainian government through the questionnaire and information exchange, as well as other governmental and non-governmental statistical sources. The questionnaire responses shared by the Secretariat of the CMU contained aggregated figures on the SOE sector, which was compiled by MDETA for 2019. The CMU also provided information from the Unified Register of State Enterprises, which is managed by the SPFU, containing a list of SOEs, including their location and ownership entities, as well as some financial indicators. Further aggregated figures on the SOE sector may also be found through the State Statistics Service of Ukraine (SSSU). In presenting information regarding sectoral distribution, employment and value, this report has relied on figures shared through the questionnaire. However, it has also referred to other sources to compare information. Notably, the ProZvit platform provides quarterly data on SOEs starting from 2016. It contains both aggregated and disaggregated information on the SOE sector, including cross-sectoral indicators and financial data. However, the database is nascent and information regarding SOEs for 2019 and 2020 remains to be added. Following its launch, the platform has also gone through a number of upgrades, which has impacted information availability.

Further to governmental sources, this report has also referred to YouControl, a platform used for compliance and market analysis. YouControl gathers information regarding all entities, including SOEs and private companies. Along with financial data, it provides information regarding ownership structure, tax payments, court cases and affiliated individuals. This database has been used to verify information and outline discrepancies, and to conduct comparative analysis between the SOEs and private companies.

For the purposes of conducting the review, sectoral data (received from the Ukrainian government) on SOEs in this report have been grouped and presented based on the Size and Sectoral Distribution of State-Owned Enterprises and relevant OECD publications, as outlined below.

<table>
<thead>
<tr>
<th>OECD categories</th>
<th>Sectoral grouping</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity and gas</td>
<td>Supply of electricity, gas, steam and air conditioning</td>
</tr>
<tr>
<td>Finance</td>
<td>Financial and insurance activities</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>Manufacturing</td>
</tr>
<tr>
<td></td>
<td>Construction</td>
</tr>
<tr>
<td>Primary sector</td>
<td>Agriculture, forestry and fisheries</td>
</tr>
<tr>
<td></td>
<td>Mining and quarrying</td>
</tr>
<tr>
<td>Real estate</td>
<td>Real estate transactions</td>
</tr>
<tr>
<td>Telecoms</td>
<td>Information and telecommunications</td>
</tr>
<tr>
<td>Transportation</td>
<td>Transport, warehousing, postal and courier activities</td>
</tr>
<tr>
<td>Other utilities</td>
<td>Water supply; sewage; waste management</td>
</tr>
</tbody>
</table>
Annex A.2. Discrepancies in data availability within the SOE sector

The exact number of SOEs in Ukraine has been subject to debate. The questionnaire submitted by the government cited 3,293 SOEs for 2019 based on MDETA’s aggregate reporting on SOE performance, while the Unified Register provided by the Secretariat of the CMU listed 3,457 SOEs for January 2020. The information available on ProZvit, however, has varied – notably, while 3,677 SOEs were identified for 2018, the number of SOEs was reduced to 3,605 for 2019 and to 3,555 for Q2 in 2020. As ProZvit continues to be updated, figures may vary, and financial and non-financial information may be unavailable for some SOEs on the platform.

Table A.1. Comparison of data availability for SOEs

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SPFU Unified Register</td>
<td>3,457 (in 2020)</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>ProZvit</td>
<td>3,605 (in 2019)</td>
<td>1,848 (in 2019)</td>
<td>-1,100</td>
<td>-1,400</td>
</tr>
<tr>
<td>YouControl</td>
<td>N/A</td>
<td>N/A</td>
<td>1,922</td>
<td>1,839</td>
</tr>
<tr>
<td>MDETA (Questionnaire)</td>
<td>3,293 (in 2020)</td>
<td>1,535 (in Q1 2020)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Note: The information availability is regarding the data on SOEs through 2019 (as of September 2020). ProZvit website continues to be updated, and figures may vary. It is also worth noting that MDETA reports on the SOE figures separately: [https://bit.ly/35mi3cu](https://bit.ly/35mi3cu). Moreover, figures submitted by MDETA exclude SOEs located in the territory of the Autonomous Republic of Crimea (In 2020, out of 3293 SOEs, 168 were located in Crimea, while in 2019, out of 3363 SOEs reported, 173 were located in Crimea).

One of the key reasons for discrepancies and information unavailability is a lack of systematic reporting. Despite requirements to disclose information (including to MDETA and the CMU), SOEs may not always report their activities in a timely manner (or at all). Considering the size of the SOE portfolio and the involvement of over 80 ownership entities (as outlined below), the central bodies have also found it challenging to monitor the activities of individual entities.

In addition, nearly half of the SOEs in the total portfolio are non-operational or are located in non-government controlled areas, and information regarding these entities is unavailable. While ceasing operations, a number of companies have also witnessed de jure existence due to owning real estate and, considering the difficulties in privatising their assets, have remained on the registers.

Along with lacking sufficient resources, there are different reporting requirements and methodological differences for entities gathering information on the SOE sector. For example, ProZvit contains data on centrally-owned SOEs and a small fraction of municipally owned entities, though lacking information for a majority of the 14,000

<table>
<thead>
<tr>
<th>OECD categories</th>
<th>Sectoral grouping</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other activities</td>
<td>Administrative and auxiliary services</td>
</tr>
<tr>
<td></td>
<td>Arts, sports, entertainment and recreation</td>
</tr>
<tr>
<td></td>
<td>Education</td>
</tr>
<tr>
<td></td>
<td>Health care and social assistance</td>
</tr>
<tr>
<td></td>
<td>Other</td>
</tr>
<tr>
<td></td>
<td>Professional, scientific and technical activities</td>
</tr>
<tr>
<td></td>
<td>Public administration and defence; compulsory social insurance</td>
</tr>
<tr>
<td></td>
<td>Temporary accommodation and catering</td>
</tr>
<tr>
<td></td>
<td>Wholesale and retail trade; repair of motor vehicles and motorcycles</td>
</tr>
</tbody>
</table>
entities owned at sub-national level. Databases at the central government level, however, may contain no information regarding the MOEs. In addition, while ProZvit provides consolidated figures for Naftogaz and its subsidiaries, it contains disaggregated figures for Ukroboronprom and its affiliated companies. While presenting consolidated figures for Naftogaz, the database may omit other information regarding its subsidiaries (such as employment figures, which were available in the July 2020 and were later removed). There may be additional differences regarding sectoral information, particularly regarding the number of SOEs, employment, and equity value across reporting entities. Moreover, if SOEs have multiple subsidiaries performing different functions, consolidated reports and the absence of information on the subsidiaries may impact sectoral data. (For example, while the CMU questionnaire cited that Naftogaz parent was engaged in professional services, its subsidiaries are engaged in various activities within the hydrocarbons sector. This may also impact how the aggregated sectoral figures are presented based on the sector in which Naftogaz’s financial figures are reported).

Figure A.1. Size and distribution of SOE portfolios by ownership entities

Source: Author’s compilation is based on the Unified State Register shared by the Secretariat of CMU, listing 3,457 SOEs. The figures reflect the number of SOEs within each ownership entity. Exact figures may vary depending on the reporting agency. Along with line ministries, SOEs are under the ownership of the State Property Fund and agencies under the line ministries. For example, the State Agency of Forestry Resources is under the Ministry of Environmental Protection and Natural Resources. Moreover, while the information on Ukroboronprom’s subsidiaries are individually reported, other SOEs present consolidated figures. Further discrepancies may arise due to privatisation and restructuring, through which SOEs may shift from one ownership entity to another. For example, the Ministry of Energy was reorganised twice within a year, which may have impacted the size of its SOE portfolio. While previously established as the Ministry of Energy and Coal Industry, in 2019 it merged with another ministry, becoming the Ministry of Energy and Environmental Protection. In 2020, it was further divided into the Ministry of Energy...
and the Ministry of Environmental Protection and Natural Resources of Ukraine, thus contributing to the redistribution of SOEs under the management of each entity. Other examples may include MDETA (which was established after the Ministry of Economic Development and Trade merged with the Ministry of Agriculture), as well as newly established ministries (such as the Ministry of Digital Transformation and the Ministry of Strategic Industries) which may develop their own SOE portfolios. Moreover, as the government is looking to reduce the size of the SOE sector through privatisation, it continues transferring SOEs under the SPFU, the portfolio of which has significantly increased over the years.

Annex A.3. Discrepancies in the operational performance of SOEs

In addition to data discrepancies, it is worth noting that the calculation of operational performance of SOEs varies between the OECD assessment and figures provided by the Ukrainian government. The OECD figures are based on the analysis of YouControl database, where full dataset of indicators was available. The figures provided by the government of Ukraine (with discrepancies outlined in red) are based on the unified monitoring of the efficiency of state property management. However, access to this database was not available to the assessment team and the figures cannot be verified. Moreover, while financial indicators and data regarding the SOEs is available on ProZvit, at the time of writing the website was still being updated.

Table A.2. Comparison of data on financial performance in SOEs

The OECD calculated financial performance in SOEs based on the YouControl database. The Ukrainian authorities also provided financial indicators based on the unified monitoring of the efficiency of management of state-owned objects (internal database). However, the OECD Secretariat was not provided with access to the internal database, and the discrepancies are outlined below:

<table>
<thead>
<tr>
<th>OECD calculations (for financial year 2019)</th>
<th>Return on equity</th>
<th>Return on assets</th>
<th>Profit margin</th>
<th>Current ratio</th>
<th>Quick ratio</th>
<th>Debt-to-equity ratio</th>
<th>Asset turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned enterprises</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>1.05</td>
<td>0.51</td>
<td>0.40</td>
<td>0.97</td>
</tr>
<tr>
<td>Municipally-owned enterprises</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.81</td>
<td>1.02</td>
<td>0.05</td>
<td>0.93</td>
</tr>
<tr>
<td>Private companies</td>
<td>8%</td>
<td>1%</td>
<td>2%</td>
<td>1.28</td>
<td>0.83</td>
<td>0.18</td>
<td>1.10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GoU calculations (for financial year 2019)</th>
<th>Return on equity</th>
<th>Return on assets</th>
<th>Profit margin</th>
<th>Current ratio</th>
<th>Quick ratio</th>
<th>Debt-to-equity ratio</th>
<th>Asset turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned enterprises</td>
<td>5.8%</td>
<td>3.4%</td>
<td>7.3%</td>
<td>1.5</td>
<td>n/a</td>
<td>0.52</td>
<td>1.6</td>
</tr>
<tr>
<td>Municipally-owned enterprises</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1.81</td>
<td>1.02</td>
<td>0.05</td>
<td>0.93</td>
</tr>
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<td>0.83</td>
<td>0.18</td>
<td>1.10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>OECD calculations</th>
<th>Return on equity</th>
<th>Return on assets</th>
<th>Profit margin</th>
<th>Current ratio</th>
<th>Quick ratio</th>
<th>Debt-to-equity ratio</th>
<th>Asset turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>1.10</td>
<td>0.58</td>
<td>0.34</td>
<td>0.95</td>
</tr>
<tr>
<td>2018</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>1.07</td>
<td>0.56</td>
<td>0.38</td>
<td>1.01</td>
</tr>
<tr>
<td>2019</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>1.05</td>
<td>0.51</td>
<td>0.40</td>
<td>0.97</td>
</tr>
</tbody>
</table>
Annex A.4. Discrepancies within top-15 SOEs

In addition to the data within the SOE sector, there may be discrepancies in the reporting of individual SOEs. Financial information for the top-15 SOEs was provided through the data collection exercise in the questionnaire submitted to the Ukrainian government. The questionnaire requested information on the 10 largest SOEs defined as follows:

- First 10 by equity value (+ 5 largest by employment, if different from the first 10);
- Mostly commercial SOEs, operating in the market place;
- Individual companies rather than corporate groups (provide individual data in the case of holdings for example).

Information was requested for each SOEs for the reporting years from 2014 through 2019 (or latest available information).

The government of Ukraine submitted information regarding the top-15 SOEs identified through the CMU Protocol Decisions 26 and 62, in which the government seeks to introduce OECD standards for corporate governance. However, financial information was provided for 14 companies, as the Gas Transmission System Operator was established in 2019 (and transferred to MGU) and there was no data available at the time of questionnaire submission. Moreover, information on individual subsidiary companies was not provided.

In analysing their performance, this report has used the data submitted by the Secretariat of the CMU. However, the information has also been compared with other sources, including YouControl, ProZvit, and company statements. While some discrepancies have been identified across reporting agencies regarding these SOEs, the following should be noted:

a) Ukroboronprom: YouControl listed 225 employees and the CMU listed 67,780 employees, and the revenue reported in the former was significantly lower. One of the explanations is that the CMU provided aggregated figures, while YouControl provided data only on the parent company. Moreover, aggregated figures would likely imply a sum, rather than a consolidation, and therefore contain no information regarding the intermediate outputs. There were no other sources available (including online financial statements) to verify information.

b) Automobile Roads of Ukraine: YouControl cited 61 employees and a revenue of UAH 1,272,504, while the CMU cited 16,444 employees and a revenue of UAH 5,582,048. It is worth noting that the CMU figures coincided with the reporting on ProZorro. The latest financial report for the company was available for 2018, with a consolidated revenue of UAH 6,569,912.
There may also be discrepancies between figures reported through the questionnaire responses and financial statements issued by SOEs.
Annex B. Description of Ukrainian SOEs (continued)

Annex B.1. Gas TSO of Ukraine

Overview

The Gas Transmission System Operator (GTSO) is a Ukrainian monopoly that delivers natural gas to regional distribution networks for wholesale operators and transports it to Europe (GTSO, n.d.[291]). It was established as part of the unbundling plan, by separating the gas transmission assets from Naftogaz into a new legal entity.

GTSO faces a number of business-related challenges. For one, the company faces the risk of uncertainty and reduced transit flows following the possible completion of the Nord Stream 2. For another, GTSO has continued to experience unauthorised gas withdrawals. Notably, the operators of gas distribution networks (known as oblgazy) and district heating companies (known as teplokomunenergo) annually utilise about 1.5-1.8 billion cubic meters of gas belonging to GTSO free of charge, resulting in annual losses of about UAH 10-12 billion. These costs are not included in the company’s tariff. One of the suggested mechanisms for resolving this situation would be the introduction of a PSO with a cost recovery mechanism for the company, though such schemes have not been set up to date.

Financial performance

While the company is still nascent, based on the financial results for 2020 (Table C.1.) it is already one of the largest SOEs in terms of asset value and revenue, as well as the number of employees (ca. 11,000). It has witnessed high profitability ratios and a profit margin, which was primarily due to the five-year gas transit contract between Naftogaz and Gazprom. However, the long-term capacity utilisation of the Ukrainian gas transmission system is uncertain and will largely depend on the launch of the Nord Stream 2 pipeline by Gazprom.

Table B.1. Financial indicators of GTSO

<table>
<thead>
<tr>
<th>GTSO (in thousand UAH)</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>1,654,112</td>
<td>57,574,713</td>
</tr>
<tr>
<td>Net financial result</td>
<td>-2,490</td>
<td>20,353,550</td>
</tr>
<tr>
<td>Total assets</td>
<td>4,520,690</td>
<td>149,029,354</td>
</tr>
<tr>
<td>Equity</td>
<td>3,738,002</td>
<td>116,626,204</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>78,800</td>
<td>10,521,875</td>
</tr>
<tr>
<td>ROA, %</td>
<td>0.0</td>
<td>13.7</td>
</tr>
<tr>
<td>ROE, %</td>
<td>0.0</td>
<td>17.5</td>
</tr>
<tr>
<td>Profit Margin, %</td>
<td>-0.2</td>
<td>35.4</td>
</tr>
</tbody>
</table>

Source: (GTSO, 2021[292]).
Corporate governance

Initially, GTSO was established as a limited liability company (LLC) under Ukrtransgaz, a wholly-owned subsidiary of Naftogaz responsible for gas transmission. The subsidiary was unbundled and sold to the Main Gas Pipelines of Ukraine (MGU) through a share purchase agreement with a 15-year payment plan based on an earn-out formula (GTSO, n.d.[293]). Ukraine’s national energy regulator, NEURC, certified GTSO according to the independent system operator (ISO) model and issued a license to carry out the transmission of natural gas in December 2019. According to the model, the GTSO is not able to own the gas transmission assets, though it has the right of their economic management.

The main reason for unbundling the ownership structure was to meet the requirements under Ukraine’s Gas Market Law adopted in 2015. The law sought to meet Ukraine’s commitments under the Energy Community Treaty and the EU-Ukraine Association Agreement. The unbundling was also to be implemented following the Stockholm arbitration case between Naftogaz and Gazprom. In the meantime, MGU was established as a future operator of the GTSO under the ownership of the Ministry of Finance (though in 2021 it was announced that MGU would be transferred under the Ministry of Energy). MGU is a corporatised entity, and has established a supervisory board with an independent majority.

This ownership framework, however, has resulted in a number of challenges: with two companies (GTSO and MGU) established instead of a single company. GTSO is the actual transmission system operator regulated by NEURC and MGU ended up performing holding functions, the rationale for which is unclear. The governance bodies of GTSO include the general meeting and the general director (CEO). At the beginning, GTSO’s general meeting functions were supposed to be exercised by the management board of MGU. However, since inception, the role of the management board of MGU has de facto been performed by a single person, the acting CEO. As a result, the reporting and accountability lines have been broken between the MGU’s supervisory board and GTSO’s management, and MGU’s board has been unable to ensure the oversight and internal controls of GTSO. As part of the solution, MGU’s charter was amended in October 2020, with the powers of GTSO’s general meeting transferred from MGU’s CEO to MGU’s supervisory board.

In addition, an ownership policy for GTSO was approved in December 2020, which implies the establishment of a supervisory board. However, considering its legal form, it is unlikely that its board members would have the adequate exclusive powers (which is a key component of the TSO independence and certification requirements of the Energy Community). Moreover, other corporate governance functions, including internal audit, compliance and risk management, cannot be established appropriately under its current

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262 The Ukrainian name for MGU is Mahistralni Gazoprovody Ukrainy.
263 Independent system operator (ISO) model is one of the three unbundling options envisaged by the EU’s Third Energy Package. This option is also reflected in Ukraine’s Gas Market Law, along with the ownership unbundling (OU) option.
264 Ukraine established the MGU in 2016 as part of meeting requirements under international agreements and the amended legal framework. To prepare for unbundling, GTSO was established. However, its transfer to MGU was delayed because of Naftogaz’s Stockholm Arbitration case against Gazprom, as the ruling was announced in February 2018. If the company had been transferred earlier, Naftogaz’s position in the Stockholm arbitration would have been threatened, as it could have been accused of asset stripping.
form, nor can these functions report directly to MGU’s supervisory board or its committees.

As foreseen by GTSO’s charter, its executive body consists of a single person, the General Director (CEO) with an appropriate contract. GTSO’s top management also includes four deputy CEOs who are not part of the executive body.

Annex B.2. Ukrainian State Air Traffic Services Enterprise (UkSATSE)

Overview

Ukrainian State Air Traffic Services Enterprise (UkSATSE) is a base of the national Air Navigation System and the Integrated Civil-Military Air Traffic Management System of Ukraine. The enterprise is authorised by the State Aviation Administration to provide air navigation services in the Ukrainian airspace and over high seas where air traffic service is delegated to Ukraine under international agreements (UKSATSE, 2020[294]).

UkSATSE is a natural monopoly and it is separate from the civil aviation regulatory body, the State Aviation Administration.²⁶⁵ UkSATSE consists of the Ukrainian Airspace Management and Planning Centre (Ukraerocentre), Aeronautical Information Services, “UkSATSE” Airline, the UkSATSE Training and Certification Centre, as well as six regional branches based in Kyiv, Dnipro, Simferopol, Lviv, Odesa, and Kharkiv (UKSATSE, n.d.[295]).

Financial performance

In 2019, UkSATSE was the eleventh largest SOE by asset value and thirteenth largest by revenue, while employing approximately 4,300 individuals. As Table C.2 shows, enterprise was profitable until 2017, but turned increasingly loss-making thereafter, especially in 2019 when the total losses reached more than UAH 1 billion. One possibility is that due to an influence of vested interests, as the Ukraine International Airlines owed UkSATSE UAH 1.3 billion (UKSATSE, 2020[296]). The enterprise has also exhibited a dramatic decrease in liquidity ratios (current ratio decreased from 11.4 to 3.7, quick ratio decreased from 10.8 to 3.6).²⁶⁶ In 2020, the company reported approximately UAH 1.5 billion in net losses considering the impacts of the Covid-19 pandemic, as well as challenges related to the existing debts.

In 2020, the company attracted a EUR 25 million loan from the EBRD, and it has also attracted financing from the EBRD and EIB in the previous years. It also received a UAH 200 million assistance from Ukrainian Sea Ports Authority, and, while the rationale is unclear, it is worth noting that both companies are under the ownership of the Ministry of Infrastructure (Boytsun et al., 2021[77]).

²⁶⁵ The Administration’s activities are directed and coordinated by the CMU through the Ministry of Infrastructure of Ukraine. The Administration ensures the implementation of the state policy in the sphere of civil aviation and airspace management of Ukraine (the competent authority for Civil Aviation).
²⁶⁶ Authors’ calculations are based on YouControl data.
Corporate governance

UkSATSE is a state unitary enterprise under the ownership of the Ministry of Infrastructure of Ukraine. The company has yet to establish a supervisory board with an independent majority, as required by law. However, its charter does not currently envisage the establishment of such board. Its executive body consists of a single person, the Director (CEO), who was appointed in October 2019 and is currently performing as an acting (temporary) head. UkSATSE’s top management also includes three deputy CEOs who are not part of the executive body.

Annex B.3. Automobile Roads of Ukraine

Overview

Automobile Roads of Ukraine was established in 2002, as part of measures to improve the efficiency of road management. The company’s main task is to construct, repair, and maintain roads, bridges, and other road infrastructure. Its construction work on public roads span 170,000 kilometres. Automobile Roads consists of 33 subsidiaries operating in all regions of Ukraine, which together have over 350 branches. The main task of these branches is to ensure safe and uninterrupted traffic on Ukrainian roads. Annually, they build and repair 3,000 kilometre of roads worth about UAH 4 billion (Automobile Roads of Ukraine, n.d.[297]).

Financial performance

Automobile Roads of Ukraine was Ukraine’s twelfth largest SOE by asset value and eleventh by revenue in 2019. It has been consistently loss-making over the past six years, surpassing UAH 1 billion in losses (Table C.3).
Table B.3. Financial indicators of Automobile Roads of Ukraine

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>2,178,973</td>
<td>2,807,908</td>
<td>4,277,032</td>
<td>5,328,732</td>
<td>6,569,912</td>
<td>5,827,077</td>
</tr>
<tr>
<td>EBITDA</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>86,114</td>
<td>(204,199)</td>
<td>(313,301)</td>
</tr>
<tr>
<td>Net financial result</td>
<td>(98,080)</td>
<td>(143,912)</td>
<td>(38,025)</td>
<td>(82,030)</td>
<td>(314,699)</td>
<td>(1,165,491)</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total assets</td>
<td>3,079,221</td>
<td>4,076,408</td>
<td>3,911,530</td>
<td>5,583,320</td>
<td>7,687,155</td>
<td>5,582,048</td>
</tr>
<tr>
<td>Equity</td>
<td>2,661,331</td>
<td>2,338,467</td>
<td>2,231,967</td>
<td>3,601,588</td>
<td>3,318,137</td>
<td>2,359,248</td>
</tr>
<tr>
<td>Total payables</td>
<td>1,603,302</td>
<td>1,602,484</td>
<td>1,567,619</td>
<td>1,817,171</td>
<td>2,207,752</td>
<td>2,336,108</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>20,354</td>
<td>20,912</td>
<td>19,247</td>
<td>71,309</td>
<td>48,953</td>
<td>34,802</td>
</tr>
<tr>
<td>ROA, %</td>
<td>-3.0</td>
<td>-3.4</td>
<td>-1.0</td>
<td>-1.6</td>
<td>-4.3</td>
<td>-19.5</td>
</tr>
<tr>
<td>ROE, %</td>
<td>-3.5</td>
<td>-5.9</td>
<td>-1.7</td>
<td>-2.8</td>
<td>-9.3</td>
<td>-41.6</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42]).

Corporate governance

Automobile Roads of Ukraine is a joint-stock company and its ownership entity is the State Road Service of Ukraine (Ukravtodor), a state agency under the Ministry of Infrastructure. The rationale for the existence of Ukravtodor is unclear and besides ownership, it also performs policymaking functions, which could normally be delegated to the line ministry (Ministry of Infrastructure).269

The company’s charter states that it should have an independent supervisory board. However, it also states that if there is no such board, the functions should be performed by the general meeting of shareholders (Automobile Roads of Ukraine, 2019[298]). Competitive selection for the position of an independent member of the supervisory board of Automobile Roads of Ukraine was announced in June 2020 and a new board was established in November 2020 (MDETA, 2020[299]). The supervisory board of Automobile Roads of Ukraine consists of five members, with three members being independent.

According to the charter of Automobile Roads of Ukraine, its management board (a collegiate executive body) should consist of at least three members. The current management board is composed of three members, including an acting (temporary) CEO who was appointed in September 2020.

Annex B.4. Agrarian Fund

Overview

The Agrarian Fund was established in 2013 by the CMU. Its mission is to create conditions conducive to the development of agriculture and the functioning of the market for agricultural products. The fund also supports domestic agricultural producers and

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268 There are substantial discrepancies between CMU and YouControl data. For e.g. according CMU total assets are UAH 5.6 bn, while according YouControl – UAH 1.3 bn. The potential reason for discrepancy is that CMU data is a consolidated data, including the subsidiaries.

269 https://ukravtodor.gov.ua/ukravtodor/pro_nas.html
looks to generate profit from business activities (Agrarian Fund, n.d.[300]). As a key player in Ukraine’s grain market and processing, the Agrarian Fund’s share in the domestic food grains amounts to 20%, with a 13% share in flour trade.

Financial performance

In 2019, Agrarian Fund was the thirteenth largest Ukrainian SOE by asset value and tenth largest by revenue, while employing approximately 250 individuals. As Table C.4 shows, the company exhibited losses of UAH 3.3 billion in 2019, although it had been marginally profitable in the previous five years. Its ROA and ROE were modest over 2014-2018, though figures plummeted drastically in 2019. According to the results of the internal audit, the losses occurred in the previous years, and, due to fraudulent activities, the company’s real financial performance was concealed (Agrarian Fund, 2020[301]). NABU also suspected the management of the Agrarian Fund of colluding with the vested interests in purchasing and storing mineral fertilisers in 2017, which cost the company UAH 243.41 million in losses.270

Table B.4. Financial indicators of the Agrarian Fund

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>2,772,091</td>
<td>2,874,551</td>
<td>2,109,009</td>
<td>4,372,247</td>
<td>6,859,979</td>
<td>6,140,593</td>
</tr>
<tr>
<td>EBITDA</td>
<td>n/a</td>
<td>380,880</td>
<td>3,755</td>
<td>188,685</td>
<td>267,796</td>
<td>(2,956,223)</td>
</tr>
<tr>
<td>Net financial result</td>
<td>666,423</td>
<td>329,900</td>
<td>48,711</td>
<td>94,796</td>
<td>147,043</td>
<td>(3,269,084)</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>42,163</td>
<td>333,212</td>
<td>115,977</td>
<td>24,356</td>
<td>71,097</td>
<td>132,339</td>
</tr>
<tr>
<td>Total assets</td>
<td>6,096,673</td>
<td>6,115,502</td>
<td>5,951,639</td>
<td>6,999,158</td>
<td>8,764,997</td>
<td>3,544,534</td>
</tr>
<tr>
<td>Equity</td>
<td>5,708,586</td>
<td>5,530,011</td>
<td>5,462,745</td>
<td>5,533,185</td>
<td>5,609,131</td>
<td>2,030,219</td>
</tr>
<tr>
<td>Total payables</td>
<td>388,087</td>
<td>585,491</td>
<td>488,894</td>
<td>1,465,973</td>
<td>3,155,866</td>
<td>1,501,223</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>0</td>
<td>0</td>
<td>2,128</td>
<td>2,123</td>
<td>15,071</td>
<td>21,385</td>
</tr>
<tr>
<td>ROA, %</td>
<td>11.6</td>
<td>5.4</td>
<td>0.8</td>
<td>1.5</td>
<td>1.9</td>
<td>-53.1</td>
</tr>
<tr>
<td>ROE, %</td>
<td>12.3</td>
<td>5.9</td>
<td>0.9</td>
<td>1.7</td>
<td>2.6</td>
<td>-85.6</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

The Agrarian Fund is a joint-stock company established, with MDETA as its ownership entity. The company’s charter adopted in June 2020 states that an independent supervisory board should be established, as also required by law. However, if no supervisory board is established, the charter vests the relevant functions in the general meeting of shareholders. To date, no independent supervisory board in Agrarian Fund has been established, and plans are unclear regarding the launch of the nomination process. The management board (a collegiate executive body) of the Agrarian Fund consists of four members, including an acting (temporary) CEO appointed in May 2020.

ANNEX B. DESCRIPTION OF UKRAINIAN SOEs (CONTINUED) | 247

Annex B.5. Polygraph Combine Ukraina (PK Ukraina)

Overview

State Enterprise Polygraph Combine Ukraina (PK Ukraina) is a printer of securities certificates, letterheads for official documents, and identity documents and cards for Ukrainian citizens. The enterprise produces passports, bank cards, stamps (including excise duty and postage stamps), diplomas, certificates, and security documents, among others (PK Ukraina, n.d.[302]).

PK Ukraina’s major customers are ministries, government agencies, and SOEs. They include the State Fiscal Service, the Ministry of Internal Affairs, and the State Migration Service. The company also prints voting ballots for presidential and parliamentary elections for the Central Election Commission (PK Ukraina, n.d.[303]). According to its website, PK Ukraina also conducts quality control and certification. Notably, it works with MasterCard to ensure compliance with the latter’s payment systems and relevant standards (PK Ukraina, n.d.[304]).

Financial performance

PK Ukraina was the fourteenth largest SOE by asset value and revenue in 2019, with over 960 employees. The company has exhibited high profitability over the past five years, which somewhat decreased in 2019 (see Table C.5). As state institutions and agencies are its main customers, PK Ukraina’s revenues are heavily dependent on the demand from the state.

Table B.5. Financial indicators of Polygraph Combine Ukraina

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>1,088,883</td>
<td>1,150,275</td>
<td>1,476,539</td>
<td>1,737,811</td>
<td>2,477,797</td>
<td>2,437,243</td>
</tr>
<tr>
<td>EBITDA</td>
<td>107,605</td>
<td>317,640</td>
<td>488,947</td>
<td>506,260</td>
<td>701,285</td>
<td>541,892</td>
</tr>
<tr>
<td>Net financial result</td>
<td>43,416</td>
<td>143,551</td>
<td>323,843</td>
<td>340,901</td>
<td>512,897</td>
<td>315,329</td>
</tr>
<tr>
<td>SOE dividends / profit share payable to the state budget</td>
<td>13,025</td>
<td>39,860</td>
<td>205,436</td>
<td>174,225</td>
<td>209,620</td>
<td>351,242</td>
</tr>
<tr>
<td>Total assets</td>
<td>909,860</td>
<td>952,422</td>
<td>1,326,366</td>
<td>1,511,266</td>
<td>1,808,144</td>
<td>1,905,133</td>
</tr>
<tr>
<td>Equity</td>
<td>577,610</td>
<td>650,538</td>
<td>1,065,200</td>
<td>1,216,962</td>
<td>1,508,038</td>
<td>1,604,299</td>
</tr>
<tr>
<td>Total payables</td>
<td>248,806</td>
<td>282,969</td>
<td>156,093</td>
<td>214,100</td>
<td>182,028</td>
<td>175,445</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3,616</td>
<td>7,057</td>
</tr>
<tr>
<td>ROA, %</td>
<td>5.4</td>
<td>15.4</td>
<td>24.0</td>
<td>24.0</td>
<td>30.9</td>
<td>17.3</td>
</tr>
<tr>
<td>ROE, %</td>
<td>7.7</td>
<td>23.4</td>
<td>31.1</td>
<td>29.9</td>
<td>37.6</td>
<td>20.7</td>
</tr>
</tbody>
</table>

Note: There may be discrepancies between figures reported by the companies and Ukrainian authorities. Source: Questionnaire responses from the Ukrainian authorities (CMU, 2020[42])

Corporate governance

PK Ukraina is a state unitary enterprise, and its ownership entity is MDETA. The company has a supervisory board, established in February 2018 in line with the 2016 corporate governance changes to the state property management law. The board consists of five
members, including three independent members. The executive body of PK Ukraina consists of a single person, the Director (CEO) appointed in 2017.
## Annex C. Full list of legal forms and types of SOEs

<table>
<thead>
<tr>
<th>Legal form or type of SOE</th>
<th>General Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Entity Operating in the Public Sector of the Economy</td>
<td>Entity that operates solely on the basis of state ownership; Entity in which the state owns more than 50% of authorised capital; or Entity in which the state’s share is of value that provides the state with the right to exercise a decisive influence on its economic activity</td>
</tr>
<tr>
<td>State Enterprise</td>
<td>Enterprise operating on the basis of state ownership</td>
</tr>
<tr>
<td>Municipal Enterprise</td>
<td>Enterprise operating on the basis of municipal ownership</td>
</tr>
<tr>
<td>State Unitary Enterprise</td>
<td>Either a commercial or a budget-supported (kazenne) enterprise, established by a competent body of state power via administrative order on the basis of a detached part of state property, which usually is not divided into shares and transferred into management of such enterprise</td>
</tr>
<tr>
<td>State CommercialEnterprise</td>
<td>Unitary enterprise, which has property assigned to it on the right of economic management and is liable for the consequences of its activities with all such property. As a rule, the state and the managing body of state commercial enterprises are not liable for obligations of such enterprises</td>
</tr>
<tr>
<td>Budget-Supported (Kazenne) Enterprise</td>
<td>Unitary enterprise, which has a property assigned to it on the right of operational management and is liable for the consequences of its activities only with the funds at its disposal. In case of insufficiency of the specified funds, the managing body on behalf of the state, bears full subsidiary liability for obligations of the enterprise. Budget-Supported Enterprises are established by a decision of the Cabinet of Ministers of Ukraine and only in sectors of the economy where: the law allows only SOEs to carry out economic activities; the state consumes more than 50% of products (works, services) of such enterprise; the free competition of commodity producers or consumers is impossible; more than 50% of production are socially necessary products (works, services) and as a rule, production cannot be profitable; privatisation of property complexes of state enterprises is prohibited by law.</td>
</tr>
<tr>
<td>Municipal unitary Enterprise</td>
<td>Enterprise, established by a competent local self-government body via administrative order on the basis of a detached part of municipal property that was transferred into management of such enterprise</td>
</tr>
<tr>
<td>State (Municipal) Business Association</td>
<td>An association of enterprises formed by state (municipal) enterprises upon the decision of CMU or, in instances specified by law, by the decision of ministries (other managing bodies forming associations), or by a decision of the competent local self-government.</td>
</tr>
<tr>
<td>State Joint Stock Company (Entity)</td>
<td>Entity, established as a result of conversion of wholly-owned State Unitary Commercial Enterprise into a joint stock company under the procedure established by CMU.</td>
</tr>
<tr>
<td>State Property Objects of Strategic Importance for the Economy and Security of the State</td>
<td>Enterprises and entities, which are defined by CMU resolution as strategically important and operating in the following sectors: airspace, metallurgy, transport, chemical-production, science, geology and exploration, energy, defence, state reserve, agriculture, telecommunication, etc.</td>
</tr>
<tr>
<td>Enterprises of Particular Importance for the Economy and Security of the State</td>
<td>Enterprises with asset value, according to the latest financial statements, exceeding UAH 2 billion or annual net profit exceeding UAH 1.5 billion.</td>
</tr>
<tr>
<td>Joint Stock Company</td>
<td>Entity with an authorised capital divided into a certain number of shares of equal nominal value, corporate rights for which are certified by shares. The main difference between Private Joint-Stock Company and Public Joint-Stock Company—in respect of the latter, a public offering has been made and / or its shares have been admitted to trading on the stock exchange via inclusion in the stock exchange register. The shareholders are liable for JSC’s obligations only to the amount of their shares, subject to certain exceptions. Shares are considered to be a type of security and are subject to registration with NCSSMU.</td>
</tr>
<tr>
<td>Company with Limited Liability</td>
<td>Entity with an authorised capital divided into participatory interest, the value of which is determined in company’s charter. The participants of LLC are liable for LLC’s obligations only to the amount of their participatory interest. The participatory interest is neither considered to be a security nor being a subject to registration with NCSSMU.</td>
</tr>
<tr>
<td>Company with Additional Liability</td>
<td>Entity with an authorised capital divided into participatory interest, the value of which is determined in company’s charter. In case the CAL does not have a sufficient amount of funds to fulfil its obligations, its participants are jointly and severally liable for CAL’s obligations by their individual property in the amount determined in the CAL’s charter pro rata to their shares.</td>
</tr>
<tr>
<td>Consortium</td>
<td>Temporary statutory union of enterprises for the achievement of a certain common economic goal by its participants (implementation of targeted programs, scientific and technical, construction projects, etc.). The consortium uses the funds that are allocated to it by the participants, the centralized resources allocated to finance the corresponding program, as well as funds coming from other sources, in the manner determined by its charter. Once the goal for which it was founded is achieved, the consortium ends its activities.</td>
</tr>
<tr>
<td>Concern</td>
<td>Statutory union of enterprises and other organizations, based on their financial dependence on one or a group of members of the union, with the centralisation of the functions of scientific, technical and industrial development, investment, financial, foreign economic and other activities. The members of the concern delegate their powers, including the right to represent their interests in relations with the authorities, other enterprises and organisations. Concern members cannot be members of another concern simultaneously.</td>
</tr>
<tr>
<td>Corporation</td>
<td>Contractual union established on the basis of a combination of production, scientific and commercial interests of the united enterprises, with the delegation of certain powers to the governing bodies of the corporation.</td>
</tr>
<tr>
<td>Legal form or type of SOE</td>
<td>General Overview</td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Holding Company</td>
<td>Joint-stock company that owns, uses and disposes of holding corporate blocks of shares (shares, units) of two or more corporate enterprises;</td>
</tr>
<tr>
<td>State Holding Company</td>
<td>Holding company established in the form of a 100% state-owned joint stock company</td>
</tr>
<tr>
<td>State Managing Holding Company</td>
<td>Holding company, the corporate enterprise of which may be another state holding company or a business company, the holding corporate block of shares (shares, units) of which belongs to the state;</td>
</tr>
<tr>
<td>Subsidiary Enterprise</td>
<td>Enterprise, the sole founder of which is another enterprise (enterprise dependent on another).</td>
</tr>
<tr>
<td>State Organisation (Institution, Establishment)</td>
<td>Institution, created by one or more persons (founders) that do not participate in its management, by combining (allocating) their property to achieve the goal set by the founders, at the expense of this property.</td>
</tr>
</tbody>
</table>
Annex D. Procedures for supervisory board and CEO appointments

Annex D.1. Competitive selection process for independent board members

To launch the competitive selection process of the independent board members, the ownership entity announces the vacancy (and, if it does not do so within 30 days, then the CMU and MDETA may initiate it), and submits relevant information regarding the company’s financial position. It also establishes a commission on competitive selection, approves its structure, and appoints the commission chair and secretary. Representatives from international financial organisations, as well as professional personnel and consultants, may be invited to attend the commission’s meetings. The selection commission develops and approves the selection criteria, examines the applications, requests background checks, shortlists the candidates and determines the winner of the competitive selection based on the selection criteria. The decision is made based on the majority votes of the commission members present, and, in case of equal distribution of votes, the chair’s vote becomes decisive. Once the results are submitted to the ownership entity and the contestants are notified, the information may become publicly available.

As noted, these procedures, may vary based on the SOE type, legal form and the sector in which it operates. Notably, the CMU may be involved in approving the supervisory board members if the SOE is deemed especially important for the economy, with additional requirements in the banking sector (as outlined in the respective sections). In addition, joint-stock companies have a requirement to elect supervisory board members through a general meeting of the shareholders. However, considering that the state holds the company shares in full in most of these SOEs, their selection is subject to the same competitive procedures elaborated earlier. Practices may differ in certain entities, such as Ukrzaliznytsia, in which the CMU delegates its ownership functions over the SOE to the Ministry of Infrastructure, and the latter is responsible for organising the competition.

Moreover, the selection process is very basic in the defence sector, where SOEs have a separate framework for corporate governance and the appointment of board members and management. This framework concerns Ukroboronprom, an association of more than 100 enterprises within the defence industry. Some of the entities under its oversight include aircraft manufacturing companies (such as Antonov and Kharkiv State Aviation Manufacturing Company), repair, shipbuilding and manufacturing plants, and design agencies. Its key governing bodies include the supervisory board, the board of directors and the general director. The supervisory board consists of five members (who are not remunerated for their services and, in practice, may never meet). Three board members are appointed by the President of Ukraine and two are appointed by the CMU.

271 Processes for appointing the chair of the selection commission, who casts a decisive vote during the nomination process, is unclear. The meetings of the commission are quorate if two-thirds of the members are present.
Supervisory board members are not contracted and, in practice, may never meet. They are also not remunerated for their work due to the defence industry law. The President and the CMU may prematurely terminate powers of the supervisory board members (CMU, 2020[42]) (Verkhovna Rada, 2011[125]), According to the questionnaire, the main rationale behind special procedures in defence SOEs is that defence and national security issues are under the responsibility of the President of Ukraine. It is worth noting that the President is also responsible for submitting the candidates for the Minister of Defence and chairs at the National Security and Defence Council.

Annex D.2. Procedure for appointing independent board members in economically important SOEs

Along with a framework for supervisory board appointments, separate regulations apply for the selection process in enterprises deemed economically important, with over UAH 2 billion in assets or UAH 1.5 billion in net income.

Similar to the aforesaid selection process, the ownership entity is responsible for announcing the competition, but the role of MDETA and the CMU is more pronounced. Notably, the ownership entity should submit information regarding the SOE performance (such as financial statements), as well as draft selection criteria for independent board members to MDETA. To launch the competitive selection process of independent board members, the ownership entity announces the vacancy (and, if it does not do so within 30 days, then the CMU and MDETA may initiate it). The Secretariat of the SOE nomination committee (at MDETA) may provide assistance throughout the process, particularly in liaising with relevant parties, registering and reviewing applications, doing background checks, and submitting proposals of selected candidates. As the same process applies to CEO appointments, the role of the ownership entity may be delegated to the supervisory board if specified in the charter, and in other regulations, as applicable (procedure is further summarised in Table E.1.)

During this process, a nomination committee helps select independent board members (and CEOs in economically important SOEs). However, unlike in other SOEs, a permanent committee is established by the CMU, consisting of Ministers or Deputy Ministers of MDETA and the Ministry of Finance, head or deputy head of the ownership entity, and four independent (non-governmental) experts (Box 6.2). Executive search consultants may also assist with the selection process.

Following the selection, the committee prepares conclusions and proposals for the approval of MDETA, which are submitted to the CMU. After the CMU’s decision, the selected candidate is formally appointed by the ownership entity and a contract should be concluded.

Along with independent members, the state representatives are also appointed through a selection process in economically important SOEs, though that process is much less rigorous. (CMU, 2020[42]) (CMU, 2017[229]).

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272 Formally, it is known as the Committee for the Appointment of Heads of Enterprises Especially Important for the Economy, commonly referred to as the “SOE Nomination Committee”.

273 It is worth noting that the CEO signs supervisory board members’ contracts on behalf of the company.
Table D.1. Board nomination procedures in Ukrainian SOEs

<table>
<thead>
<tr>
<th></th>
<th>Especially important SOEs**</th>
<th>Strategic SOEs*** and other SOEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMU</td>
<td>Establishes procedures for selecting supervisory board members; Determines procedure for setting supervisory board member remuneration; May initiate vacancy announcement (on MDETA’s submission) in an SOE if its ownership entity fails to do so within 30 days; Approves board members in fully owned SOEs (in theory, proposes board members in SOEs in which the state’s share is over 50% - has not yet been used in practice); Established the SOE Nomination Committee; Reviews conclusions and other material submitted by MDETA and approves candidates.</td>
<td>Establishes procedures for selecting supervisory board members; Determines procedure for setting supervisory board member remuneration; May initiate vacancy announcement (on MDETA’s submission) in an SOE if its ownership entity fails to do so within 30 days; Approves two board members in Ukrоборонпром (another three are appointed by the President).</td>
</tr>
<tr>
<td>MDETA</td>
<td>May initiate vacancy announcement (through CMU) in an SOE if its ownership entity fails to do so within 30 days; Provides a secretariat that assists the SOE Nomination Committee in the selection process; Submits the candidates selected by the SOE Nomination Committee to the CMU for approval.</td>
<td>May initiate vacancy announcement (through CMU) in an SOE if its ownership entity fails to do so within 30 days</td>
</tr>
<tr>
<td>Ownership entity</td>
<td>Launches the competitive selection process for board members and submits draft selection criteria to MDETA; Delegates a representative to the SOE Nomination Committee (who has a casting vote in case of tie); Nominates state representatives on supervisory board to be approved by the CMU; Formally appoints the independent supervisory board members approved by the CMU.</td>
<td>Launches the competitive selection process for independent board members; Determines selection criteria for independent board members within the framework set by law and CMU regulations; Appoints the selection commission (and its chair); Appoints the candidates selected by selection commission; Appoints state representatives on supervisory board; Sets remuneration within the framework set by CMU regulations, as well as terms of contract for board members.</td>
</tr>
<tr>
<td>Nomination (selection) committee</td>
<td>SOE Nomination Committee Established according to CMU regulations, with independent members appointed by CMU Elects committee chair and deputy chair; Selects professional executive search consultants to assist with the process; Develops selection criteria for independent board members; Examines applications and shortlists candidates; Submits conclusions to the CMU (via MDETA); Develops material terms of contract for board members; Opines on the candidates for the state representatives on supervisory board (proposed by the ownership entity).</td>
<td>Competitive selection commission Appointed by the ownership entity; Develops selection criteria for independent board members; Examines applications and shortlists candidates; Selects candidates for independent board members and submits their candidacies for appointment by the ownership entity.</td>
</tr>
</tbody>
</table>

Notes:
* The table excludes state-owned banks and municipally owned enterprises, where the processes are significantly different.
** The procedure applies to the “enterprises especially important for the economy”. These are enterprises whose asset value, according to the latest financial statements, exceeds UAH 2 billion or whose annual net profit exceeds UAH 1.5 billion.
*** “Enterprises of strategic importance for the economy and security of the state” are SOEs where asset value exceeds UAH 200 million or their annual net income exceeds UAH 200 million. The criteria for defining “enterprises of strategic importance for the economy and security of the state” (strategically important SOEs) are set by CMU Resolution No. 999. Based on these criteria, CMU Resolution No. 83 establishes a specific list of strategical SOEs. The same procedure may be optionally applied to other SOEs, but is almost never applied in practice.

Source: Author’s compilation is based on CMU Resolutions No. 777, 142, and 143, and the Law on Management of Objects of State Property (CMU, 2008[142]) (CMU, 2020[42]) (Verkhovna Rada, 2006[122]) (CMU, 2017[161]).
Annex D.3. CEO nomination and appointment

Nomination and appointment process varies based on the SOE type. Notably, in SOEs deemed economically important, the procedures are the same for both CEOs and independent supervisory board members described above. However, the general procedures for CEO appointments are outlined below.

The procedures for a competitive selection of CEOs in state-owned enterprises (though separate procedures apply for SOEs that are economically important, as described above) are announced by the order of the Ministry or another body performing the ownership function (including a state holding company). The ownership entity should also submit relevant information (including financial statements and a contract concluded with the previous CEO) to MDETA, form the committee and approve its members, and include any advisors. Similarly to the selection of independent board members in such SOEs, the committee develops and approves the selection criteria, assesses the applications and, in consultation with the ownership entity, shortlists the candidates who may participate in the selection process (the process for CEO appointment in SOEs is summarised in Table E.2).

The CEO candidate’s proposal may be developed based on financial and economic activities of the SOE, and may contain specific elements related to the strategic plan, including budget contributions and investment plans. The winner is determined on the evaluation of each applicant (including application, proposals, and an interview). Within two weeks of the selection commission’s decision, a contract should be concluded between the ownership entity and the winner. The process may be re-launched if the commission rejects all applicants, if there are no applications or only one applicant, and, in some cases, if the CMU disapproves of the appointment. Moreover, in SOEs deemed strategically important, CMU needs to approve the selected candidate.

It is worth noting that the nomination framework regarding CEO appointments contain conflicting provisions which has been subject to litigation. While certain laws (such as the Law on the Management of Objects of State Property) are ambiguous on the issue and the JSC law suggests that CEOs (including temporary heads) should be appointed by supervisory board members, other laws and secondary legislation reserve the right to ownership entities and the CMU (CMU, 2008[162]) (CMU, 2020[42]) (Verkhovna Rada, 2006[122]). CMU Resolution 777 also contains ambiguities regarding the procedures for determining the need to launch the competitive selection, while further exemptions may apply.

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274 There may also be additional exceptions to the CMU Resolution No. 777, including the selection of CEOs in the SOEs in the defence sector, Naftogaz and its subsidiaries, Ukrzaliznytsia, and the National Public Television and Radio Broadcasting, among others.

275 Same procedures may be used in approving the head of enterprise as the head of local state administration. In case of refusal of the head of regional state administration to approve the appointment of the head of enterprise, the ownership entity may submit proposals to the CMU (CMU, 2008[162]).
Table D.2. CEO nomination procedures in Ukrainian SOEs

<table>
<thead>
<tr>
<th></th>
<th>Especially important SOE**</th>
<th>Strategic SOEs*** and other SOEs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CMU</strong></td>
<td>Establishes procedures for selecting CEOs; Determines procedure for setting CEO remuneration; May initiate vacancy announcement (on MDETA’s submission) in an SOE if its ownership entity fails to do so within 30 days; Approves CEOs in fully owned SOEs (subject to variations described in this section); Established the SOE Nomination Committee; Reviews conclusions and other material submitted by MDETA and approves candidates.</td>
<td>Establishes procedures for selecting CEOs; Determines procedure for setting CEO remuneration; May initiate vacancy announcement (on MDETA’s submission) in an SOE if its ownership entity fails to do so within 30 days; Approves candidacy in strategic SOEs; Proposes the CEO candidate for Ukroborongrom (to be appointed by the President).</td>
</tr>
<tr>
<td><strong>MDETA</strong></td>
<td>May initiate vacancy announcement (through CMU) in an SOE if its ownership entity fails to do so within 30 days; Provides a secretariat that assists the SOE Nomination Committee in the selection process; Submits the candidates selected by the SOE Nomination Committee to the CMU for approval.</td>
<td>May initiate vacancy announcement (through CMU) in an SOE if its ownership entity fails to do so within 30 days.</td>
</tr>
<tr>
<td><strong>Ownership entity</strong></td>
<td>Launches the competitive selection process for CEOs and submits draft selection criteria to MDETA; Delegates a representative to the SOE Nomination Committee (who has a casting vote in case of tie); Formally appoints the CEO approved by the CMU.</td>
<td>Launches the competitive selection process for CEOs; Determines selection criteria for CEOs within the framework set by law and CMU regulations; Appoints the selection commission (and its chair); Appoints the candidates selected by selection commission; Sets remuneration within the framework set by CMU regulations, as well as terms of contract for CEOs.</td>
</tr>
<tr>
<td><strong>Supervisory Board</strong></td>
<td>May perform certain ownership entity functions, including announcing the competition and appointing the CEO, if provided by law, outlined in the charter, or if the SOE is explicitly exempt from the application of CMU Resolution No. 777.</td>
<td>May perform certain ownership entity functions, including announcing the competition and appointing the CEO, if provided by law, outlined in the charter, or if the SOE is explicitly exempt from the application of CMU Resolution No. 777.</td>
</tr>
<tr>
<td><strong>Nomination Committee</strong></td>
<td>SOE Nomination Committee Established according to CMU regulations, with independent members appointed by CMU; Elects committee chair and deputy chair; Selects professional executive search consultants to assist with the process; Develops selection criteria for CEOs; Examines applications and shortlists candidates; Submits conclusions to the CMU (via MDETA); Develops material terms of contract for CEOs.</td>
<td>Competitive selection commission Appointed by the ownership entity; Develops selection criteria for CEOs; Examines applications and shortlists candidates; Selects CEO candidates and submits their candidacies for appointment by the ownership entity.</td>
</tr>
</tbody>
</table>

Notes:

* The table excludes state-owned banks and municipally owned enterprises, where the processes are significantly different.
** The procedure applies to the “enterprises especially important for the economy” as defined in CMU Resolution No. 143. These are enterprises whose asset value, according to the latest financial statements, exceeds UAH 2 billion or whose annual net profit exceeds UAH 1.5 billion.
*** The procedure is mandatory for “enterprises of strategic importance for the economy and security of the state” if their asset value exceeds UAH 200 million or their annual net income exceeds UAH 200 million. The criteria for defining “enterprises of strategic importance for the economy and security of the state” (hereinafter, strategically important SOEs) are set by CMU Resolution No. 999. Based on these criteria, CMU Resolution No. 83 establishes a specific list of strategical SOEs. The same procedure may be optionally applied to other SOEs, but is almost never applied in practice.
Source: Author’s compilation is based on CMU Resolutions No. 777, 142, and 143, and the Law on Management of Objects of State Property (CMU, 2008[162]) (CMU, 2020[42]) (Verkhovna Rada, 2006[122]) (CMU, 2017[161]).
Annex E. Selection process of independent board members in state-owned banks

The procedure for establishing competitive selection of candidates for independent supervisory board members in state-owned banks is set by the CMU. The process involves establishing a competitive selection commission and selecting a recruitment company, following which a decision may be made by the former regarding board member appointments.

Annex E.1. Competitive Selection Commission

The selection of candidates for the competitive selection commission is carried out by the CMU Resolution No. 175. The commission chair and the deputy are elected by the members by majority vote, and the chair (or the deputy chair in case of the former’s inability to carry out its role) is responsible for organising committee work and convening meetings. The committee’s tasks are the following:

- Deciding the announcement of the competitive selection process and the date of its holding
- Evaluating applicants based on the requirements under the Law on Banks and Banking and approving the evaluation criteria, reviewing and verifying applications, and conducting interviews
- Selecting candidates by competitive selection and submitting the decision to the CMU
- Preparing proposals on the terms of contract and remuneration (including incentive and compensation payments)

The committee meetings are valid if at least four members of the commission are present, though participation may be in person or remote. Their decisions are made by majority vote based on meeting minutes, and a decision is considered adopted if at least three members vote for it. The international financial organisations participating in the work of the commissions may be invited to attend the meetings, and their opinions may be recorded. Further organisational support may be provided by the secretariat consisting of at least three individuals (non-members of the committee), whose responsibilities would cover counting votes, accepting applications, and publishing announcements, among other tasks.

276 Sources: CMU Resolution No. 267, dated March 27, 2019; CMU Resolution No. 159, dated February 13, 2019 (CMU, 2019[312])(CMU, 2019[313]).
Annex E.2. Executive Search Company

The candidates for the competitive selection are pre-selected by an executive search company, which requires launching a separate tender. The procedures for announcing the tender and selecting the company to assist the competitive selection commission are detailed under the CMU Resolution No. 159, with requirements including at least 10 years of international experience in selecting supervisory board members and price offerings, among others.277 The potential candidates are evaluated by the tender committee appointed by the Ministry of Finance, based on criteria outlined in the Resolution and those with the highest points may be selected. The Ministry of Finance submits a draft decision for CMU’s approval.

Annex E.3. Selection Process

1. The recruitment company pre-selects candidates (at least three individuals for each vacant position) and submits a list of potential candidates for the competitive selection commission’s consideration. The candidates may be selected from either domestic or international spheres, though they should meet the professional and educational requirements, among others listed under Annex 1 of the CMU Resolution No. 159. Along with general provisions, each state-owned bank (namely, PrivatBank, OschadBank and Ukreximbank) has its individual requirements set for the position of independent supervisory board member.278 The recruitment company may also include reports regarding the candidate’s competencies and suitability, and outline the presence of any conflicts of interest.

2. During its meeting, the competitive selection commission considers the proposals and documents submitted by the executive search company, and, based on the results of the consideration, prepares and submits conclusions to the CMU regarding the appointment of a selected candidate. The competitive selection commission may consider and assess proposals of any other candidate involved in the competitive selection.

3. The decision to appoint independent members of the supervisory board is made by the CMU based on the commission’s submission and meeting minutes. The CMU is responsible for appointing the independent members of the supervisory board among those submitted by the commission and within five working days from the date of receipt of the relevant submission.

In case of early termination of the powers of the independent members or the entire supervisory board, the commission may determine candidates for vacant positions from a list of other candidates pre-selected by the recruitment company. However, the process may be re-launched if the position is unfilled.

277 Similar requirements also apply for the executive search consultants in SOE nominations, detailed in CMU Resolution No. 777.
278 CMU Resolution No. 159 Annex 1.
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