FINDING BALANCE
Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga

Volume II: Comparative Review of the Legal, Governance and Monitoring Frameworks
Appendix 2: Analysis of SOE legislation against key requirements

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Appendix 1: Contents of SOE Legislation
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**Executive Summary**

This report examines the legal, governance and monitoring frameworks supporting the state-owned enterprise (SOE) sectors in Fiji, Republic of the Marshall Islands, Samoa, Solomon Islands and Tonga. The frameworks guide the operations of the SOEs and enable their shareholders to monitor performance. The comparative analysis reveals that robust SOE frameworks, while being important in ensuring strong SOE performance, are only fully effective when there is political commitment to ensure that they are fully implemented. Where the frameworks are incomplete or inadequately implemented, SOE performance suffers. This is illustrated in the case of these five Pacific island countries, as well as in many other countries around the world.

This report therefore focuses on the comparative effectiveness of each country’s (i) legislation pertaining to SOEs, (ii) mechanisms in place for monitoring SOE performance and (iii) governance practices that manage and direct the operation of SOEs and characterise the accountability arrangements. The comparative effectiveness of the frameworks is a function of their design and the extent to which they have been properly implemented. The recommendations provided in each section of the report, if adopted, will directly contribute to improved performance of the SOE portfolios in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga.

*The legal frameworks for SOEs in Fiji, Samoa, Solomon Islands, and Tonga are largely based on the New Zealand model, which each country has adapted differently. The most striking difference, however, is in the extent to which the legislative provisions have been implemented; Tonga has had the strongest implementation performance. There is no overarching SOE legislation in the Marshall Islands.*

Of the five countries studied, Samoa has the most detailed SOE legislation¹, but implementation performance has been weak. The Solomon Islands legislation is based heavily on the Samoan SOE Act, but only limited progress has been made in implementing the legislation since its enactment in 2007. Fiji has the less robust SOE and companies legislation, but implementation performance has generally been good. While there has been little new reform work undertaken since 2007 it appears that the pace of reform has picked up in 2010. Tonga had the weakest SOE legislation, yet since 2007 has adopted several excellent practices that went beyond the requirements of the law. The law has now caught up with practice with the enactment of the 2010 SOE Amendment Act².

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¹ SOE Act and Regulations
² The 2010 Amendment Act was gazetted on 13th October 2010.
**Fiji should consider refining and updating its SOE and Companies Acts**

Overall, Fiji’s SOE legal framework provides adequate guidance for the effective operation of its SOEs. However, it is now quite dated and could be refined by providing greater guidance to directors in terms of duties and obligations. This would eliminate the uncertainty and the complications arising from each SOE having to rely on the director’s duties contained in its own particular establishing legislation. The Companies Act, which is based on the old New Zealand 1955 Act, is in the process of being updated, and plans exist to update the SOE Act in 2011. It is recommended that Fiji look at the developments in SOE and companies legislation in the Solomon Islands and Tonga as useful guidance in this process.

**Marshall Islands should develop an SOE policy and legislation**

There is no overarching SOE Act in the Marshalls Islands. The Companies Act has limited provisions dealing with director’s duties and obligations, but even the limited guidance in the Companies Act is of no value to the Marshall Islands SOEs, as none of them are companies. Instead the SOEs must rely on their own establishing legislation, which generally provide limited guidance on the duties and obligations of SOE directors; reporting requirements and monitoring mechanisms.

**Solomon Islands has introduced some innovative concepts in their new SOE Act and Regulations, but much more needs to be done to support implementation.**

The Solomon Islands SOE Act is heavily modelled on the Samoan legislation, but introduces some useful innovations. All documents tabled in the National Parliament, such as the Statement of Corporate Intent and annual report and all notices appointing, reappointing or removing directors, must be published in local newspapers. The SOE Regulations also introduce a skills based director selection process driven by a requirement to find the candidate with the best match of knowledge, skills and experience for the particular SOE board.

The new Act is only 3 years old and the supporting Regulations came into force in April 2010: efforts now must be focused on implementation.

**Samoa needs a stronger implementation regime**

Samoa’s SOE law is very thorough and detailed and establishes a clear requirement that all SOEs must be operated as successful businesses. Implementation of the law has been weak, however, with many of the key provisions in the SOE Act and Regulations largely ignored, such as the obligation to operate as a successful business; procedures relating to approval of CSOs; and the provisions requiring stricter controls on board membership, by restricting public servants and members of parliament from serving on SOE boards. Further,
Samoa’s companies law should be properly implemented, especially with regard to insolvency and directors’ duties and liabilities.

Some progress has been made in the last two years as the government has been working through a process to ensure that the provisions dealing with the director selection and appointment process contained in the SOE specific legislation is consistent with the SOE Act; but more needs to be done to bring practice in line with the legislative requirements.

**Tonga’s legislative framework is now one of the most robust in the region.**
The 2010 amendment to the SOE Act has propelled Tonga’s legislation from the weakest to one of the most robust of the five countries studied. The new Act introduces the requirement that every SOE operate as a successful business; introduces a stringent CSO application and approval process; improves accountability and transparency; strengthens governance and also formalises the decision that politicians should not serve as SOE directors.

**SOE monitoring units are most effective when they are independent and supported by parliamentary oversight**

**Ministers and public servants should be encouraged to step down from SOE boards**
Fiji, Samoa, Solomon Islands and Tonga each deploy different monitoring mechanisms; each structures the relationship between the SOE and the principal monitoring unit in a particular way. In the Marshall Islands there is no central monitor and a noticeable absence of the concept of “ownership” monitoring.

Fiji has a monitoring unit within the Ministry of Finance as well as the Ministry of Public Enterprises. In Samoa, the monitoring unit is part of the Ministry of Finance as it is in the Solomon Islands; however in the latter the head of the unit reports to a Deputy Secretary in the Ministry rather than to the Secretary, as is the case in Samoa. In Tonga, the monitoring unit comprises a separate ministry. This study found that it was not so much the particular structure that impacted on monitoring effectiveness; rather it was the independence of the monitoring unit. Where ministers and public servants serve on SOE boards, the independence and effectiveness of the SOE monitoring unit is compromised. It is recommended that all ministers and public servants step down from SOE boards.

This study also demonstrates that the lack of an effective ownership monitor has an adverse impact on the performance of the SOE portfolio.
**Workable systems should be in place regarding parliamentary oversight**

For all countries one of the obstacles for effective parliamentary oversight is the delay in finalizing audits, which means that annual reports, when tabled in the parliament, are often out of date. Fiji and Samoa have strengthened their respective monitoring mechanisms by establishing a parliamentary committee to review all SOE annual accounts. The Solomon Islands and Tonga have recently introduced requirements that all SOE annual reports and Statements of Corporate Intent\(^3\) (SCI) must be published in local newspapers. This will encourage more public interest in SOE performance and, as a consequence, parliamentarians will be more focused on performance and being seen as effective stewards of these significant public assets. It is interesting to note that even with these positive developments, the monitoring units in each country still consider that parliamentary oversight could be further improved.

**Governance practices in each country should be more focused on accountability**

The governance practices adopted in each country reflect, to some extent, their SOE legal framework: Fiji should refine aspects of its existing governance regime; Samoa has very robust policies in place, but it does not effectively implement them; Solomon Islands also has robust legislative requirements, but lacks a track record in implementation; Tonga has some very effective practices in place which have now been codified in the 2010 amendment to the SOE Act. The Marshall Islands has no clearly stated governance policy and no coordination of governance practice amongst its SOEs.

**Fiji requires a more explicit process for the appointment of directors**

Fiji only implicitly establishes guidelines for the selection and appointment of directors, based on the ‘principle objective’ provisions of the SOE Act. Given the element of uncertainty that compromises this aspect of its governance practices, Fiji should explicitly provide a clear process and guidelines for the selection and appointment of SOE directors. Monitoring unit staff should not be deployed as “observers” on boards and risk becoming treated as “deemed directors”—with liabilities that are not necessarily accompanied by protections such as professional indemnity. Fiji should actively discourage such observers from becoming de facto members of SOE boards. The recent move to appoint public servants as directors, explained on the basis of a shortage of willing private sector candidates, is not a positive development and should be seen as a short-term expediency.

\(^3\) The Statement of Corporate Intent is also referred to as the Statement of Corporate Objectives and Business Plan in the different SOE Acts (see section on monitoring).
**Marshall Islands suffer from lack of consistent provisions in its entity specific SOE Acts and a lack of coordinated SOE governance.**

Governance practices in the Marshall Islands suffer from the lack of clear and consistent guidelines. While SOE specific legislation provides some guidance, it is very rudimentary and differs from one SOE to another. Only by adopting an all-embracing SOE Act will it be possible to establish universally binding governance practices. The governance arrangements are further confused by the fact that sector ministers and public servants sit on the boards of SOEs for which they are the purchasing or regulatory counterparts.

**Samoa should implement the provisions relating to the appointment of directors and strengthen governance and reporting practices**

Samoa has made good progress in enhancing accountability by giving effect to the provisions of its SOE Act regarding audit committees. The development of an independent selection committee for SOE directors; the move to regularise entity specific Acts so that they are consistent with the director selection process mandated in the SOE Act; and the move to implement the prohibition on paying directors fees and other remuneration to public servants sitting on SOE boards are all positive developments, but much more needs to be done if Samoa is truly committed to improving the financial performance of its SOEs.

**Monitoring guidelines in the new Solomon Islands legislation is robust but has yet to be fully implemented**

While past practice saw SOE director appointments driven largely by political imperatives, the new Act and Regulations contain robust and unambiguous guidelines and, provided they are fully implemented, should ensure that future appointments are based on the candidate’s qualifications. Early indications are positive that the new provisions will be effectively implemented.

**Tonga’s legislation has caught up with Tongan practice**

The 2010 amendment to the SOE Act has codified much of what was existing practice in Tonga and also introduces some further improvements in governance and accountability; such as the requirement that summaries of the SOE’s annual accounts and actual performance achieved against SCI targets be published in local media. The Amendment Act also provides helpful assistance for those selecting SOE directors and strengthens SOE director duties. Tonga has also introduced job descriptions for all SOE directors and chairs which provide additional practical detail on director’s duties and obligations; key competencies; and the fiduciary duties owed by directors. A director performance assessment tool, that identifies areas for future training and development, has also recently been implemented.
Tonga’s legislative requirement for performance based contracts for SOE chief executives is excellent, but could be made more effective through penalties for non-performance.

Table 1 below summarises the status of the legislative, monitoring and governance frameworks in the five countries and their average return on equity over the period 2002 to 2009\(^4\). New Zealand is included for benchmarking purposes. The countries with the most boxes shaded are those with the more robust frameworks and, as a consequence, the countries that are achieving higher rates of return. The key point of difference between Tonga and New Zealand is evidence of a political commitment to SOE reform.

Table 1: Comparative Legislative, Monitoring and Governance Frameworks

<table>
<thead>
<tr>
<th>SOE Performance Indicator</th>
<th>Fiji</th>
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<th>Samoa</th>
<th>Solomon Islands</th>
<th>Tonga</th>
<th>New Zealand</th>
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<td>SOE Specific Legislation(^5)</td>
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<td>CSO provisions and Guidelines</td>
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<td>SOE Act implemented(^6)</td>
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<td>Ownership Monitor</td>
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<td>SOEs Operate Within Tight Budget Constraints</td>
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<td>Profitability Target Set (such as ROE)</td>
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<td>Skills based Appointment Process for Directors operating(^7)</td>
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<td>Politicians and Civil Servants not appointed as SOE Directors(^8)</td>
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<td>Good Governance Principles enforced</td>
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<tr>
<td>Evidence of Political Commitment to Reform(^9)</td>
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<tr>
<td>Average ROE</td>
<td>0.70%</td>
<td>-13.20%</td>
<td>0.20%</td>
<td>-13.90%</td>
<td>6.00%</td>
<td>5.09%</td>
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\(^4\) ROEs for Marshall Islands and Solomon Islands are for the financial years 2002 to 2008
\(^5\) The legislation is at least as comprehensive as the New Zealand SOE Act
\(^6\) Most of the key provisions are being followed and enforced
\(^7\) Although the Solomon Islands now has a skills based appointment process, it is recent and has not been fully implemented.
\(^8\) Tonga no longer appoints politicians to SOE boards, but prior to end 2009 the practice was still common
\(^9\) Measured by the number of SOE reform policies adopted by the government and put into practice in the period 2002 to 2009 inclusive.
**INTRODUCTION**

*The legal, monitoring and governance frameworks of SOEs have a direct bearing on their financial and operational performance*

This report evaluates the scope and effectiveness of the current SOE frameworks in Fiji, Marshall Islands, Samoa, Solomon Islands and Tonga, presenting recommendations on the ways in which they could be significantly improved. The report was prepared with the active support of the SOE monitoring agencies in each country. Each agency provided copies of their SOE legislation and completed a questionnaire broadly describing their SOE monitoring practices and governance arrangements. This information was then discussed with each agency for further clarification before being assessed comparatively across the four countries. A broader review was undertaken in the Marshall Islands as they have no specialist SOE legislation; no central ownership monitor; and diverse governance practices amongst the SOEs. Information on the Marshall Islands was obtained through a review of the individual SOE establishing Acts; fieldwork; interviews with key stakeholders; and a review of the SOE’s annual accounts.

This report is part of a series of two reports that assess the comparative performance of the SOE portfolios in the five Pacific island countries:

1. **Finding Balance 2011: Benchmarking the Performance of State-Owned Enterprises in Fiji, the Marshall Islands, Samoa, Solomon Islands, and Tonga**, which focuses on the comparative financial performance of the SOE portfolios in each country, the lessons from their respective reform efforts, and approaches to improve the effectiveness of future reform measures, and

2. **Comparative Review of the Legal, Governance, and Monitoring Frameworks of State-Owned Enterprises in Fiji, the Marshall Islands, Samoa, Solomon Islands, and Tonga**, which provides a detailed analysis of the frameworks summarized in volume 1, and is available from the Asian Development Bank (ADB) website www.adb.org.

This volume is the Comparative Review of the Legal, Governance and Monitoring Frameworks. It includes two appendices that provide further analysis of the provisions of the legislation in each country.

This volume contains three chapters: Chapter I evaluates the SOE and company legislation; Chapter II examines the monitoring frameworks and Chapter III assesses the governance frameworks.
The legal framework of SOEs is composed of laws, regulations and institutional arrangements that define how SOEs are established, managed and supervised. A carefully designed SOE legal framework is essential for ensuring the economic efficiency of the SOE sector. The legal parameters for the operation of SOEs are typically set out in a specific SOE law as well as in parts of the companies law.

The SOE Act guides the process underlying the formation of SOEs, detailing their obligations, powers and liabilities and specific rules around SOE governance.

The companies law also has a bearing on the operation of SOEs that are also companies, particularly in terms of the general principles of governance, the rights and obligations of shareholders, and the administration rules that apply to companies.

The following sections provide an overview of the legal framework for SOEs in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga, assessing their effectiveness in terms of the most current tenets of best practice.

Box 1: What makes good SOE legislation?

Ideally, the SOE law should cover the following:

- The establishment of SOEs
- The principal objectives of SOEs
- The appointment and removal processes for directors
- The roles and responsibilities of directors
- Managing conflicts of interest
- The appointment of CEOs
- The roles and duties of Responsible Ministers and Shareholding Ministers
- The requirements dealing with the content and approval of
  o Business/corporate plans
  o Statement of Corporate Objectives/Intent
  o Annual (and semi-annual) reports
  o Audit requirements
  o Performance review/audit
- Reporting requirements to Parliament
- The definition and management of Community Service Obligations (“CSOs”)

In some jurisdictions, the divestiture of SOEs is also covered in SOE legislation, particularly if it is necessary to make it clear that SOEs can be divested and that there is a process that should be followed.

Box 2: In terms of SOE provisions, what should the Companies law cover?

Ideally, the Companies law should cover the following:

- Capacity, powers and validity of actions
- Directors’ duties, including the duty of care and managing conflicts of interest
- Director’s liabilities
- Accounting records and audit
- Reporting requirements (i.e. annual report)
- Insolvency provisions
- Conduct of board meetings
- Appointment and removal of directors
- Rights and obligations of shareholders
- Conduct of Annual General Meetings
- Offences and penalties
- The rules governing the company’s management (Constitution or Articles and Memorandum of Association)
A. Key Findings

Fiji, Samoa, Solomon Islands and Tonga have all enacted SOE laws. While each jurisdiction has based their legislation on the New Zealand SOE Act of 1986, there are significant differences between the four acts. Further, each jurisdiction is unique in terms of their success in implementing their SOE legislation.

In Fiji, the SOE Act meets many of the requirements for good SOE legislation—but it remains vulnerable to implementation risk and suffers from an uneven application of the rules concerning Community Service Obligations (CSOs). In Samoa, the SOE Act is very comprehensive, but it suffers from a lack of implementation. The Solomon Island Act was enacted in 2007 and is heavily based on the Samoan legislation, but with important changes to meet local requirements and some interesting enhancements. In Tonga, in contrast, the SOE Act lacked a number of key provisions, but practice has been to adopt effective governance behaviours that went beyond the strict requirements of the law. An amendment Act has recently been passed by the Legislative Assembly, which has brought the Tongan SOE legislation in line with best practice.

B. Fiji Islands

1. Key components of the SOE Act

Fiji’s SOE Act is sound, but could be improved

The Fijian Public Enterprise Act 1996 is the oldest of the four SOE Acts examined in this report and, overall, appears sound: it covers most of the requirements for good SOE law. Fiji’s SOE Act empowers the Ministry of Public Enterprises as the specialist-monitoring agency; it sets out the rights and obligations of the responsible minister in a clear and concise manner, and sets out adequate reporting requirements for the SOEs. Indeed, prior to the introduction of the Tongan amendment Act in 2010, of the four SOE Acts reviewed, the reporting requirements in the Fijian SOE Act could be seen as the closest to best practice.

In this report, in the interests of clarity and brevity, the generic term “SOE Act” will be used to refer to the specific SOE legislation of each jurisdiction. Strictly speaking, however, Fiji’s SOE Act is the Public Enterprise Act 1996; Samoa’s SOE Act is the Public Bodies (Performance and Accountability) Act 2001; Solomon Island’s Act is the State Owned Enterprise Act 2007 and Tonga’s SOE Act is the Public Enterprises Act 2002, which has recently been substantially amended by the Public Enterprise Amendment Act 2010. There is no SOE specific Act in the Marshall Islands.

The differences are summarized in the discussion below and further detailed in Appendix 1 and 2. Appendix 1 summarizes the contents and range of cover of the SOE Acts in each of the three countries; Appendix 2 provides a detailed analysis of each country’s SOE legislation against the key requirements listed above.

Prior to December 2007 it was known as the Ministry of Public Enterprises and Public Sector Reform; however it was split into two ministries as part of a general government restructuring.
**Fiji’s SOE Act should provide guidelines for directors, especially with regard to duties and obligations**

However, while Fiji’s SOE Act emphasizes transitional rules and the processes associated with the establishment of an SOE, it provides little or no guidance to directors on how to best steward an SOE once established.\(^\text{13}\) Indeed, the area of greatest weakness in Fiji’s SOE Act concerns directors’ duties and obligations, a weakness exacerbated by the outdated supporting legislation in the Companies Act. Further, as a number of the SOEs are not registered companies, the guidance and protections of the Companies Act—such as managing conflicts of interest—are not available to non-company SOEs, which must rely on their own establishing legislation to deal with these matters.

While it may be that the establishing legislation specific to some SOEs cover matters—such as the appointment of directors, terms of appointment, criteria for appointment, duties and obligations and managing conflicts of interest—it would be more useful to include these standardised provisions in the SOE Act. To this end, the Fijian government should consider amending its SOE Act to provide guidance for the non-company SOEs by adopting some of the provisions in the New Zealand Crown Entities Act 2004\(^\text{14}\) concerning the role and accountability of members; the appointment and removal of members; the collective duties of the board; the individual duties of members, and several others.\(^\text{15}\)

**Fiji’s SOE Act should include more detailed provisions relating to CSOs**

The provisions in Fiji’s SOE Act require the Ministry of Public Enterprises (in consultation with the Ministry of Finance) to prepare binding guidelines covering the implementation of CSOs in terms of pricing, costing, funding, contracting and monitoring. To this end, the Ministry of Public Enterprises has prepared a useful two-page document outlining guidelines on CSOs for commercial SOEs.\(^\text{16}\) However, it contains a number of gaps. To address its shortcomings, the SOE Act should be amended to include more detailed provisions dealing with CSOs, such as how they are documented, monitoring requirements and enhanced accountability. Consideration should also be given as to whether there would be benefit in including penalties for non-compliance, especially where SOEs act outside of the approved

\(^{13}\) Fijian SOEs are categorised as either Government Controlled Companies (GCCs) or Commercial Statutory Authorities (CSAs). This report refers to both as SOEs unless it is meaningful to identify them separately. It should be noted that GCCs must operate as successful businesses—that is, as profitable as comparable businesses in the private sector; CSAs, however, are not subject to the same requirement.

\(^{14}\) This is also recommended for Tonga where the same problem arises.

\(^{15}\) To be more precise, the following sections from New Zealand’s Crown Entities Act 2004 should be adopted: sections 25–27 dealing with the role and accountability of members; sections 28–46 dealing with the appointment, removal, and conditions of members; sections 49–52 dealing with the collective duties of board; sections 53–57 dealing with the individual duties of members; sections 58–60 dealing with the effect of non-compliance with duties; sections 62–72 dealing with conflicts of interest disclosure rules; and sections 73–75 dealing with delegation.

\(^{16}\) As noted above, in Fiji’s SOE Act, Commercial SOEs are called ‘Commercial Statutory Authorities’ (CSAs).
provisions: it should also apply to the not-for-profit SOEs along with the commercial SOEs. The Samoan and Solomon Islands SOE Acts provide useful examples of how penalties might be incorporated into the Fijian Act, while the Tongan amendment Act provides a useful precedent for provisions dealing with establishing, monitoring, documenting and pricing CSOs.

2. Implementation performance

Good implementation performance

Beyond the area of CSOs—where there would appear to be a number of unfunded and informal CSOs—there does not appear to be any significant non-compliance issues with the provisions of the SOE legislation in Fiji.

3. Companies Act

*Fiji’s Companies Act should be updated to provide additional guidance to board members regarding duty of care and insolvency*

The Fijian Companies Act 1984 appears to be based on the antiquated New Zealand Companies Act of 1955. As a consequence, it lacks a number of useful provisions that would give additional guidance to board members concerning their duty of care and SOE insolvency. The New Zealand Companies Act of 1993 is widely regarded as good practice and the Samoan 2001 Companies Act, the Tongan Companies Act of 1995\(^{17}\) and the Solomon Islands Companies Act 2009 are all based on this New Zealand Act. The Fijian government could also use the New Zealand 1993 act as a reference point in any update of its Companies Act. A review of the Fiji companies Act was commenced in 2010 with the intention of updating it in line with international good practice. The government expects the new Act to be in place by the end of 2010 or early 2011.

C. Marshall Islands

1. Key components of the SOE Act

*There is no SOE Act and therefore no concept of the “ownership” interest in the Marshall Islands legislative framework for its SOEs*

There is no centralised SOE Act in the Marshall Islands. While the government has agreed to develop an SOE policy, which would then lead to an SOE Act, no decision on detail has been made at this stage. In the Comprehensive Adjustment Program “Reform and Development Framework 2010 – 2012”, which is sponsored by the Minister of Finance, one of the targets is to develop and pass legislation to strengthen SOE governance, possibly

\(^{17}\) As amended in 2009
through a specific SOE Act. In the interim the government has adopted a set of SOE reform guiding principles, which include

1. SOEs are to prepare business plans that disclose the strategic direction and performance targets and, after Cabinet has approved them, they are to be publicly released.

2. The activities undertaken by SOEs are to be categorised as either essential or non-essential and the non-essential should then be sold or wound down.

3. The government will ensure that SOE boards have independence in operation and that they comprise members who are suitably qualified and experienced.

4. The government will also ensure that the senior management within the SOEs have suitable qualifications and experience.

5. SOEs will be required to align their prices and changes with the total cost of service delivery, except where they are being funded by CSOs.

6. SOEs will be required to operate in accordance with sound financial management principles.

7. The government has agreed to establish an SOE policy and SOE Act to provide mechanisms for the sound application of good practice principles.

While the foregoing are helpful and if implemented will provide useful guidance, the principles are too short on detail to be sufficient on their own. The government should adopt a more detailed SOE policy that could then be used to guide the development of an SOE Act.

In the absence of a specialist SOE Act governance of the Marshall Islands SOEs is dependent on the robustness of the individual SOE’s establishing legislation. While the establishing Acts generally contain clear provisions dealing the appointment of directors, and the functions, responsibilities and basic reporting requirements of the SOEs, they are silent on director’s duties and obligations.

A review if the existing legislation and governance practice in the Marshall Islands demonstrates an absolute lack of any “ownership” focus in the management and stewardship of the SOEs, either individually or as a portfolio.
2. Implementation performance

The SOE specific Acts appear to be followed; but they don’t focus the boards’ attention on performance

Generally it would appear that the individual SOE Acts are being followed, however these Acts have no provisions dealing with the ownership interest in SOEs, such as the duties and obligations of directors and how they interact with and are accountable to the shareholder/s; requirements in relation to establishing the core planning documents and how they are approved; how boards manage themselves; expectations the shareholders may have in relation to financial and operational performance; clear reporting requirements; and how the shareholder will monitor performance. There is therefore no focus on medium to long term SOE performance.

Governments tend to interact with their SOEs at different levels or through different “relationships”: as “owner”, as “purchaser” and as “regulator”. In the Marshall Islands, the government as owner is missing which means that SOEs are not managed as a long-term commercial investment, but as a vehicle to deliver a particular policy outcome, often with a short-term or immediate focus. The “ownership” interest could be simply stated, “If I owned this SOE, how would I behave, what would I want to know and how would I want to control the operation of the board and hold them accountable?” This lack of an ownership interest is a significant reason behind the very poor performance of the Marshall Islands SOEs. (The diagram above shows the difference between the ownership and purchase interest).
3. Companies Act

_The Companies legislation is light on director’s duties and obligations_

The Marshall Islands companies legislation—the Business Corporations Act—establishes some basic duties and obligations for directors, such as how to manage a conflict of interest (section 58) and the standard of care directors must show (section 61), but generally it is the least well developed of the five Companies Acts reviewed in this study. Furthermore, none of the Marshall Islands SOEs are companies and as such they do not benefit from the few governance provisions that can be found in the companies legislation.

To cover these shortcomings the government should ensure that the SOE Act, when drafted, has very detailed provisions dealing with director duties and governance matters. The Tongan SOE Act (including the 2010 amendments), the Solomon Islands Act and Regulations and the Samoan SOE Regulations would be useful benchmarks.

D: Samoa

1. Key components of the SOE Act

_Samoa’s SOE laws contain thorough and detailed provisions_

The Samoan Public Bodies (Performance and Accountability) Act 2001 covers the key elements of good SOE legislation and makes a useful differentiation between commercial or profit driven SOEs, which are called Public Trading Bodies (PTBs), and not-for-profit SOEs, which are called Public Beneficial Bodies (PBBs). While they both operate under similar governance, monitoring and reporting arrangements, the PTBs are required to make a profit. The Act states that the principal objective of a PTB is to operate as a “successful business”, which is further defined as being as profitable and efficient as “comparable businesses that are not owned by the state”. A PTB must also meet the following three requirements:

1. The SOE must meet any CSO established under the Act.\(^{18}\)
2. The SOE must comply with the provisions of the Labour and Employment Act 1972.
3. The SOE must be an organization that demonstrates a sense of social responsibility by having regard to the interests of the community in which it operates.

These three criteria in effect reinforce the principal objective of operating as a successful business: they encourage long-term viability through the demonstration of a sense of social responsibility.

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\(^{18}\) CSOs are provided for in Part II of the Public Bodies (Performance and Accountability) Act 2001.
responsibility and by meeting local labour laws.\textsuperscript{19} Further, the CSO requirements contained in the Samoan legislation require SOE boards to refuse to undertake a CSO that is not approved within the rules established in the Act and Regulations and also contain detailed provisions dealing with the process of establishing and approving CSOs.\textsuperscript{20} These are in turn supported by detailed guidelines issued by the Ministry of Finance and approved by cabinet.

Another important feature of the Samoan SOE Act is that it stipulates penalties for breaching the key requirements of (i) operating as a successful business and (ii) meeting the CSO guidelines. The provisions categorically state that a failure to meet the legislative requirements will make the person at fault “guilty of an offence and liable to a fine”\textsuperscript{21}. That is, a failure to meet these requirements can result in fines being levied against the delinquent parties—which may include managers, board members and ministers. This provision is useful in enforcing high standards of performance, and it is noteworthy that Samoan SOE law includes it. The problem, however, is that Samoa has not been successful in implementing its SOE laws, nor in taking action against those that breach the clear requirements of the SOE Act.

2. Implementation performance

\textit{Samoa needs a more powerful implementation regime}

Despite the unambiguous wording of the Samoan SOE Act and accompanying Regulations, implementation has been weak. Including the rules governing CSOs there are three other significant areas where the provisions have historically been either ignored or breached: the criteria by which an SOE is deemed to operate as a “successful business”; the membership of boards; and the payment of director fees and allowances. The latter two areas have come under review by cabinet since the release of Finding Balance I and this has resulted in some progress in addressing the weaknesses identified.

\textit{Samoa should implement the criteria by which an SOE is deemed to operate as a “successful business”}

Every decision taken by individual directors and the board of PTBs must be made “in compliance with the provisions of the Act”. That is, the decisions of SOE boards must be consistent with the operation of a “successful business.” However, the poor performance of most PTBs suggests that decisions are not being made with the objective of operating as a successful business. In practice, the PTB portfolio generated a return on equity (ROE) of -

\textsuperscript{19} This is a business point: looking after staff and the community are organizational health indicators, impacting on the longer-term viability of an organization. For example, if a company does not look after staff, they may be subject to a high turnover, which increases cost, reduces efficiency and adversely affects profitability.

\textsuperscript{20} The Public Bodies (Performance and Accountability) Regulations 2002.

\textsuperscript{21} Sections 13 and 17 of the Public Bodies (Performance and Accountability) Act 2001
0.70% in FY2009 and an average of just 0.2% over the FY2002-2009 period. This performance is well below the Weighted Average Cost of Capital for the portfolio and well below the government’s ROE target of 7%. This has occurred because SOE boards have supported decisions that fall short of sound business practice—and what would logically be required to “operate as a successful business.”

**Samoa has moved towards implementing the general prohibition against public servants and ministers being appointed to SOE boards**

Under the SOE Act, public servants and members of parliament, including ministers, can only be appointed to the boards of SOEs under very limited circumstances. Regulation 3.1.1(g) clearly states that no politician or public servant shall be a director unless cabinet has certified that the appointment is necessary because (i) the appointment is in the national interest and (ii) the qualifications of the appointee are both required on the board and cannot be found elsewhere. This limitation is meant to override any other provision that suggests otherwise.

Although the requirements in Regulation 3.1.1 are hard to satisfy, there are numerous politicians and public servants serving on SOE boards. Following the publication of the first SOE comparative study “Finding Balance”, in 2009, the government has moved to address this and is working through a process to amend individual SOE’s establishing legislation that is inconsistent with the requirements of the SOE Act. In some of the establishing Acts particular persons or office holders, such as ministers and ministry CEOs, are required to serve as directors on a particular SOE. In 2009 the government established an independent director selection panel that has responsibility to coordinate a process to bring all the “conflicting” legislation in line with the SOE Act through a series of specific amendments to be incorporated in an overarching amendment Act.

**Samoa has implemented a prohibition against the payment of board member fees and allowances to public servants and ministers**

One of the recommendations from the 2009 “Finding Balance” study was that the government should implement the prohibition on the payment of fees and allowances to public servants and politicians serving on SOE boards in accordance with the requirements of the SOE Regulations. Cabinet has since moved to enforce this requirement.

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22 Schedule 3.1.1(g) of the Public Bodies (Performance and Accountability) Regulations 2002.
23 Section 4(a) of the Public Bodies (Performance and Accountability) Act 2001 states that “If there is any inconsistency between an individual public trading body’s empowering Act, the Companies Act 2001, the Public Finance Management Act 2001 and this Act, the provisions of this Act shall prevail to the extent of the inconsistency.”
24 Cabinet decision April 2009 stated that (a) removal of all ex-officios and ministers by June 2010 and prohibition on paying sitting fees (b) All SOEs must achieve the 7% ROE. Failure to comply would result in the board and
3. **Companies Act**

*In alignment with best practice, Samoa has updated its Companies Act*

The majority of Samoa’s SOEs are companies and, as a consequence, are subject to the provisions of the companies law, particularly those relating to directors’ duties, governance and solvency. Until 2008, the operative companies legislation in Samoa was the Companies Act 1955, which was based on the New Zealand 1955 Act. In June 2008, however, the 2001 Companies Act, together with the 2006 amendment Act, became effective, bringing the Samoan companies legislation into alignment with international benchmarks of best practice.

*Samoa should enforce its provisions regarding directors’ duties, especially with regard to insolvency, reporting requirements and liabilities*

The Companies Act that became effective in 2008 introduced new requirements in relation to directors’ duties and liabilities in situations where the company may be insolvent. Some of the provisions in the new Act were already in the SOE Act and Regulations, such as those dealing with insolvency. They have, however, been generally ignored and it appears that the introduction of the new Act has not changed behaviour.

The main provisions in the SOE Act that are supported by the new companies law are that:

1. A director of an SOE must not act, nor agree to act, in a manner that contravenes the Public Finance Management Act 2001 or the Public Bodies (Performance and Accountability) Act 2001, or the Companies Act 2001.

2. A director must call a meeting of directors within 10 days to consider whether an administrator or liquidator needs to be appointed when (i) they believe that an SOE is unable to pay its debts or (ii) a director is aware of matters that would make a reasonable person question whether an SOE can pay its debts when they fall due.

3. A director must advise the chairperson and the shareholding ministers in writing if they believe that a breach of the Public Bodies Act, the Public Finance Management Act or the Companies Act has or may occur or if they become aware of any event that may materially and adversely affect the financial position of the SOE.\(^ {25} \)

4. If a director is aware of the matters mentioned in (2) above and does not act, or alternatively votes not to appoint a liquidator and the company subsequently fails,

\(^ {25} \) See Schedule 8 of the Public Bodies (Performance and Accountability) Regulations 2002. It should be noted that Schedule 8 included a number of duties that were referenced back to the Companies Act 2001. In the context of the Public Bodies Act 2002, these duties apply to both PTBs and PBBS.
then that director could be personally liable for the subsequent loss incurred by a creditor. Furthermore, the company cannot provide directors with an indemnity to cover this potential liability.\textsuperscript{26}

A financial analysis of the Samoan SOE portfolio reveals that the majority of the SOEs are probably insolvent, with nine SOEs operating with a cash ratio\textsuperscript{27} of 0.52 or less. However, it does not appear that any of the provisions listed above have been applied to either inform the chair, the shareholding ministers or the creditors. This is probably due to the confused governance practices in Samoa, where the chair of the SOE has historically been the shareholding minister.

It would be hoped that once politicians, particularly ministers, and public servants step down from the SOE boards the improved governance structure will encourage a greater degree of scrutiny in this area. If implemented properly, the Companies Act 2001 will increase the liabilities that directors face for poor performance. This will make them less likely to approve investments or make decisions that negatively impact upon the financial viability of the SOEs and expose creditors to greater risk.

E. Solomon Islands

1. Key components of the SOE Act

\textit{Solomon Island SOE Act builds on the Samoan model but adds some local flavour and interesting enhancements}

The Solomon Islands SOE Act was enacted in 2007 and the supporting Regulations were made effective in 2010. The Solomon Islands Act is based very largely on the Samoan Act: adopting the Samoan definition for CSOs; the same wording for the SOE’s Principal Objective,\textsuperscript{28} and very similar wording for the director’s duties and obligations. The Solomon Islands Act also includes penalties if a director fails to comply with the obligation to act in good faith and in the best interests of the SOE, or if any person acts contrary to the CSO rules set out in the Act or supporting Regulations. The Act also follows the same or very similar reporting and accountability processes and procedures as found in the Samoan and Tongan legislation.

However the Solomon Islands Act and Regulations introduce some new and interesting provisions not found in the other SOE legislation reviewed as part of this study:

\begin{itemize}
  \item \textsuperscript{26} Section 65 of the Companies Act 2001.
  \item \textsuperscript{27} Cash ratio is the ration of the SOE’s cash and cash equivalent assets to its current liabilities.
  \item \textsuperscript{28} To operate as a successful business.
\end{itemize}
1. The SOE Act differentiates between commercial and regulatory SOEs and also the commercial and regulatory functions that may be undertaken by the same SOE. In essence the differentiation (a) attempts to exempt the regulatory SOEs from having to operate as successful businesses; and (b) a minister\textsuperscript{29} as defined in the SOE Act cannot give a direction to an SOE relating to its regulatory function.

2. The Act requires every SOE\textsuperscript{30} to have published in local newspapers, and provide copies free to anyone who requests them, any information that has been tabled in the National Parliament under Section 17 of the Act. Information that must be tabled under Section 17 includes the SCI and any notice of a modification made during the period the statement is valid; the annual report and auditors report; and a notice relating to the appointment, reappointment, retirement or termination of any SOE director.

3. The Regulations establish a skills based selection process for SOE directors whereby the SOE board first assesses the skills required when a vacancy arises and then informs the accountable ministers of their determination and this then drives the selection process.

4. The Regulations also require newly appointed directors to be briefed by the SOE’s chief executive on such matters as the SCI, annual report and financial statements and by the Ministry of Finance on the roles, duties and responsibilities of an SOE director.

5. The Regulations require that the candidate selected must sign a consent to being a director; certifying that they are not disqualified to act as a director and disclosing the nature and extent of any interest they might have.

6. Finally, the Regulations provide a clear statement of the duties and responsibilities an SOE director has and establishes the concept of an Interests register and the process directors must follow to declare an interest.

The provisions listed above significantly strengthen the transparency, disclosure and governance guidelines for the SOEs in the Solomon Islands.

\textsuperscript{29} A Minister is defined a Minister of the Crown, which is different to the Accountable Ministers, who are the Responsible Minister and the Minister of Finance.  
\textsuperscript{30} Section 18 of the SOE Act
2. Implementation performance

*Slow start but momentum gaining*

The introduction of the new SOE Act appears to have led to little immediate change in the performance of the SOE portfolio or how the government manages its SOE ownership interest. Certainly there are significant gaps between the requirements in the SOE Act and actual performance or practice. However this could be a function of how much “base” work was required just to bring the portfolio to the “starting line” in relation to ownership expectations and the availability of meaningful information on the financial and operational status of the SOEs.

Reform momentum is starting to build. The Regulations, enacted in 2010, cover such important matters as the process to select and appoint directors; the disqualification and removal of directors; directors duties and obligations including managing conflicts of interests; directors capacity and accountability; and rules around the application and approval of CSOs. The Economic Reform Unit (ERU) within the Ministry of Finance, which has monitoring responsibility for the SOEs, has embarked on an information program to inform SOE directors and senior managers about the requirements of the Act and Regulations. Amongst other innovations, an SOE Forum has been established—comprising members from the ERU and SOE directors and senior managers—which creates an opportunity to discuss new monitoring initiatives and also to communicate and educate SOEs on the legal and governance regime under which they operate.

3. Companies Act

*The Companies Act is sound, but only applies to two SOEs*

The Solomon Islands Companies Act was updated in 2009 and contains all of the provisions dealing with director’s duties and obligations that exist in modern companies legislation. However, only two of the Solomon Islands SOEs are registered as companies: Solomon Airlines Limited and Solomon Island Printers Limited, which are therefore subject to the provisions of the Companies Act as well as the SOE Act. However the SOE Act and Regulations use similar terms and concepts as those found in the Companies Act dealing with such matters as:

1. The solvency test, which is defined in the SOE Act in the same terms as Sections 5 and 70 (1) (a) of the Companies Act.

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31 It monitors all of the SOEs owned by the government including the Investment Corporation of the Solomon Islands (ICSI), but not those SOEs owned by ICSI.
2. The requirement that directors must act in good faith and in what the director believes is in the best interests of the company is set out in Section 6(5) of the SOE Act and Regulation 18 and also Section 64 of the Companies Act.

3. The standard of care owed by a director in the SOE Regulation 23 is similar to the standard established by Section 69 of the Companies Act.

The balance of the Solomon Islands SOEs have been established under entity specific legislation, which in some cases contain additional rules and obligations relating to the roles and duties of directors and the management of the SOE.

What happens if there is a conflict between the entity specific legislation and the SOE Act?

The Solomon Island SOE Act attempts to establish clear rules governing how the Companies Act, the SOE Act and the entity specific legislation apply to the SOEs, how the various Acts interface and how conflicts are resolved. For those SOEs that are also companies: the Companies and SOE Acts apply. In the case of the non-company SOEs, if there is any conflict between the entity specific legislation and the SOE Act it is intended that the SOE Act—and any regulations made under that Act—shall prevail. However it is not clear that the legislation as drafted actually achieves this outcome in matters relating to director selection and appointment where both the entity specific legislation and SOE Act purport to govern the process that must be followed.

F. Tonga

1. Key components of the SOE Act

The Tongan SOE Act was the weakest of the countries studied

Of the countries reviewed, Tonga had the weakest SOE Act when Finding Balance 2009 was published. The Ministry of Finance originally administered the Act, which was enacted in 2002. However, in early 2007 the Ministry of Public Enterprise (MPE) was formed to monitor the ownership interest in Tonga's SOEs. The Tongan Act had a major overhaul in 2010 and has developed from being the weakest SOE Act amongst the legislation reviewed in this study, to being now perhaps the most thorough and robust. Even before the 2010 amendments the Tongan SOE Act represented best practice in three areas

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32 The Entity specific legislation is listed in Section 26(8) of the SOE Act
33 Section 25 (1) SOE Act.
34 This is because the SOE Act (Sec 6 (2)) requires any appointment to be consistent with the “rules” of the SOE which probably includes the provisions of the entity specific Act.
35 Prior to 2008 it was the Ministry of Public Enterprise and Information.
1. The prohibition on incurring obligations that cannot be met. This is important as a number of SOEs in the three countries reviewed are probably insolvent and directors have to be continually reminded that it is their statutory duty to ensure that the SOE can meet its obligations (Section 13);

2. The requirement that the Annual Report contain sufficient information for the reader to assess the operations of the SOE in terms of the targets set out in the Statement of Corporate Intent (SCI) (Section 20(2)); and

3. The provision dealing with the appointment of the SOE chief executives and detailing the minimum requirements for a written performance-based employment contract (Section 26).

*Tonga has adopted many of the recommendations from Finding Balance 2009*

Finding Balance 2009 made a number of recommendations on how the Tongan legislation could be strengthened. In essence the recommendations included introducing new legislation that:

1. Included a principal objective that every SOE should operate as a successful business and to be at least as profitable as comparable businesses that are not state-owned.

2. Made it clear that all SOEs, whether they be companies or non-companies, are subject to the governance provisions contained in the SOE Act.

3. Required the annual reports—commenting upon actual performance against targets set in the statement of corporate intent—be tabled in the Tongan Parliament36.

4. Provided guidelines on who should be appointed as an SOE director and on what basis.

5. Contained provisions dealing with the application and approval process for CSOs, including requirements that any approved CSOs must be properly documented, costed and funded.

All of these recommendations, plus other enhancements, have been incorporated into the SOE Act through the October 2010 amendment. Other improvements to the SOE legislative regime, that go beyond that found in most other Pacific island countries, include; a requirement that each SOE publish a report on its performance against the SCI targets in

36 The Legislative Assembly
local newspapers\textsuperscript{37}; confirmation that the cost of a CSO must include a margin to cover the SOE’s cost of capital; incorporating the provisions of the Companies Act dealing with directors duties and obligations into the SOE Act and making them apply to both company and non-company SOEs; establishing the concept of an SOE holding company as the ownership vehicle for the other SOEs; introducing an absolute prohibition on politicians being appointed as SOE directors\textsuperscript{38}; and establishing strict controls the appointment of public servants as SOE directors.

2. Implementation performance

\textit{Tonga’s implementation efforts have exceeded legislative requirements}

Even though Tonga’s SOE legislation possessed numerous shortcomings prior to the 2010 amendment, the Tongan government imposed operating, monitoring and governance requirements upon its SOEs that went beyond the pure requirements of the old SOE Act. For example, while there was no profit motive in the pre 2010 Act, the government established a requirement that all SOEs should target a 10\% return on equity. In many cases the enhancements introduced through the 2010 amendments bring the legislation in line with actual practice.

3. Companies Act

\textit{Tonga’s Companies Act provides adequate guidance}

The Tongan Companies Act of 1995 is based on the New Zealand Act of 1993 and as such includes robust provisions dealing with directors’ duties, managing interests and prohibitions on trading while insolvent. Together, the SOE Act and the Companies Act provide good coverage for the roles and responsibilities of directors, the rights of shareholders and overall company stewardship.

The Companies Act was amended in 2009 to facilitate the introduction of an electronic companies register\textsuperscript{39}; bring the Act up to date with changes made to the New Zealand Act upon which it is based; and also to reduce the discretion the responsible Minister had in determining whether a company could be registered.

\textsuperscript{37} A similar provision is contained in the Solomon Islands SOE Act

\textsuperscript{38} Politicians can be appointed to a new start-up SOE but only for the first twelve months.

\textsuperscript{39} The previous companies register was destroyed in the 2007 civil disturbances.
II. The Monitoring Frameworks of State-Owned Enterprises

Monitoring frameworks ensure the accountability of SOEs

This chapter evaluates the comparative effectiveness of the SOE monitoring frameworks found within the five countries. The analysis was conducted through questionnaires, observation and in-country interviews and focuses on three key monitoring mechanisms: parliamentary oversight; institutional arrangements and the primary reporting documents.

The extent of monitoring undertaken in the Marshall Islands is quite limited. While there appears to be reasonable output and outcome monitoring and good financial data is available on the SOEs, there is no concept of an ownership monitor and no central monitoring agency. Therefore the Marshall Islands has been excluded from some of the analysis in this section, as it is not relevant to their current institutional arrangements.

The analysis undertaken for this section revealed that the most notable differences between the monitoring practices in Fiji, Samoa, Solomon Islands and Tonga were (1) how the monitoring function was undertaken; (2) the primary monitoring document; (3) the extent the monitor is able to obtain meaningful data; and (4) compliance.

A. Key Findings

While Fiji, Samoa, and Tonga have similar degrees of parliamentary oversight, there appears to be minimal parliamentary oversight of the ownership interest in the Marshall Islands and Solomon Islands SOEs. In Fiji and Samoa the establishment of parliamentary committees to review SOE performance boosts the degree of parliamentary oversight. In the Solomon Islands, while the SOE Act requires all SCIs and annual reports to be tabled in the parliament, in practice this seldom occurs and just three out of the eleven SOEs actually produce an SCI. Even in those countries where parliamentary oversight exists, the monitoring units were all of the view that oversight could be improved.

The evidence suggests that differences in the legal structure of the monitoring units, i.e. separate ministry or division within a ministry, do not have a significant impact on the ability of the monitoring units to execute their mandate. Rather, the presence of ministers and public servants on the boards of SOEs continues to compromise the independence of the monitoring units and their capacity to effectively scrutinize the performance of SOEs.
Fiji, Samoa and Tonga have adopted robust reporting practices: in Fiji and Samoa the monitoring unit uses detailed corporate plans to set performance targets and agreed actions to achieve them. In contrast Tonga relies solely on SCIs to set targets against which performance is measured and while non-financial performance measures contained in the SCIs are quite limited; the monitoring unit undertakes its own analysis against performance measures that it has established based on their knowledge of the individual SOEs and their respective businesses. While this has built a significant level of analytical capability within the Tongan monitoring unit, it exposes the unit to the risk of key staff departing and also removes some responsibility from the SOEs: the SCI is really the SOE’s document and they should be continually improving and developing its usefulness as a key accountability tool.

**Pace of reform in Tonga exceeds that found in Fiji and Samoa**

While there is no evidence to suggest that the pace of reform is driven by the structure of the monitoring framework, there is evidence suggesting that the pace of reform is closely linked to the level of political commitment to achieve reform. In relation to the monitoring function, that commitment is demonstrated by the empowerment of the agency responsible for monitoring the performance of SOEs. The surveys indicate that the Tongan monitoring agency has been given greater freedom to “get on with the job” and it has been quite innovative in developing monitoring mechanisms and practices that have exceeded the requirements set out in their legislation.

**Solomon Islands have introduced some innovative practices**

While the development of the monitoring function in the Solomon Islands is quite recent, the ownership monitor has adopted some innovative practices that could be usefully applied within other monitoring units. For example, the Minister of Finance has written to each SOE setting out his expectations for the SOEs and their boards, which provides valuable “ownership” guidance for the SOEs as they develop their SCIs. It is intended that this “Letter of Expectation” will be sent to each SOE at the beginning of their planning period to emphasize the key issues they should take into consideration as they develop their plans. The monitoring unit has also instigated an SOE Forum, comprising representatives from the unit and the SOEs, as a means to discuss current issues, provide guidance on monitoring and governance issues, improve general understanding of the SOE Act and Regulations and also to encourage shared learning amongst the SOEs.

**The absence of an ownership monitoring function in the Marshall Islands has a direct impact on performance**

The financial performance of the Marshall Islands SOEs is captured as part of the government’s annual audit process, which is funded through the Compact agreement with
the United States. This process results in reliable audited accounts being available for all SOEs, although it may take twelve to eighteen months after the end of the financial year for the audits to be complete and the accounts to be made available\textsuperscript{40}. However, although good financial data exists, the lack of any ownership monitoring means that there is limited proactive monitoring or reporting on performance and issues that impact on the long-term organisation health of the SOEs. While some of the entity specific legislation requires the SOE to produce a business plan for approval by the Minister, this is not a universal requirement\textsuperscript{41}. In those cases were a business plan is required it is reviewed and approved by the sector Minister, such as the Minister for Transport in the case of the Shipping Corporation. This creates a potential conflict of interest\textsuperscript{42} and while the Minister may be interested in how well the SOE is undertaking its statutory role and the outputs or outcomes it is required to deliver, there is nothing to encourage him or her to ensure that the SOE is actually “fit for purpose”: that it is being managed in such a manner that it will be able to achieve its statutory responsibilities now and into the future.

B. Parliamentary Oversight

*The pervasive view amongst the monitoring units in each country is that parliamentary oversight should be improved*

Parliamentary oversight is an essential element of effective SOE monitoring. While in practice Fiji, Samoa and Tonga demonstrated an acceptable level of parliamentary review over the performance of their SOEs, the common view amongst monitoring unit officials was that it should be enhanced. One of the key problems identified is that information is not tabled in Parliament in a timely manner, with annual reports often tabled as much as twelve months after the end of the financial year. The reasons cited include the slow preparation of accounts by the SOEs and bottlenecks in the auditing process, particularly where the accounts must be audited by the Auditor General’s office. Regardless of the reasons, the information is out of date and may bear little resemblance to current performance.

Further, the systems in place to check whether reports have been tabled in Parliament are not always effective: in Tonga, for example, it is not clear whether the most recent annual reports have been tabled as there appears to be no system to record whether or when this has occurred. Alongside other measures, these problems could be addressed by imposing significant penalties on the SOEs that do not meet reporting deadlines.

\textsuperscript{40} The 2009 accounts had not been audited by November 2010.

\textsuperscript{41} For example a business plan is required in the Act establishing the Shipping Corporation, but not the National Telecommunication Authority or the Tobolar Copra Processing Plant.

\textsuperscript{42} Further discussed in the Governance section of this study
In Fiji and Samoa the potential for greater parliamentary oversight has been achieved through the use of a standing parliamentary committee\(^{43}\) that reviews all of the SOE’s formal reporting documents tabled in the Parliament. The SOE board and management may also be invited to appear before the committee.

**Solomon Islands practice falls short of statutory requirements**

The Solomon Island SOE Act requires the preparation of an SCI\(^ {44}\) and an audited financial report—which should include a comparison of the performance of the SOE against the objectives and performance measures established in the relevant SCI—and that these documents should be tabled in the Parliament. However in practice this seldom happens. Only three of the SOEs actually produce an SCI and while the balance may have audited accounts, the financial data upon which the annual accounts are based is so questionable that the Auditor cannot provide an opinion, let alone a qualified opinion. It would be hoped that over time, as the SOEs and monitoring unit become more familiar with the reporting requirements in the SOE Act and Regulations, that practice will move closer to the statutory requirements.

As previously mentioned, the Solomon Islands SOE Act introduces additional public disclosure requirements not found in the Fijian and Samoan legislation. Similar requirements have been introduced into the Tongan SOE Act through the 2010 amendment. These are very positive developments as greater public awareness of the performance of the SOEs can only help to encourage improved financial and operational performance and also encourage responsible ministers to ensure they maintain an adequate level of oversight.

**Marshall Islands parliamentary oversight suffers from lack of SOE legislation**

Due to the lack of an effective SOE Act, the provisions in the entity specific legislation determines the degree of parliamentary oversight and as noted previously the reporting requirements vary from one SOE to another. This combined with the fact that the annual reports are often not audited until twelve to eighteen months after the end of the financial year means that when and if Parliament does get a chance to review the SOEs’ performance, the data is substantially out of date.

C. Institutional Arrangements

*Institutional arrangements should be structured to maximize accountability and encourage an environment of continuous improvement*

In Fiji, two ministries undertake the SOE monitoring function: the Ministry of Finance is responsible for 5 SOEs (which are partially owned by the state) while the MPE is responsible

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\(^{43}\) The committees in Fiji and Samoa are both termed the Public Accounts Committee.

\(^{44}\) In the Solomon Islands Act it is actually termed an Statement of Corporate Objectives (SCO)
for 16 SOEs (which are wholly owned by the state). The monitoring unit within the Ministry of Finance has 6 staff, including the division’s head, with each staff member monitoring less than one SOE. The chief executive of the ministry reports directly to the Minister of Finance. The MPE has 4 staff, including the division’s head. The ministry monitors 16 SOEs, resulting in a staff to SOE ratio of 4:1. The chief executive of the ministry reports directly to the Minister of Public Enterprises.

**The Marshall Islands** has not established an SOE monitoring unit. While the Minister of Finance and the Ministry of Finance maintain an interest in the SOE portfolio, it is really from the standpoint of their fiscal impact rather than the ownership interest. In the SOE’s establishing legislation the sector or line minister is identified as the responsible minister for that particular SOE and as such there is no one minister responsible for performance, accountability, governance or monitoring of the entire SOE portfolio. This lack of portfolio coordination was apparent during the fact finding for this study. Despite numerous requests for a list of all of the SOE directors from the Ministry of Finance and other central government agencies, one could not be provided. A list was finally compiled by telephoning each individual SOE. Further, identifying the sector minister as the responsible minister creates a conflict of interest and ensures that whatever monitoring is undertaken; it is focused on the provision of goods or services or the regulatory function of the SOE and not its long-term organisational health.

**In Samoa**, the SOE monitoring function is undertaken by the State Owned Enterprise Monitoring Division (SOEMD), which is established as a division within the Ministry of Finance. The division consists of 7 staff, including the division’s head. SOEMD monitors 27 SOEs with a total asset value of around USD618 million. Each staff member monitors almost 4 SOEs. The Head of the SOEMD reports directly to the CEO of the Ministry of Finance, but also is able to brief the Minister on a direct basis when the need arises.

**In the Solomon Islands** the Economic Reform Unit (ERU) within the Ministry of Finance undertakes the SOE monitoring function. It is a new unit—just three years in existence—and has three staff. However the use of external consultants in its start up phase has provided operational and technical support, which has meant that the unit has been able to realise some significant gains in a short period of time. The ERU monitors 11 SOEs with a total asset value of $75 million. The head of the unit reports directly to the Undersecretary of Finance who in turn reports to the Secretary, who then reports to the Minister of Finance. However the head of the unit is able to brief the minister in person when necessary and also represent the minister/ministry in discussions with the SOEs’ management and board.
The two SOEs in the Solomon Islands that are companies are actually owned by another SOE, the Investment Corporation of the Solomon Islands (ICSI). This complicates the monitoring arrangements, as the board of ICSI appoints the directors of the two subsidiary SOEs and also monitors their performance. The legislation setting up ICSI is more appropriate for a commercial holding company managing a variety of different commercial investments and is particularly well suited where it is in the role of a minority shareholder. Historically the flow of information from ICSI to the government relating to its SOE subsidiaries has been poor: as has been the effectiveness of its ownership monitoring. It is recommended that ownership of the two commercial SOEs be transferred out of ICSI, so that the government directly owns their shares, or ICSI itself is restructured to improve accountability, transparency and its effectiveness as an investor and manager of commercial assets.

In Tonga, a dedicated ministry undertakes the SOE monitoring function: the Ministry of Public Enterprises (MPE). The ministry was established in 2006. Previously the monitoring function was undertaken within the Ministry of Finance. The establishment of the MPE has resulted in a greater focus on monitoring activity. The ministry consists of 4 monitoring staff, including the division’s head. The MPE monitors 16 SOEs, with each staff member monitoring 4 SOEs. The chief executive of the ministry reports directly to the Minister of Public Enterprises.

A summary of the institutional arrangements for SOE monitoring is presented in Table 2 below.

### Table 2: Institutional Arrangements for SOE Monitoring

<table>
<thead>
<tr>
<th>Institutional Arrangements</th>
<th>Samoa Structure of monitoring unit</th>
<th>Tonga Structure of monitoring unit</th>
<th>Fiji (MOF)a Structure of monitoring unit</th>
<th>Fiji (MPE)b Structure of monitoring unit</th>
<th>Solomon Islands Structure of monitoring unit</th>
<th>Marshall Islands Structure of monitoring unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOEs Monitored</td>
<td>Unit within Ministry of Finance</td>
<td>Dedicated Ministry</td>
<td>Ministry of Finance</td>
<td>Dedicated Ministry</td>
<td>Unit within the Ministry of Finance</td>
<td>No SOE monitoring division</td>
</tr>
<tr>
<td>SOEs Monitored 5 years ago</td>
<td>27</td>
<td>16</td>
<td>51</td>
<td>161</td>
<td>11</td>
<td>N/A</td>
</tr>
<tr>
<td>Number of Staff</td>
<td>7</td>
<td>4</td>
<td>6</td>
<td>4</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Asset value of SOEs (USD millions)</td>
<td>$618</td>
<td>$144</td>
<td>$346</td>
<td>$885</td>
<td>$75</td>
<td>$116</td>
</tr>
<tr>
<td>SOE per staff member</td>
<td>3.9</td>
<td>4</td>
<td>0.83</td>
<td>4</td>
<td>3.67</td>
<td></td>
</tr>
<tr>
<td>Asset value per staff member (USD)</td>
<td>$88</td>
<td>$36</td>
<td>$49</td>
<td>$177</td>
<td>$25</td>
<td></td>
</tr>
</tbody>
</table>
In each of the countries that have a monitoring unit they seem appropriately sized, although teams of four or less can be susceptible to loss of capacity and expertise if staff leave. In Fiji there could be benefits gained from a larger scale monitoring agency: the function is currently split between two ministries. The Ministry of Finance monitors partially owned SOEs while the MPE monitors wholly owned SOEs. This is a suboptimal arrangement: it raises costs and disperses the resources and skills available to monitor the SOEs. In the absence of a strong justification for maintaining separate monitoring functions within Fiji, the government should consider combining the two SOE monitoring units within one ministry.

Regardless of structural arrangements, the monitoring unit should be sufficiently independent

In Fiji and Tonga the monitoring agency is composed of a ministry where the CEO of that ministry reports directly to the responsible minister. In Samoa and the Solomon Islands the monitoring agency sits within the Ministry of Finance and the head of the agency reports either to the CEO of the Ministry of Finance or the Undersecretary. While the structural differences may appear significant, it is not clear that one model is better than the others.

There is no empirical evidence to suggest that one model encourages better monitoring outcomes or performance. While the financial performance of the Samoa and Solomon Islands SOEs is comparatively poor, this is not necessarily because their respective monitoring agencies sit within a ministry. In New Zealand, the monitoring agency used to be a semi-autonomous body that sat within Treasury with the head of the unit reporting to the Secretary of Treasury on operational matters, but directly to the SOE Minister on monitoring matters and board appointments. This has recently been changed and now the monitoring activity has been bought back within a division of Treasury. The rational behind this change is to re-establish ownership monitoring skills within core government, something that had been lost over the preceding few years. The New Zealand structure is now similar to the Samoan and Solomon Islands model, but in New Zealand the monitoring unit still has direct reporting lines to the Minister of SOEs and other responsible ministers. The ability for the head of the monitoring agency to have direct access to the shareholding and responsible ministers is important as it provides the minister with separate and contestable lines of

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45 The Crown Company Monitoring Advisory Unit (CCMAU)
advice relating the ownership interest, which might diver from advice on fiscal impacts and purchase considerations.

**Ministers and ministry chief executives should be encouraged to step down from SOE boards**

The effectiveness and robustness of the SOE monitoring agency must be considered in the context of the overall legal, monitoring and governance arrangements in place within a particular country. The role of the monitoring agency is complicated and often compromised when ministers, ministry chief executives and senior public servants sit on the boards of the SOEs. This is because it is difficult for:

- a public servant to critique the performance of a board or SOE where the chair is a minister or ministry chief executive;
- a responsible minister to hold a board accountable for poor performance if he (or she) is either the chair or the chair is a cabinet colleague;
- a ministry chief executive to put forward a paper to cabinet criticising the performance of a board that is chaired by that chief executive, a minister or chaired by a fellow senior public servant.

The best response to address these problems is to have all ministers, politicians and ministry chief executives step down from SOE boards. If this cannot be achieved immediately, then an interim step would be to establish a separate minister of SOEs, responsible for all SOEs. This minister would not be allowed to sit on any SOE boards and the monitoring agency would report directly to the SOE minister against outputs contained in either a purchase agreement or SCI (as agreed between the minister and the monitoring agency). This would establish a direct reporting line from the monitoring agency to the minister.

Although this arrangement remains less desirable than a situation where there are no ministers on SOE boards, it does at least create a greater degree of accountability for the performance of SOEs at cabinet level. The SOE minister would be held accountable for the performance of all SOEs and, in turn, would hold the chairs of the SOEs accountable for the performance of the SOEs that they chair.

**Developments in Samoa and Tonga**

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46 Chapter III provides further discussion on the significant and irreconcilable conflicts of interest faced by Ministers who serve as both the owner representative and the chair of the SOE.
The Samoan government has embarked upon a legislative reform program to amend all of the entity specific legislation for its SOEs so that they do not contradict the provisions of the SOE Act and Regulations that prohibit—except under very limited circumstances—the appointment of politicians and public servants as SOE directors. The legislative changes are expected to be in place by early 2011.

In Tonga, the 2010 amendment to the SOE Act prohibits the appointment of politicians to SOE boards and limits the power to appoint public servants so that no more than one can be appointed per board and never as chair.

D. The Primary monitoring document

It is beneficial to have both a corporate plan and a SCI: each serves specific functions

While both the Samoan and Fiji legislation prescribes the SCI as the SOEs’ key planning and accountability document, in practice they rely heavily on the corporate plan as their primary means to monitor performance and influence the direction of SOEs. The SCI is seen as the medium-term planning document, while the corporate plan covers the more detailed planning for the next twelve-month period.

In Solomon Islands the SOE Act requires the preparation of an SCI, but only three SOEs have produced one. Business plans are also used as a monitoring tool where they exist, but they are not specifically required under the SOE legislation. The SCI must contain detailed twelve-month plans together with less detailed longer-term plans.

Tonga, in contrast, relies heavily on the SCI. The SCI must contain full budgets and sufficient operational detail to ensure that the monitoring agency can assess the performance of the SOE. The practical difference between the use of a corporate plan or SCI may not be significant. However, to fully match the value of a separate corporate plan, the SCI should include detailed forward-looking operational and Capex plans. In Tonga, the past practice was that the SCI typically contained limited financial information. However in line with recommendations made in Finding Balance 2009, Tonga introduced additional

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47 Ministers can be appointed to a start up SOE on a transitional basis for not more than a twelve-month term.

48 It should be noted that in Fiji, Corporate Plans are called ‘Business Plans’.

49 The 2010 amendment to the SOE Act relabels the SCI as the “business plan” although the contents are largely the same as the previously labelled SCI.
reporting requirements through the 2010 amendment to the SOE Act, which included cash flow projections going out six years together with forward looking balance sheets and profit and loss statements. As a result the Tongan SCI will now be an effective forward-looking monitoring document and combined with the requirement, also introduced in the 2010 amendment, that performance against the SCI must be reported in the annual report and published in local newspapers, the result is a very high level of public transparency and accountability.

**Clear guidance is required on what to include in a corporate plan and SCI**

In all five countries participating in this study, we recommend that the monitoring agency provide clear guidelines to the SOEs regarding what to include in the business plan, corporate plan or SCI as well as when it should be submitted and how it is to be reviewed and approved. Providing training for the SOEs on the development and preparation of the plan would also be good practice. It should be noted that this has already been recognized in Samoa, where the SOEMD provides special training for directors, as well as detailed guidelines, on the preparation of the corporate plan.
III. THE GOVERNANCE FRAMEWORKS OF STATE-OWNED ENTERPRISES

Effective governance frameworks provide guidance for directors and encourage better performance and greater accountability

This chapter evaluates the application of basic governance practices within the five countries that participated in this study. In particular it reviews the effectiveness of SOE boards; as influenced by their composition, independence, provision for the training of members and the processes by which they appoint the company’s chief executive. Whereas the formal legal arrangements for the selection and appointment of directors have been discussed in Chapter I of this report, this chapter focuses on actual governance practices, including matters not necessarily covered by the relevant SOE legislation. The findings of this chapter are based on analyses of detailed responses to questionnaires sent out to the SOE monitoring unit in each country.50

The boards play a crucial role in setting the strategic direction for the SOEs, and have a significant impact on the performance of the SOE. From observation it is noted that different governance practices directly influence performance. Boards comprising appropriately skilled independent directors, operating under an unambiguous commercial mandate while applying proper governance practices results in comparatively better SOE performance. Where SOEs generate consistently poor returns, the boards can and should be held to account. As will be seen, the findings of this report on the governance frameworks in Fiji, Marshall Islands, Samoa, Solomon Islands and Tonga affirm the results of other studies of SOE sectors around the world: strong SOE performance requires not only a competent board of directors, but also one that is free of inappropriate political influence.

A. Key Findings

Fiji should refine its policies regarding monitoring unit staff who act as “observers” on SOE boards

Fiji’s SOEs generally follow good governance practices and there is a regular interface between the board and monitoring agency. However the continued practice of having staff from the Monitoring unit sit as observers on SOE boards is suboptimal. The formal monitoring tools such as the SCI and corporate plan should be sufficient to effectively

50 Questionnaires were sent to the monitoring units in Fiji, Samoa, Solomon Islands and Tonga. A questionnaire was also sent to the Ministry of Finance in the Marshall Islands, but it was never completed. However the authors of this report undertook a mission to the Marshall Islands in June 2010 and were able to obtain information from interviews with public servants and SOE directors and managers.
monitor performance and influence future direction, without requiring the added input of observers. The drawbacks of having public servants sit as observers on SOE boards outweigh the benefits. If observers are judged to be required, they should be appointed on a temporary basis and for a specific purpose. In all other cases, best practice guidelines argue against monitoring unit staff sitting as observers on the boards of SOEs. In the last two years, in response to a shortage of private sector directors, the practice of appointing public servants as directors has developed. While this is comparatively less risky than having public servants serve as observers, it is still not recommended as good practice.

**The lack of an SOE Act and centralised SOE management inhibits good governance practice in the Marshall Islands.**

While the individual Acts establishing the Marshall Islands SOEs contain some basic governance provisions, there is no standardisation of acceptable practice or guidelines to assist boards in undertaking their role in an effective manner. From interviews it appears that governance practices vary between the SOEs and is driven by the views and aspirations of board members rather than by the government as owner.

**The governance framework in Samoa suffers from a lack of implementation**

Samoa has well-documented and detailed processes for the selection and appointment of its SOE directors. There are also provisions regarding how directors are expected to undertake their stewardship role once appointed to the SOE board. However in the past actual governance practice has ignored the legislative requirements. Most alarmingly, contrary to the law and standards of good practice, there are large numbers of ministers and public servants on SOE boards.

It is probable that the most significant factor contributing to the poor financial performance of the Samoan SOE portfolio has been the governance framework within which they operate. We conclude that if Samoa were to follow the requirements of its existing SOE legislation and regulations, the SOE portfolio would show immediate and dramatic performance improvements. The implications of the poor governance practices have now been recognised by the Samoan government, which has taken significant steps to bring practice into line with the legal requirements.

**Solomon Islands legislation provides the platform for effective governance, but much work is required to change past behaviours.**

The new SOE Act and Regulations in Solomon Islands provide an excellent platform for proper governance practices to emerge. While no ministers sit on the SOE boards, politicians are often appointed as directors. In the past, political considerations have driven these appointments. Changing past practices is always difficult, but if this can be achieved
and the governance provisions in the Act and Regulations fully implemented, the performance of the Solomon Islands SOEs will show improvement.

**Tonga has formalized past good governance practices in the new SOE Act**

Despite incomplete legislative provisions dealing with governance; the actual processes and policies implemented by the government and the Ministry of Public Enterprises (MPE) during the last four years have been robust and designed to ensure strong, independent and properly skilled boards. Tonga, through the introduction of the 2010 amendment Act, now has legislation that enshrines those good practices. The MPE has continued to be innovative in relation to adopting new governance practices such as undertaking governance consultations; sharing best practice amongst SOE boards; developing position descriptions for each chair and director; and implementing a director performance assessment system that focuses on developing and training existing SOE directors.

**There are positive developments in the accountability of CEOs**

With regard to chief executive selection, the Tongan legislation provides the most robust guidelines for the selection and appointment of the chief executive, requiring written performance-based employment contracts. In the last two years both Fiji and Samoa have placed all SOE chief executives on written performance-based contracts. Solomon Islands and the Marshall Islands should also consider including explicit incentive structures and consequences for non-performance in chief executive contracts.

### B. Fiji

#### 1. Director Selection Process

**Fiji’s SOE Act should provide for a formal director selection and appointment process**

In Fiji there is no formal director selection and appointment process detailed in the SOE Act. However, Fiji’s MPE has developed a selection and appointment process and affirms that the mandated director selection process is followed for every board appointment. The MPE submits names to the Minister of Public Enterprises to fill potential director positions. The recommendations are based on applicants possessing the skills required by the vacant position. The Minister consults with the responsible minister and the Prime Minister; once they have agreed on a preferred candidate, the Minister of Public Enterprises formally appoints the director to the board.

Typically, directors are appointed for a three-year term; and on average they serve for two terms. In practice, directors and chairs are seldom removed from office for non-performance prior to the expiration of their term. This is not an optimal arrangement: directors should face the consequences of poor performance, which may be further training or removal. The
Ministry of Finance—responsible for monitoring the majority owned SOEs—reviews the SOE directors’ performance on an ongoing basis and has stated that it would be prepared to recommend corrective action be taken when a director is underperforming.

**Fiji’s MPE should ensure the ongoing availability of director training and development**

The MPE believes that the pool of potential directors is insufficient to meet their ongoing needs. The practice of appointing public servants to SOE boards has emerged in the last three years and it has been stated that it is a consequence of increasing reticence by private sector directors to serve on government boards due to possible overseas travel bans. Public servant SOE directors now comprise 24% of all board appointments: from zero in 2008.

Existing directors are seen as having an important role in mentoring new directors and the MPE believes that a reenergised Fiji Institute of Directors would be the most effective means of increasing the size of the director pool.

2. **Directors’ duties**

**Fiji’s SOE Act should provide for the selection and appointment of SOE directors**

Fiji’s SOE Act contains a “principal objective” for its commercial SOEs: to operate as successful businesses. Evidence of the skills and experience to assist the SOE meet this principal objective should therefore drive the selection of all SOE directors. The SOE Act also provides guidance on the role of the board, the Minister’s relationship to the board, and the responsibility of board directors. However, when it comes to the actual processes to be followed in the selection and appointment of directors to SOE boards, the SOE Act is essentially silent. To enhance transparency and accountability, Fiji’s SOE Act should explicitly provide for the process to guide the selection and appointment of SOE directors.

**All types of SOEs should have an audit committee to enhance accountability**

It is commendable that all of the SOEs monitored by the MPE have audit committees; this is an increase from just 30% in 2008.

**The use of monitoring unit staff as “observers” should be discouraged**

The practice of requiring staff from the monitoring unit to sit as observers on SOE boards has both positive and negative consequences. On the positive side, it gives the staff the ability to observe boardroom dynamics first hand, which can assist in the task of evaluating the performance of the board and its directors. It also assists the staff to understand the operational and strategic issues the SOE faces which, in turn, enables them to provide

informed briefings to the minister—especially with regard to the corporate plan and the SCI.\textsuperscript{52}

The negative consequences are that the monitoring unit staff could become “deemed” directors. This means that they may end up carrying the risks and liabilities of a director, without the usual protections available to those formally appointed as directors; protections which include professional indemnity insurance cover. If the “observer” provides a comment during the board meeting or in any way influences decisions that the board makes, then they may be held to account for the outcome of those decisions. And if a board makes a decision that is not subsequently supported by the shareholders or the monitoring unit, the “observer” staff member may be compromised in relation to either that decision, or in his or her ability to subsequently provide free and frank advice to the shareholder (which may be contrary to that decision).

Directors, particularly if they are new and inexperienced, will tend to look to the monitoring unit observer for guidance and direction during the board meeting, especially when dealing with difficult or contentious issues. This has several negative consequences: it can give that observer too much influence over the decisions of the board and direction of the company; weaken the accountability of directors for the decisions the board makes; hinder the growth and development of new directors; and influence the way in which board members perform, which could negate a perceived benefit of “observers” being able to assess director performance.

On balance, the formal monitoring tools such as the SCI and corporate plan, if used to their full extent, are sufficient to enable the monitoring unit to effectively monitor performance and influence future direction. If public servants are required to serve on SOE boards, they should be chosen based on the skills they can bring to the board and appointed on a temporary basis. The appointment of public servants may sometimes be justified: for example, when an SOE is going through privatization or when an SOE has had a history of significant poor performance. If the view is that they should sit in on all board meetings during this transition period, then they should sit as full directors rather than observers to overcome the problems of becoming a “deemed director”. Best practice guidelines would argue against the use of monitoring unit staff as observers on SOE boards.

The MPE argues that the practice of appointing monitoring staff as observers is justified on the basis that the formal monitoring and accountability tools set out in the legislation have not been used or developed to their full potential. In part this is a competency issue: the view

\textsuperscript{52} In Fiji’s Public Enterprise Act 1996, the equivalent document to the SCI is the Statement of Corporate Objectives or SCO.
being that the quality, content and timeliness of the reports are insufficient to provide the
monitoring team with confidence that the board is functioning as it should. Reliance is
therefore placed on the monitoring staff observing and reporting on board decisions and
performance issues by attending the board meetings. For the reasons already stated this is
suboptimal, however, the removal of monitoring staff observers should be undertaken
contemporaneously with addressing the competency issue by providing training to directors
and managers and by strengthening and improving the use of the monitoring and
accountability mechanisms established in the SOE Act.

3. **Appointment of SOE CEOs**

**Fiji makes effective use of performance-based contracts**

All of the Fijian SOE chief executives have written performance-based contracts, some with
a moderate bonus incentive structure of around 20% of base salary. The introduction of a
bonus structure is reasonably recent\(^{53}\) and should have the positive effect of encouraging
improved performance within the SOE portfolio.

B. **Marshall Islands**

1. **Director Selection Process**

**Director selection is controlled by the entity specific legislation**

There is no standardisation in the director section process in the Marshall Islands, with the
sector minister determining the composition of the board of the SOE/s that he or she is
responsible for, sometimes with the approval of Cabinet or the President. In some cases the
legislation setting up the SOE requires that persons holding particular roles or positions must
be appointed, such as the permanent secretary for a ministry. In other cases ministers
individually, or collectively as Cabinet, are free to choose as they see fit, but none of the
legislation reviewed\(^{54}\) provided any guidance on the criteria that should be applied when
selecting candidates or determining the most suitable person to be appointed as a director.
The table below illustrates the divergence in process identified through a review of SOE
specific legislation.

\(^{53}\) Introduced in the last two years.

\(^{54}\) The acts establishing the National Telecommunications Authority; Shipping Corporation; Marshall Islands
Development Bank; Tolobar Copra Processing Authority and the Port Authority were reviewed.
Table 3: Marshall Islands Board composition and appointment process

<table>
<thead>
<tr>
<th>Company</th>
<th>Directors Appointed by:</th>
<th>Number of Directors</th>
<th>SOE establishing legislation requirements for board composition</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Telecommunications Authority (NTA)</td>
<td>Minister of Transport &amp; Communications nominates and President appoints</td>
<td>5 Directors</td>
<td>Minister must be appointed chair</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Must appoint two officials from Ministry of Transport &amp; Communications</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Two members from the private sector</td>
</tr>
<tr>
<td>Marshall Islands Shipping Corporation (MISC)</td>
<td>Act is silent on how appointments are made</td>
<td>5 Directors</td>
<td>One official from Ministry of Finance</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>One official from the Port Authority</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Three members from the private sector</td>
</tr>
<tr>
<td>Marshall Islands Development Bank (MIDB)</td>
<td>Cabinet</td>
<td>5-7 Directors</td>
<td>CEO must be appointed as the managing director</td>
</tr>
<tr>
<td>Tobolar Copra Processing Authority (TOBOLAR)</td>
<td>Cabinet</td>
<td>5 Directors</td>
<td>Board elects chair – silent on other appointments</td>
</tr>
<tr>
<td>Marshall Islands Ports Authority (MIPA)</td>
<td>Cabinet</td>
<td>7 Directors</td>
<td>Cabinet selects chair – silent on other appointments</td>
</tr>
</tbody>
</table>

Not only does the appointment process vary from SOE to SOE; in many cases the board members have to deal with significant conflicts of interest. The case of the National Telecommunications Authority (NTA)—listed in the Table above—illustrates these major governance issues. The minister—who must be appointed as chair—will see the NTA, not as an independent commercial organisation, but as an operational arm of his ministry. The two officials from the ministry—who also must be appointed by law—would find it very difficult to do anything other than support the initiatives the minister as chair wishes to peruse. Certainly it would be difficult for them to vote against a motion from the chair. The two members from the private sector—being in a minority—could find themselves exposed to the dictates of the majority and could thereby carry significant professional if not legal liability if matters take a turn for the worse.
There are more efficient methods to influence behaviour than having ministers chair SOE boards

While the private sector in the Marshall Islands is of the view that the pool of potential private sector directors is quite limited; they are concerned that the government is seeking to maintain control over the SOE boards through appointing politicians and public servants as directors and, as a consequence, it does not make full use of the experienced private sector directors that are available. In the absence of any other means to influence SOE decision making; which would normally be achieved through mechanisms such as SCIs and the other reporting and accountability arrangements, this is understandable, if not misguided, behaviour. Elected members and public servants comprise 51% of all SOE directors and serve as the chair on 10 of the 11 SOE boards. As previously observed, appointing ministers and public servants is a suboptimal governance arrangement, which is precisely why other countries that have established SOEs also develop a specialist SOE Act to introduce governance and accountability frameworks that then allow sector ministers to focus on the development of policy, regulation and purchasing outcomes and leave it up to the shareholding ministers and SOE boards to focus on how the desired outputs can be delivered in the most commercially sustainable manner.

2. Directors’ duties

There is a worrying absence of codified directors duties in the Marshall Islands

As observed in the Legislation chapter of this review there are some limited directors’ duties set out in the Marshall Island’s Business Corporations Act: dealing with such matters as conflicts of interest; indemnification of directors and officers; and the standard of care to be observed by directors and officers. However as none of the Marshall Islands SOEs are registered as companies these duties provide no effective guidance

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Box 4: Director’s Duties normally found in SOE legislation

- The Principal Objective is for the SOE to operate as a successful business.
- Ensure that the SOE conducts its business in accordance with the Principal Objective.
- Must act in good faith in the best interests of the SOE.
- Ensure that the business of the SOE is conducted in a manner that will not cause loss to the SOE’s creditors.
- Not to allow the SOE to incur an obligation that cannot be met in a timely manner.
- To disclose any interest and not to act in a manner that breaches the director’s fiduciary duties to the SOE.
- Ensure proper processes are in place to regulate board functions and to manage the affairs of the SOE.
- Employ a chief executive on a performance based contract with well-documented delegations and to hold the chief executive to account.
- Board is accountable to the shareholding minister for the proper management of the SOE in accordance with the statutory requirements and the SCI.
- Must act consistently with the law and constitution of the SOE.
- Must meet the reporting and accountability requirements as set out in the SOE Act.
- Responsible for the preparation of annual accounts and to have them audited within a reasonable period after the end of the financial year.

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55 From interviews undertaken as part of June 2010 Mission
to the SOE directors. They must go to the legislation under which their SOE has been established and these are only of limited assistance.

The legislation establishing NTA, for example, contains no provisions dealing the duties and obligations of directors: although it does require the SOE to adopt a constitution, it gives no guidance as to what it should contain. While the MISC legislation provides some limited guidance on how boards should manage their meetings and requires the board to prepare a corporate plan and submit it to the sector minister for approval; there are no other provisions dealing with director's duties. The TOBOLAR legislation has a provision dealing with conflicts of interest, but that is the extent of its guidance on director's duties. Text box 4 provides an example of director duties that the government should consider adopting for all of its SOEs. The lack of a proper governance framework in the Marshall Islands is a direct causal factor leading to the poor performance of the SOEs. It is difficult to hold a board accountable for poor performance if there are no clear statements as to what contributes a proper standard of care and what constitutes acceptable performance.

3. Appointment of SOE chief executives

In the SOE specific legislation the appointment process for the chief executive is only referred to where the chief executive is also a board member. There are no other useful guidelines. The practice of appointing a chief executive as a board member, which is often termed a “managing director”, is not recommended as it can undermine the line of accountability between the board and the chief executive. It is more difficult to challenge or discipline the CEO if he or she is also a board member.56

D. Samoa

1. Director Selection Process

**Samoa should enforce its laws regarding the selection and appointment of directors**

In Samoa the SOE Act and accompanying Regulations establish a formal process for the selection and appointment of directors to the boards of the SOEs. In practice it seems that it has seldom been followed. Instead, it appears that the selection and appointment process is closely connected to the election cycle. Cabinet appoints SOE directors for a term of around five years and the term usually coincides with the term of the government: it is usually expected that the directors will remain in office until the end of that parliamentary term. Once appointed, directors are seldom removed from office prior to the expiration of their term: only once in the last five years has a director or chair been dismissed for non-performance.

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56 The recent Tongan Royal Commission into the sinking of the Ferry Ashika is illuminating on this point. The chair of the Tongan SOE that operated the ferry observed in evidence to the Commission that the fact that the CEO was also a director weakened the accountability relationship.
It is common practice in Samoa to appoint ministers and senior public servants to chair SOE boards, or to appoint public servants as directors. For example, out of the 19 SOEs reviewed for this report, ministers and senior public servants chaired 17 boards. Only in two cases were independent non-executive directors appointed as chair. Out of the 176 board positions in the 19 SOEs, politicians and public servants filled 86 of those positions or 48%. The chief executive of the Ministry of Finance sits on 10 SOE boards and chairs 3.

Most professional company directors limit themselves to 5 to 8 boards, and less if they are also chair. Experience has shown—based on the usual time commitment for a chair or director—that it is not possible to be an effective director if your commitment extends to more than five to eight boards concurrently. Therefore to sit on any more than three boards while also being a full-time chief executive would seem to comprise a very high workload: a situation that may be expected to compromise performance, efficiency and functionality.

Samoan ministers and public servants should be prohibited or restricted from serving on commercial SOE boards.

The practice of allowing ministers and public servants to serve on commercial boards is not considered best practice. However, it is important to stress that this is not due to competency concerns; rather it is due to the time commitment necessary to be an effective director and inherent conflict-of-interest issues. More specifically:

- Ministers who are both chairs and responsible ministers violate a basic principle of good governance, namely the separation of the ownership function of the SOE (responsible or shareholding Minister) with the management function (board of directors). A cornerstone of SOE reform is that there should be a clear separation between these roles and the persons who undertake them.

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57 Detailed information was provided on board appointments for the 19 commercial and mutual SOEs.
58 Samoa Post and Samoatel.
59 Multiple directorships are not as common in the private sector. A 2005 review by the Australian Institute of Company Directors showed that 81% of directors in the ASX top 100 companies served on only one board, only 13% served on 2–4 boards, while only 1% held 4 directorships and just 1 director held 5.
• Where a minister is also the chair of an SOE, the appropriate level of transparency and accountability is lacking. The minister’s role is to hold the board to account for how well they steward the public funds invested in the SOE: it is not possible to do this in a transparent manner when the minister is also the chair.

• Senior public servants who serve on the boards of SOEs similarly violate the principle of the purchaser/provider separation, particularly where the public servant has some responsibility in their role as public servants for the area within which the SOE operates.

• Senior public servants are engaged in full-time work and they cannot be expected to apply the time necessary to fully discharge their obligations as a board member (unless that board position is clearly part of the public servant’s job responsibilities as a public servant).  

• Public servants in monitoring units cannot be expected to monitor SOEs effectively if they are reporting to more senior public servants or ministers who also sit on those SOE boards. They cannot be expected to hold to account or recommend disciplinary action against a board or director when that board comprises of ministers and/or senior public servants senior to themselves; their employment as a public servant may be compromised by such an action.

These concerns are well understood in many countries, where neither ministers nor public servants are permitted to sit on SOE boards. And it should be noted that the concerns are starting to be recognized by Pacific island countries: in Fiji, ministers are not permitted to sit on boards; in Tonga, the 2010 amendment to the SOE Act prohibits appointing politicians to SOE boards and in Samoa the government is in the process of drafting legislation to align the individual SOE establishing Acts to the requirements of the Samoan SOE Act, which only allows politicians and public servants to be appointed to SOE boards under exceptional circumstances.

The Solomon Islands SOE Act closely follows the Samoan Act in relation to the appointment of politicians and public servants, but also makes it clear that if appointed they receive no remuneration or other benefits.

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60 Some public servants are expected to sit on industry boards or representative groups or even commercial boards as directors or observers. This would be factored into their normal work commitments and available time constraints.
Independent committee to assist in the appointment of SOE directors

The Samoan government has recently appointed an independent director selection panel, comprising three members from the private sector, to review candidates and to make recommendations to Cabinet. This is a first in the Pacific and it will be interesting to observe how it functions over time. It is important to note that while the independent selection panel makes recommendations, it is still Cabinet that makes the appointment.

The Samoan Institute of Directors (SIOD) is training candidates for membership of SOE boards

One of the reasons cited to justify the continued presence of ministers and public servants on SOE boards is the lack of sufficient private sector directors. The SOEMD, the monitoring agency in Samoa, maintains that there is an adequate pool of potential SOE directors available and that they are comfortable recommending candidates from this pool to the responsible minister. In part, the size of the pool is due to the existence of the Samoan Institute of Directors, which has been in operation for over five years and undertakes regular director training. SOEMD recognizes the importance of ongoing training in the professional development of existing directors and the development of the pool of possible future directors and it sees the Samoan Institute of Directors as the primary medium for such training. It is compulsory for all SOE directors to be members of the Institute and the SOE pays the membership fees on behalf of the individual director/members. In this way the government has effectively externalised ongoing director training and development.

2. Directors’ duties

Directors’ duties are clearly articulated in Samoa, and where practice falls short of requirements, there should be consequences

The Samoan legislation and Regulations dealing with governance matters could be considered “best practice”—or at least very close to best practice. Samoa has well-documented and detailed processes for the selection and appointment of directors for their SOEs. There are also provisions dealing with how directors are expected to undertake their stewardship role once appointed to an SOE board. Not only are there clear provisions in the Act, but Schedule 8 of the Regulations contain a further eight pages of more detailed guidance dealing with such matters as management of the SOE; establishing audit committees; standard of care owed by directors; guidelines on insolvency; reporting obligations; managing conflicts of interest; and use and disclosure of SOE information.

Practice falls well short of the legal requirements, however, and as a consequence financial performance suffers. For example, every decision made by a director must be consistent
with the Principal Objective of the SOE: to operate as a successful business.\textsuperscript{61} It is clear from the poor performance of the Samoan SOEs that directors are almost universally ignoring this principal duty. If it were being followed, Samoan SOEs would be closing down loss making business lines; selling or exiting from non-core activities; and only investing in areas where they could meet the government’s 7% return on equity target.

However in some areas there have been improvements in compliance. It is a requirement that the board of the SOEs establish an Audit Committee.\textsuperscript{62} In 2007 only six SOEs had formal audit committees; that is now up to 15 out of 27\textsuperscript{63}.

3. Appointment of SOE chief executives

\textit{CEOs should not sit on their own board(s)}

In Samoa a high number of chief executives sit on their own boards. In the 19 commercial and mutual SOEs, 16 (or 84\%) have the chief executive sitting on the board. The 8 not-for-profit SOEs have four chief executives sitting as directors. While chief executives sitting on the board is quite common in the United States, it is not considered best practice in many other countries as it is seen to confuse the accountability relationship between the board and management.

\textit{A CEO should be appointed on a performance-based contract with a well-designed bonus component}

Performance measures are vital for ensuring that there are objective grounds upon which performance can be measured. Samoa is making progress in developing written performance based contracts for chief executives. In 2007 46\% of chief executives had written employment contracts; that number is now 100\%, all with performance measures. In 2007 only 15\% of the chief executive contracts that were in place at that time included performance-based measures. This development can perhaps be attributed to the Cabinet decision of April 2009, sponsored by the Prime Minister, which stated that the board and chief executives would be terminated from their respective posts if the SOE failed to meet the 7\% return on equity. While it does not appear that this threat has been actioned, if it has resulted in improved chief executive accountability, then SOE performance should improve over time.

\textsuperscript{61} Section 16 of the Public Bodies (Performance and Accountabilities) Act 2001
\textsuperscript{62} Schedule 8.2.1 and Schedule 8.6 of the Public Bodies (Performance and Accountabilities) Regulations 2002.
\textsuperscript{63} From data provided by SOEMD and Includes PBBs
E. Solomon Islands

1. Director Selection Process

The Solomon Islands SOE Act and Regulations establish a “skills based” director selection process.

The new Solomon Islands SOE Act and Regulation contain a very robust director selection process, which is focused on appointing the most qualified director to any given SOE board. The process commences with the SOE board consulting with the accountable ministers\(^{64}\) on the knowledge, skills and experience currently represented on the board and the knowledge, skills and experience that would be desirable in the new director to be appointed\(^{65}\). There is also an obligation to advertise the vacancy in local newspapers at least two months before a shortlist is prepared and submitted to the accountable ministers for approval. The Solomon Islands SOE law introduces some innovative procedures not seen in other Pacific island countries, such as

1. In preparing the shortlist of recommended candidates, the board must identify the candidate that they consider most suitable for appointment based on the knowledge, skills and experience identified as being most needed on that board. If properly implemented this will create an objective skills based selection process.

2. While ministers can put forward names for appointment, the nominated candidate must be assessed against the identified knowledge, skills and experience gap on that board. This will limit the ability of ministers to promote or seek to appoint political cronies.

3. Following selection, the preferred candidate must be briefed by the chief executive of the SOE and be given copies of the most recent SCI and financial statements. The Ministry of Finance must also brief the preferred candidate on the role, duties and responsibilities of an SOE director.

4. Before being appointed, the preferred candidate must sign a consent to act as a director and also disclose any possible conflicts of interest.

5. A notice of an SOE director’s appointment, reappointment or termination of appointment must be tabled in the National Parliament and published in a local newspaper.

6. Any appointment made outside the proper process will be declared null and void.

\(^{64}\) Defined as the responsible minister and the Minister of Finance.

\(^{65}\) Regulation 4 of the SOE Regulations 2010
The past practice in Solomon Islands appears to have been to use SOE director appoints as a means of securing or repaying political favours. While it is perhaps too early to tell whether the new SOE Act and Regulations will change behaviour it is noted that the recently appointed Minister of Finance has written to all of his Cabinet colleagues alerting them to the need to fully comply with the SOE law on director appointments. The minister has also moved to correct some recent appointments that did not follow the proper codified process.

**Is the Solomon Islands process perfect?**

Unfortunately the answer is no. There are two concerns with the Solomon Islands director selection process.

1. The board has significant influence over the selection process: the board determines the knowledge, skills and experience gap that drives the selection process. While the board must consult with the accountable ministers, it will be important that the board is properly challenged on the skill gap that is identified to ensure they do not seek to appoint their friends or people with whom the board feels comfortable. In other words, it will be important that boards don't become closed “clubs”.

2. In many cases the specific legislation establishing an SOE contains an appointment process that is not consistent with that laid out in the SOE Act. It is not certain that the SOE Act effectively overrides the SOE specific legislation in this regard and that will need to be resolved.

Apart from these two concerns the codification of the director selection and appointment process in Solomon Islands is the most robust of the five countries studied.

2. **Directors’ duties**

*Director’s duties and obligations are well documented in the Solomon Islands legislation.*

The Solomon Islands SOE law and—for the three SOEs that are companies—the Companies Act provide excellent coverage and explanation of the duties and responsibilities that SOE directors owe to the shareholders and to the SOEs. However, due to the relative newness of the Act and Regulations very few directors are actually aware of the duties and obligations for which they are accountable. The monitoring unit is addressing this through an SOE forum—which should meet regularly and involves members of the monitoring unit, directors and senior managers from the SOEs—and also through ongoing training.

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66 The Regulations which contain the detailed director selection provisions became law in April 2010.
While there is also some thought that a directors institute might be established along the lines of the Institute of Directors in Samoa; the Samoan experience shows that in smaller counties these are only feasible if they are either significantly—if not totally—funded by the government. With an increasing focus on corporate governance emerging throughout the Pacific there may be merit in establishing a regional Institute of Directors.

3. **Appointment of SOE chief executives**

While six of the Solomon Islands SOEs have employed their chief executives under a written contract, none have performance measures. It would be hoped that over time all the boards of the SOEs would move to performance based contracts for their chief executives with clear consequences for non-performance.

F. **Tonga**

*The updated Tongan SOE Act has addressed the governance weaknesses identified in Finding Balance 2009*

The governance sections of the Tongan SOE Act prior to the 2010 amendment were far from best practice. However, the actual processes and policies that the government followed were—and continue to be—robust. The 2010 amendment brings legislative provisions in line with practice and provides excellent guidance on who should be appointed as an SOE director and their duties and obligations once appointed. Furthermore, the amendment applies the provisions of the Tongan Companies Act that deal with director’s duties to all SOEs, both company and non-company.

1. **Director Selection Process**

*Tonga deploys an effective director selection process*

While the actual director selection process is not codified as it is in Solomon Islands and Samoa; the MPE in Tonga has developed an effective process, which Cabinet has approved. Advertisements are placed throughout the year for people to submit an expression of interest to become a director of an SOE. Those that respond are added to the pool of potential directors and when a vacancy exists—or the need to increase the number of directors arises—the MPE selects eligible candidates from the existing pool of potential directors. Eligible candidates are those that have previously undertaken director training under the aegis of the MPE or other credible organizations. However, they may also be required to have specific abilities, depending on the skills required for the position. A recommendation on a preferred candidate is made to the Minister of Public Enterprises who, in turn, submits the recommendation to Cabinet and the Privy Council for approval.
The term of appointment for a director is three years but they may be re-appointed for a further term. If a director is not going to be re-appointed, the ministry looks to its database of potential directors for a replacement. An SOE with a pending vacancy may suggest names for the MPE to consider if they have identified a particular need or skill gap on that board. In this way, the MPE ensures that the board has the correct balance of skills and experience to assist the SOE to operate effectively.

In the past directors and chairs, once appointed, were not often removed from office on the grounds of non-performance but this has changed in the last two years. The government has been more willing to change or fine-tune boards where the SOEs were clearly not performing or where there were clear governance issues\(^67\).

The 2010 amendment prohibits the appointment of politicians to SOE boards except in one circumstance; where it is a new SOE and it is thought useful to have a minister serve as a director during the establishment phase. If so appointed, the minister can only serve for twelve months. Public servants can continue to be appointed to SOE boards, but only one public servant can be appointed to any one board and never as chair. It is noted that even prior to the 2010 amendment, Tonga had restructured 10 of the SOE boards: removing all politicians and public servants. By November 2010, the total SOE portfolio comprised 56 directors of which only three were politicians and one was a public servant.

The MPE believes that while there is a pool of possible SOE directors whom they would be comfortable recommending to the minister, this pool is not sufficiently large enough to provide for the full range of skills required for all positions. Additional training continues to be provided to expand the pool of skilled directors by the MPE with Technical Assistance support.

2. Directors’ Duties

*Tonga provides adequate training for directors and the new performance assessment process will enhance ongoing development*

In Tonga, it appears that directors are predominately selected and appointed on the basis of their ability to add value to the board and the SOE. While the SOE Act now provides good guidance for directors in relation to their duties and obligations, it is an ongoing task to continue to educate and train directors on those duties and obligations. Unlike Solomon Islands there is no codified induction process for new directors. While there is an onus on the monitoring unit to provide training for directors and to ensure they are aware of the duties

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\(^{67}\) An example is where the Prime Minister stood himself down from the board of Port Authority Tonga and promoted a restructuring of the board to address governance concerns.
and responsibilities that they operate within, directors also have a responsibility to make themselves aware of what is expected of them.

To assist directors better understand their roles and accountabilities the MPE has developed job descriptions for all SOE directors and chairs that describe the duties set out in the relevant legislation—the Companies Act, the SOE Act and the SOE’s establishing legislation—the role of a director; key competencies; and the fiduciary obligations owed by a director. The MPE has also developed a director performance review process that uses the job description—and the key accountabilities contained therein—as the benchmark against which performance is measured. The process is not intended to be disciplinary: if a director is not performing adequately that should be dealt with immediately. The performance review process is intended to assist in team building—a board is a team—and in ongoing training and development.

3. Appointment of SOE chief executives

*The Tongan use of performance-based contracts represents best practice*

Tonga has adopted good practice in the appointment of chief executives and the establishment of accountability structures between the chief executive and the board through performance-based contracts. The Tongan SOE Act specifically requires that chief executives be employed under a performance-based contract (Section 26). As at November 2010 all of the CEOs have been employed under a performance based contract.
IV. SUMMARY OF RECOMMENDATIONS

Fiji
Fiji’s SOE legislation meets many of the formal requirements for good SOE law but there are several areas that could be improved. Most notably there should be:

• guidelines for directors, especially with regard to duties and obligations
• penalties for non-compliance

Fiji’s Companies Act should be updated to provide additional guidance to board members regarding:

• duty of care
• insolvency

To improve its governance framework, Fiji should:

• provide clear guidance on what to include in a corporate plan
• improve parliamentary oversight by the timely tabling of adequately prepared documents
• provide for a formal director selection and appointment process
• avoid or discourage the use of monitoring unit staff as observers on SOE boards
• ensure the ongoing availability of director training and development
• cease the practice of appointing public servants to SOE boards as soon as practicable
• like the other countries, provide training or development for directors who are underperforming, or if necessary remove them from the board

Marshall Islands
Marshall Islands has no SOE Act and no concept of the ownership interest in SOEs. The government should:

• develop an SOE policy covering such matters as the commercial mandate for SOEs; selection and appointment of directors; director’s duties and obligations; establishment of an owner monitor; appointment of a principal shareholding Minister; requirements for monitoring and reporting; accountability mechanisms, including the publication of performance data for SOEs; prohibiting the appointment of politicians and ministers to SOE boards; and guidelines on the application and approval of CSOs
• agree a timeline to develop and enact an SOE Act
• agree a process to make all SOE establishing legislation subservient to the proposed SOE Act
• appoint a minister responsible to Cabinet and Parliament for the performance of all SOEs
• create an ownership monitor to monitor the performance of all SOEs

To support the measures mentioned above the government should also
• review the practice of appointing SOE chief executives to their own board
• develop a director training program for new and existing directors
• compile a data base of suitably qualified private sector director candidates
• like the other jurisdictions, improve parliamentary oversight by the timely tabling of adequately prepared documents

Samoa
Samoa has a comprehensive SOE legal framework but suffers from a lack of implementation. More specifically, Samoa needs to implement the following provisions:

• penalties for breaching the key requirements of (i) operating as a successful business and (ii) meeting the CSO guidelines
• the general prohibition against public servants and ministers being appointed SOE board members
• enforce the requirement that every SOE operate as a “successful business” whereby loss-making business lines are closed, non-core assets are disposed of and there are clear consequences for the board and management of SOEs that persistently fail to meet this requirement

Samoa is encouraged to complete the process to ensure that all SOE establishing legislation is subservient to the SOE Act in terms of director selection and appointment processes, as quickly as possible.

In terms of the provisions in the Companies Act 2001 and the 2006 Amendment, Samoa should enforce the provisions regarding:

• directors’ duties and liabilities
• reporting requirements
• SOE insolvency

In terms of SOE governance, Samoa needs to:

• authorise the independent monitoring unit to report directly to the shareholding ministers
• like the other jurisdictions, improve parliamentary oversight by the timely tabling of adequately prepared documents
• prohibit chief executives from sitting on their own board(s)
• appoint all chief executives on a performance-based contract with a well-designed bonus component to encourage productivity
• provide training or development for directors who are underperforming, or if necessary remove them from the board

Solomon Islands
Solomon Islands SOE law is relatively new so the focus should be on implementing the excellent provisions if the government wants to reverse the current poor performance of the SOE portfolio. In particular, it is recommended that the government:

• undertake workshops to familiarise SOE directors and senior managers with the SOE Act and Regulations
• ensure all board appointments are made in accordance with the process set out in the SOE Act and Regulations
• require the SOEs to improve financial management and record keeping
• ensure all SOEs prepare an SCI
• fully implement the provisions of the SOE Act and Regulations

The government is also encouraged to

• restructure ICSI so that the SOEs owed by ICSI are transferred to direct ownership of the government and ICSI’s reporting and accountability arrangements are strengthened
• explore the options of establishing an Institute of Directors or link into a Regional Institute
• develop a data base of suitably qualified persons who could act as SOE directors
• like the other jurisdictions, improve parliamentary oversight by the timely tabling of adequately prepared documents

Tonga
Tonga has adopted many of the recommendations from Finding Balance 2009, which are now incorporated in the 2010 SOE amendment Act. Tonga should focus SOE reform in the following areas:

• rationalize and/or privatize the SOEs that are competing with and crowding out the private sector
• introduce an induction process for all new SOE directors
• restructure those SOEs that have both operational and regulatory functions, such as Tonga Water Board, so that there is clear governance and, if possible, legal separation between the two functions

• in the case of the monopoly infrastructure SOEs, look for opportunities to contract out services to the private sector

• fully implement the provisions of the 2010 amendments to the SOE Act

• establish the SOE holding company structure as provided for in the 2010 amendment

• like the other jurisdictions, improve parliamentary oversight by the timely tabling of adequately prepared documents

Tonga’s governance framework is basically sound but it should:

• like the other jurisdictions, provide clear guidance on what to include in a corporate plan

• formalize existing practices regarding the selection and appointment of directors

• fully implement the new director performance appraisal process

• develop robust and SMART\(^\text{68}\) non-financial performance indicators for use in the SCIs

\(^{68}\) S = specific; M = meaningful and measurable; A = achievable; R = relevant; T = time bound.
## Appendix 1: Contents of SOE Legislation

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Appendix 2: Analysis of SOE legislation against key requirements

Fiji
Public Enterprise Act 1996

1. How are SOEs established? This is thoroughly covered in the legislation.

2. Principal Objectives. The Fijian Act clearly defines the principal objective of every Government Commercial Company “GCC” is to “operate as a successful business and, to this end, to be as profitable and efficient as comparable businesses which are not State owned” (Section 43). This wording is very similar to the New Zealand Act on which it is based. The definition is further expanded in Section 43(2) by stating that this principal objective is to be achieved through the application of the key principles of public enterprise reform as set out in Schedule 1 of the Act, which provides additional practical guidance for the benefit of all involved in SOE reform and management.

The Act does not provide a definition of the principal objective for Commercial Statutory Authorities “CSAs”. It would seem that the primary purpose behind establishing an entity as a CSA is to require it to meet the accountability provisions of the Act, such as the requirement to prepare a corporate plan and SCI, rather than to generate a profit.

3. Appointment process for directors. The Act provides the basic powers for the Minister to appoint and reappoint members to the board, although it is silent on term of appointment and also the factors the Minister should take into consideration when making an appointment. The legislation would be strengthened, for example, if it stated that board members would be selected on the basis that they would assist the SOE achieve its principal objective.

The Act is also silent on the appointment of elected members (Ministers) and public servants to the boards of the SOEs. The practice in Fiji has been that Ministers and public servants are not appointed to the boards, however in the last two years public servants have increasingly been appointed as directors due to the difficulty of recruiting private sector applicants. Public servants also sit as observers and this can create potential conflicts of interest. While the Act does not specifically provide for the appointment of observers, it is clear that a number of the provisions dealing with the power to direct and gain access to information could be seen as authorising this practice. It is recommended that the Act be amended to specifically prohibit the appointment of Ministers and public servants to the boards of SOEs as directors or observers.

4. Removal of directors. The Act (Section 56) gives the Minister the power to remove directors, but is silent on the grounds for removal.

5. Roles and responsibilities of directors. Section 57 of the Act lists five “roles” for the boards of GCCs, which are;
   a. Responsibility for the GCCs commercial policy and direction
   b. Appointment of the Chief Executive

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69 This Appendix uses the generic term of State Owned Enterprises (SOEs), but the legislation in each country uses different terminology. In Fiji the commercial SOEs are called Government Commercial Companies, the not for profit SOEs are termed Commercial Statutory Authorities; in Samoa they are Public Trading Bodies and Public Beneficial Bodies respectively; in the Solomon Islands they are termed State Owned Enterprises; and in Tonga Public Enterprises. The proper title will only be used where it is necessary to differentiate between the commercial and not for profit SOEs in Fiji and Samoa.

70 Unless otherwise stated, a reference to a section will be to a section in the relevant country’s SOE Act and a reference to “the Act” will be to that country’s SOE Act.
c. Ensure that the GCC achieves its principal objective

d. Ensure that the GCC acts in accordance with its Corporate Plan and carries out the objectives in its Statement of Corporate Intent (SCI)

e. Account to the Minister of Public Enterprises and the relevant Minister for the GCCs performance as required by the Act and other laws as applicable

f. Ensure that the GCC otherwise performs its functions in a proper, effective and efficient way.

The Act also requires that the Board keep the Minister informed of the operations, financial performance and financial position of the SOE and its subsidiaries. The Board must also proactively inform the Minister if they believe that the SOE may not be able to meet the targets set out in the Corporate Plan or SCI (Section 105). The duties as listed above are further expanded in Schedule 1 of the Act, which sets out the key principles of Public Enterprise reform.

The Act also makes it clear that GCCs are subject to the Companies Act, unless the Companies Act is inconsistent with the provisions of the SOE Act. This means that the duties of directors as set out in the Companies Act also apply to directors of GCCs, however the Fijian Companies Act appears to be based on the old New Zealand 1955 Act and as such the additional duties imposed by that Act are quite limited. There is a provision dealing with conflicts of interest (Section 201 of the Companies Act), but no general duty of care or solvency test.

CSAs are not companies and as such are not subject to the Companies Act. That means there are significant gaps in the SOE Act in relation to director's duties and obligations for CSAs unless they are covered in the individual CSA's establishing legislation.

6. Managing conflicts of interest. The Act is silent on managing conflicts of interest, although it is noted that for those SOEs that are companies, the Companies Act does contain provisions dealing with conflicts of interest (Sections 201). However it would appear that there are no statutory rules and guidelines for non-company SOEs.

7. Appointment of CEO. This is really only covered in a transition sense (covering the first establishment of an SOE) and includes a requirement that the position be advertised.

8. Roles and responsibilities of the Responsible Minister. The Fijian Act establishes the role of the Minister of Public Enterprises who has the primary accountability and powers under the Act. The other Minister established in the legislation is the "relevant Minister" who is nominated by the Prime Minister. The relevant Minister is effectively the Minister of the line Ministry or Ministry for the sector within which the SOE operates The Minister of Public Enterprises is required to consult with the relevant Minister in most instances where the Minister of Public Enterprises is exercising his powers under the Act. For example, payment of dividends; acquisition or disposal of shares; appointment of directors; giving a direction to a GCC; declaring a CSA; approving the Corporate Plan; and approving the SCI. In many cases the Minister of Finance must also be consulted at the same time as the relevant Minister. The board is also under an obligation to keep the relevant Minister informed (Section105) on matters that they must disclose to the Minister of Public Enterprises.

The Act therefore clearly establishes the role and responsibilities of the Responsible Minister.

9. Roles and responsibilities of the Shareholding Minister. There is no concept of a Shareholding Minister in the Fijian Act. The Minister of Public Enterprises and the Minister of Finance nominate the persons who hold the shares in the SOEs (Section
62), who are office holders rather than individuals. Those office holders (for example one must be the Chief Executive of the Ministry of Public Enterprises) then hold those shares on behalf of the State and must (i) consult with the Minister who appointed him or her before exercising any right as shareholder and (ii) act in accordance with any direction in writing given to him or her by the that Minister (Section 66). It is not clear why the Act is structured on the basis of the shares being held by nominee permanent secretaries\(^71\) rather than by Ministers. It seems to add an unnecessary additional layer, but as there appears to be no adverse impact on effective governance of the SOEs it would seem to be a sound alternative model.

10. **Requirements dealing with the content and approval of;**

   a. **Business or Corporate Plan.** Both GCCs and CSAs are required to prepare Corporate Plans. The Act is very clear on the need to produce Corporate Plans and the process that the SOEs need to go through to have the Plan approved. The Act provides high-level guidance on the content of the Plan (Section 89 (3)) and provides for the Minister of Public Enterprises to issue guidelines on the format of the Plan (Section 89 (1)). The Plan covers the immediate next twelve months and the two years thereafter. The Minister cannot direct the content of the Plan, but it is noted that Section 58 gives the Minister the power to give directions to a GCC in the public interest. This is a general power, not specific to the Corporate Plan, but could enable the Minister to direct a GCC to include or exclude something from the Corporate Plan, if it were in the Public Interest. There is no similar provision for CSAs. The Corporate plan must be consistent with the Statement of Corporate Intent (SCI). Generally, subject to the observations in (b) following, the provisions dealing with the Corporate Plan provide the correct balance between the role of Directors and the role of Ministers as the “owner” representatives.

   b. **Statement of Corporate Intent.** The Act covers all of the basic requirements for the preparation of an SCI. The SCI however covers only a twelve-month period and as such is a subset of the Corporate plan which covers three financial years. Some matters of note are that;

      i. The Minister can direct changes in the SCI (Section 98). The Minister can also direct changes or modifications during the term of the SCI (Section 99). By implication therefore the Minister can, through the SCI, influence and possibly direct the content of the Business Plan.

      ii. The Board can request changes to the SCI at any time, but must provide the minister with written notice of the proposed changes and after consultation with the relevant Minister the Minister of Public Enterprises must approve or otherwise the proposed changes.

      iii. Both GCCs and CSAs are subject to the provisions dealing with SCIs

The provisions dealing with who ultimately controls the content of the Corporate Plan and SCI is a fine balancing point. Does the Minister have too much control and hence risk politicising the SOEs decision-making process, or does the board have too much discretion thereby lessening the legitimate “ownership” oversight? In the case of the Fijian Act, the balance is about right for CSAs, but too far in favour of the Minister’s powers for GCCs. As the GCCs are registered Companies, the Minister should be more reliant on the powers he has as owner to influence the direction of the SOE, rather than

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\(^71\) Section 63 requires that the nominees be Permanent Secretaries or Supervising Officers.
being able to direct through the SCI (Section 98) and hence influence the Corporate Plan. A better balance of power would be to require the Minister to exercise his rights as shareholder to influence the content of the SCI, if that is thought necessary. This has been the approach adopted in New Zealand for SOEs and has worked effectively for over twenty years. However for non-company corporate entities, which are covered in the New Zealand Crown Entities Act, the Responsible Minister does have the power to direct. For company SOEs, a ministerial power to direct could mean that the Minister becomes a “deemed director”.

c. Annual Report. The provisions covering the Annual Report are adequate and set out clearly what is required to be included in the Annual Report and when it must be made available. A important requirement contained in the Fijian Act is that the Annual Report must contain such information as is necessary to enable an informed assessment of the operations of the SOE including the comparison between actual performance and the planned performance contained in the SCI (Section 103(2)). A similar provision can be found in the Tongan and Solomon Island SOE Acts; but it is absent from the Samoan legislation. One area of weakness in the Fijian Act is Section 104, which allows the SOE to request information to be deleted from the Annual Report if it is considered to be too commercially sensitive. It is hard to identify any matter that would be legitimately included in an Annual Report but would then be considered as too commercially sensitive. Private sector companies engaged in completion face this reality for every Annual Report produced. In fact as SOEs are often monopolies, and deal with public money, there is an argument that the level of disclosure should be higher than private sector companies.

For GCCs, the Annual Reports must also comply with the Companies Act.

d. Audit Requirements. These are adequately set out in Section 100 of the Act. The Minister of Finance has the power to appoint the Auditor, who more often than not is the Auditor General. If the Minister of Finance does not appoint the Auditor, or give a direction to the board as to whom they must appoint, the board is authorised to appoint the Auditor of their choice (Section 100(3)(b)).

e. Performance Audit. The Act empowers the Minister of Public Enterprises and the Relevant Minister to instigate an investigation and report on any matter relating to the SOE or a subsidiary thereof (Section 109). The powers of investigation are quite wide and the Minister can direct the SOE to provide “any information” about the SOE and provide access to specified records. The Minister can take whatever steps considered necessary or desirable for the investigation.

11. Reporting requirements to Parliament. The Act sets out clear reporting requirements for the Annual Report and SCI. Both must be tabled in Parliament and any modification to the SCI that occurs during the year must also be tabled (Section 106). The Act goes on to require that any regulations made that have the effect of making the SOEs subject to other laws, and the reasons for the regulations, must also be tabled in Parliament (Section 109(3)(a)).

12. CSO defined. The Act clearly defines CSOs and defines them as “non-commercial obligations”; however the provisions dealing with CSOs only relate to GCCs.

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72 It is also the approach followed in the SOE legislation in Tonga.
73 Section 103 and 147 New Zealand Crown Entities Act 2004
74 Section 109 of the Act provides that the Ministers can delegate their powers to investigate to the Permanent Secretary or Supervising Officer of a Department.
Presumably this is because the Government is of the view that, as CSAs are not required to operate as successful businesses, they suffer no opportunity cost if they undertake CSOs on other than a fully funded basis. Two useful requirements in the Fijian legislation dealing with CSOs are:

a. The costing, funding and other arrangements to make adjustments relating to the CSO must be identified in the SCI (Section 69 and 95), and

b. As the performance measures in the SCI must be reported upon as part of the Annual Accounts: a thorough reporting should also include performance measures relating to the delivery of the CSO.

The Fijian legislation also gives good guidance on the price the Government should pay the SOE for the delivery of the CSO if agreement cannot be reached on the calculation and payment of the cost (section 71).
Samoa

Public Bodies (Performance and Accountability) Act 2001; Public Bodies (Performance and Accountabilities) Regulations 2002

1. How SOEs are established. This is adequately covered.

2. Principal objective of the SOE. The wording of the Samoan Act, which is set out in Section 8, is very similar to the New Zealand and Fijian Acts. All of the three Acts, subject to minor wording differences, state that the “principal objective of every Public Trading Body (PTB) shall be to operate as a successful business and, to this end, to be as profitable and efficient as comparable businesses that are not owned by the State”. The Samoan legislation also adds further qualifications that require PTB to “meet any commercial services obligations established under the Act” and “comply with the provision of the Labour and Employment Act 1972”, and “exhibit a sense of social responsibility”. The important point to make at this stage is that all of the requirements established under the “principle objective” definition are reasonably quantifiable and set clear commercial imperatives that are measurable.

The Act also defines the principal objective of Public Beneficial Bodies (PBBs) in Section 14, which states that they must “provide excellent service to its users and (a) meet the purposes and objectives of its governing legislation; and (b) operate in an efficient and effective manner as comparable organizations that are not owned by the State; and (c) act as a good employer; and (d) be an organization that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates.

3. Appointment process for directors. The Act requires that every director be appointed or reappointed in accordance with the procedures set out in Schedule 3 of the Public Bodies (Performance and Accountability) Regulations 2002 (the Regulations). Schedule 3 contains quite detailed provisions dealing with the appointment of directors, the highlights being;

   a. The person appointed must be someone who, in the opinion of the Committee appointing the director, can assist the PTB achieve its objectives.\(^{75}\)

   b. No Member of Parliament, public servant or Constitutional Officer shall be appointed unless Cabinet has certified that such appointment or reappointment is necessary and (i) is in the national interest, and (ii) the qualifications or business experience cannot be found elsewhere.

   c. If a Member of Parliament, public servant or Constitutional Officer is appointed under the preceding exceptions, then the Regulations clearly state that they “shall not receive remuneration or other benefits from the PTB for services as a director”.

   d. The Regulations set out the terms and conditions upon which a director can be removed from office.

   e. Schedule 4 of the Regulations establishes the requirement that directors sign a declaration of pecuniary interests and convictions. This supports the legislative requirement established in Section 20 of the Act.

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\(^{75}\) This can be compared to the New Zealand provision that states, “the directors of a SOE shall be persons who, in the opinion of those appointing them, will assist the SOE to achieve its principal objective.”
4. **Removal of Directors.** Both the Act and the Regulations establish clear grounds for the removal of directors for non-performance or for breach of their duties.

5. **Roles and responsibilities of Directors.** It is important that the SOE Act provide a clear statement of the roles and responsibilities of directors that are specific to boards that govern entities owned by the state. These should be additional to the general responsibilities established under the Companies Act. In the case of the Samoan legislation these additional requirements are very clearly spelt out and they include:

   a. Schedule 8 of the Regulations set out explicit requirements of directors including achieving the principal objective; establishing audit committees; the standard of care required; requirements in terms of insolvency; obligation to report breaches of the SOE Act, Companies Act or the Public Finance Management Act; how interested directors must behave; and how directors use and disclose information received from the PTB.

   b. Section 17 of the Act makes it clear that every decision by each director, and each board of directors of a PTB, shall be made solely in compliance with the provisions of the Companies Act 2001 and in accordance with Section 8 of the SOE Act, which is the provisions that establishes the requirement that a PTB operate as a successful business.

   c. To reinforce the requirements set out above, Section 17 (2) states that any director who knowingly makes a decision inconsistent with the Companies Act and SOE Act shall be liable for a fine of up to 100 penalty units.

   d. The roles of PBB directors are set out in Section 18, which links the obligations back to the principal objective of PBBs (section 14) and those provisions in Schedule 8 of the Regulations that relate to PBBs.

Section 6 (7) clearly states that the Board of the PTB shall be accountable to the Shareholding Ministers.

6. **Managing conflicts of interest.** As noted above, Section 20 of the Act requires every director of an SOE upon appointment to provide a declaration of pecuniary interest and convictions and then annually thereafter. Furthermore, Section 21 specifically deals with conflicts of interest and establishes a penalty of 100 penalty units for any director who attempts to take part in a decision where the person has a pecuniary or other interest which conflicts with the interests of the SOE.

7. **Appointment of CEO.** The Samoan legislation does not deal with the appointment of the CEO. An example of a “good practice” provision dealing with the appointment of the CEO can be found in the Tongan SOE Act which covers the basic requirements of appointment, such as (i) there must be a written contract dealing with performance expectations, performance reviews and a job description (ii) delegations to the CEO are established and (iii) the CEO is empowered to employ staff.

8. **Role and responsibilities of the Responsible Minister.** The Responsible Minister is defined in Section 2 and then the duties and obligations are set out in various parts of the Act, including Sections 6, 9 - 13 (dealing with CSOs) and also in the Regulations.

9. **Role and responsibilities of the Shareholding Minister(s).** The Samoan Act defines the Shareholding Minister/s in Section 2 and then throughout the Act identifies the roles and obligations in a clear manner and establishes a good separation between

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76 Penalty units are not defined in the October 2007 reprint of the Act, but in prior editions of the Act the fine was WST 10,000.
“ownership” interest and stewardship of the SOE, which is clearly the responsibility of the board. The Act also contains penalties and consequences for shareholding Ministers (shareholding Minister and responsible Minister) who fail to meet certain duties and responsibilities. For example, failure to follow the guidelines in establishing a CSO renders the decision and consequential funding approval “null and void”. Furthermore, if a Minister (or anyone for that matter) tries to direct or attempt to direct a director to perform a CSO other than in accordance with the Act, that Minister or person is liable to a fine or up to 100 penalty units.77

10. Requirements dealing with the content and approval of;

a. Business or Corporate plans. The Corporate Plan is the primary planning document for Samoan SOEs and hence the primary “relationship” document as between the owner (shareholding Ministers) and the board. The procedural requirements are contained in Section 22 of the Act and then the Regulations set out in broad terms what the Plan must cover. The Regulations also, importantly, provide for the Treasury (Ministry of Finance) to establish detailed guidelines on content and process. The Ministry of Finance has published very thorough guidelines that are made available to all SOEs, which also cover reporting requirements against the plan. These guidelines are supported by training sessions on Corporate Plans, which are held bi-annually and run by members of the SOE Monitoring Division (SOEMD)78. The training is targeted at senior managers within the SOEs that are responsible for the preparation of the Plans. The key requirements of the Corporate plan are:

i. That the plan covers in detail the next twelve month period and then the two years thereafter,

ii. The board and the shareholding Ministers must agree the content of the Plan. If they cannot agree then it is referred to Cabinet who can then direct the board to make modifications to the plan (Schedule 5.4),

iii. The plan is only effective if there is agreement on the content of the plan, or the plan has been changed to reflect the directions of cabinet,

iv. Every SOE must comply with the approved plan

v. The provisions dealing with the plan and Statement of Corporate Objectives apply to both PTBs and PBBs.

b. Statement of Corporate Intent. Consistent with the Corporate Plan being the primary planning document, the Statement of Corporate Intent, or in Samoa it is labelled the Statement of Corporate Objectives (SCO) is purely a summary document rather than a primary accountability document and summarises the key points in the Plan. However it is the SCO that is tabled in Parliament and as such becomes a key-reporting document. To make this an effective reporting document the SCO should contain sufficient financial and non-financial performance indicators so that Parliament can gauge the performance of the SOE against the approved Corporate Plan. It is not clear that this happens.

c. Annual Reports. The detail on what is required to be included in the Annual Report and timing is adequately set out in the Regulations (Schedule 6). Two

77 See note (3) above
78 The SOEMD is located within the Ministry of Finance
useful provisions are that (a) the Ministry of Finance can ask for additional information and (b) there is a pro-active requirement that the boards keep the Ministry informed on any matters that may adversely affect the achievement of the objectives in the Plan or SCO. The audited Annual Reports must be tabled in Parliament (Schedule 6.7).

d. Audit requirements. The Controller and Chief Auditor is the auditor for the SOEs (Section 27) but the actual audit can be contracted out, which does happen in some cases.

e. Performance Audit. The Samoan legislation empowers the shareholding Minister or the “Financial Secretary” to undertake a performance audit of any SOE whenever they consider it appropriate. The grounds for the performance review are not specified in the Act (Section 24) and the powers of investigation are very wide. Bearing in mind the identified poor performance of the Samoan SOEs it is perhaps surprising that this provision has not been used more extensively. There has never been a performance audit instigated under Section 24.

11. Reporting requirements to parliament. The Samoan Act requires that both the audited Annual Accounts and the SCO be tabled in Parliament. It is not clear however whether Parliament is given sufficient time to question and debate the reports and assess performance of the SOEs. The effectiveness of Parliamentary oversight is also adversely impacted if there is any delay in competing the audit (hence a delay in tabling the report), which is often the case in Samoa.

12. CSO defined. The Samoan legislation clearly defines what a CSO is and also the process by which they can be approved and funded. The role of the Responsible Minister is also clearly described in the legislation. As noted above (under roles of the Responsible Minister) there are penalties that can be levied against the Minister, board and indeed any party who induces the SOE to undertake a CSO outside of the authorisation process mandated in the legislation. When this is combined with the principal objective to operate as a successful business (Section 8) and the penalties that arise if decisions are made inconsistent with that objective (Section 17), then it is most surprising that any CSO is undertaken that is not approved under the process set out in the Act. To provide further guidance to decision makers and those that might apply for CSO funding, the Regulations contain a detailed step-by-step process. These more detailed guidelines where recently reviewed and updated by Cabinet, which had the effect of making the criteria for approving CSOs even clearer and tighter.

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79 The Financial Secretary is not defined in the legislation but it is interpreted to be the CEO of the Ministry of Finance.
80 The SOEMD drafted updated guidelines that were submitted to Cabinet in June 2007 and approved in that year.
Solomon Islands

State Owned Enterprise Act 2007; State Owned Enterprise Regulations 2010

1. **How SOEs are established.** This is adequately covered.

2. **Principal objective of the SOE.** The wording of the Solomon Island Act is based very heavily on the Samoan legislation in many respects and this is also the case for the definition of the principal objective, which is set out in Section 5 of the Solomon Islands SOE Act. An SOE must operate as a successful business, which is defined as being as profitable and efficient as comparable businesses that are not state owned. An SOE, in meeting this objective, must also be a good employer (as defined in Section 5 (2)) and also an organisation that exhibits social responsibility by having regard to the interests of the community in which it operates.

The Solomon Island legislation does not distinguish between commercial and non-commercial SOEs, but rather between commercial and regulatory SOEs. This distinction is made in Section 26, which clearly states that all SOEs that provide services must act in accordance with the principal objective, but subsection 5 seems to imply that those SOEs undertaking a Regulatory Function need not meet the principle objective requirement. This would seem logical. A regulator should not be driven by a profit-maximizing motive. However the wording in Section 26 is not clear and appears to be overridden by other provisions in the Act. It is recommended that the government review Section 26 and how it impacts upon and is impacted by other provisions within the SOE Act to ensure that it is achieving what the policy makers sought to achieve.

3. **Appointment process for directors.** The Act requires that every director be appointed or reappointed in accordance with the procedures set out in State Owned Enterprise Regulations 2002 (the Regulations). Section 6 of the Act and Part 2 of the Regulations provide detailed provisions dealing with the appointment of directors. The process introduces some new concepts: not seen in other Pacific SOE legislation. The selection process is driven by a skills based assessment. Persons appointed to the SOE boards must be people who demonstrate “the knowledge, skills and experience most appropriate to contribute to the functions of the board”\(^{81}\). It is the board’s role, after consultation with the Accountable Ministers, to identify the knowledge, skills and experience required and to assess candidates against those attributes. While Accountable Ministers can recommend candidates, they cannot direct that a different set of knowledge, skill and experience attributes drive the selection process and as such the process has substantially reduced the potential for political manipulation of the director selection process. Other highlights include;

a. The person appointed must be someone who, in the opinion of those appointing the director, will assist the SOE achieve its principal objective (Section 6).

b. If a Member of Parliament, public servant or constitutional officer is recommended for appointment, those recommending must certify that the appointment is in the national interests; and the person has particular qualifications or business experience which the SOE requires on its board and such qualifications or business experience cannot be found elsewhere in the Solomon Islands.

\(^{81}\) Regulation 7
c. If any of the parties mentioned in (b) above are appointed, then the Regulations clearly state that they “shall not receive remuneration or other benefits from the SOE for services as a director”.

d. The Regulations set out the terms and conditions upon which a director can be removed from office.

e. Regulation 11 requires that director candidates sign a consent to act; a confirmation that they are not precluded from acting; and a declaration of interests prior to being appointed.

f. Director vacancies must be advertised in local newspapers at least two months prior to preparing a shortlist and the list of persons appointed or reappointed must also be published in local newspapers (Section 17 and 18).

g. Any appointment that is made outside of the process prescribed in the Regulations shall be “null and void” (Section 6).

h. A further very useful innovation in the Solomon Islands SOE Act, is the requirement for the SOE chief executive to provide the selected director candidate with a briefing on the operations of the SOE, including the most recent SCO, annual report and financial statements. This is supported by the requirement that the Ministry of Finance provide the selected candidate with a briefing on the role, duties and responsibilities of an SOE director. These requirements are set out in Regulation 10


5. Roles and responsibilities of Directors. Importantly the Solomon Islands legislation states that “all decisions relating to the operation of a SOE shall be made by or pursuant to the authority of the board in accordance with the statement of corporate objective (SCO)\textsuperscript{82}, which clearly establishes the SCO as the primary accountability document. Furthermore the Act goes onto to state that “a director must act in good faith and in what the director believes is in the best interests of the SOE\textsuperscript{83}. Directors must also act in accordance with Regulations made under the Act. If any director fails to meet these obligations they will be liable to a fine of SBD100,000. Other important provisions include;

a. A director must exercise the power of a director for a proper purpose (Regulation 18).

b. A director must not agree to any decision that (a) contravenes the Act; (b) where the SOE is a company, contravenes the Companies Act; (c) where the SOE is a statutory authority, the authority’s establishing legislation; and (d) the rules of the SOE (Regulation 19).

c. There are useful provisions dealing with proper decision making, such as a prohibition on trading in a reckless manner (Regulation 21) and a requirement that a director must be satisfied that the SOE can meet an obligation before that obligation can be incurred (Regulation 22).

\textsuperscript{82} Section 6(4)
\textsuperscript{83} Section 6 (5)
d. There are extensive provisions dealing with managing conflicts of interests, the need to declare all pecuniary interest and to have them recorded on an interests register (Regulations 25 to 28).

e. SOE boards are accountable to the Accountable Ministers through the SCO and the rules of the SOE.

6. Managing conflicts of interest. As noted above, the Regulations provide detailed guidelines on how directors must disclose and manage conflicts of interest. Regulation 26 requires an interest register to be established and Regulation 28 provides useful guidelines on how a director who has an interest should behave. A director with an interest must not vote on the matter he/she is interested in, nor do any other thing in his or her capacity as a director relating to the transaction in which the interest arises.

7. Appointment of CEO. The Solomon Island Act does not deal with the appointment of the CEO.

8. Role and responsibilities of the Responsible Minister. The Responsible Minister is defined in Section 2 as the “Minister responsible for that SOE”. The Solomon Islands Act then introduces the concept of “Accountable Ministers”, which are also defined in Section 2 and include the Responsible Minister and the Minister of Finance. There is therefore no SOE minister responsible for the entire SOE portfolio, but rather sector or line Ministers are responsible for individual SOEs with the Minister of Finance having an overview role as one of the two Accountable Ministers.

9. Role and responsibilities of the Shareholding Minister(s). As mentioned above the Solomon Island Act uses the term “Accountable Ministers”, which in other jurisdictions might more normally be described as the shareholding ministers. The role and responsibilities of the Accountable Ministers are well defined and include:

   a. Accountable Ministers are responsible to Parliament for the performance of the functions given to them by the SOE Act or the rules of the SOE.

   b. The Accountable Ministers hold the shares in the SOE in equal proportions to each other.

   c. Accountable Ministers consult with the board on the content of the SCO and may give a written notice directing the board to include or omit certain statements or information from the SCO. This power probably allows the Accountable Ministers to direct an SOE to undertake a task or activity that the board would not otherwise have undertaken had it not been directed to do so by the Ministers. This conclusion is reached as one of the matters covered by this power to direct is the “nature and scope of the activities to be undertaken” by the SOE (Section 12). If this conclusion is correct then it would have the effect of undermining the independence of the board and would not be considered good governance practice.

   d. The selection, appointment and removal of directors must be in accordance with the Act and Regulations.

10. Requirements dealing with the content and approval of;
a. **Business or Corporate plans.** The Solomon Island Act is silent on the need to develop a business or corporate plan.

b. **Statement of Corporate Intent.** The Statement of Corporate Intent, or in Solomon Islands it is labelled the Statement of Corporate Objectives (SCO) is the primary accountability document. The content of the SCO is fully described in Section 13 of the Act and the approval process and power to direct is set out in Section 12. The required content of the SCO contains comparable provisions to the Samoa, New Zealand and Tongan legislation and covers a three-year planning period.

c. **Annual Reports.** The detail on what is required to be included in the Annual Report and timing is adequately set out in Section 14 of the Act. The Annual Report must contain sufficient information to enable an informed assessment of the operations of the SOE and each of its subsidiaries; including a comparison of the performance of the SOE against the targets in the SCO.

d. **The half-year report.** The Act also requires a half-year report to be completed, which must also contain information relating to SCO targets. Any half-year or Annual Report must fully disclose any government assistance provided to the SOE.

e. **Audit requirements.** The Auditor General is the auditor for the SOEs (Section 20) but the actual audit can be contracted out provided the Auditor general and Responsible Minister agree.

f. **Performance Audit.** There is no concept of a performance audit in the Solomon Island Act, but the Accountable Ministers may request additional information relating to the affairs of the SOE (Section 18).

11. **Reporting requirements to parliament.** The Act clearly establishes the reporting requirements to the Solomon Islands Parliament in Section 17. Matters that must be tabled in Parliament include the approved SCO; the annual and half-yearly report; the auditor’s report; any modification to the SCO; and a notice of every appointment, reappointment or termination of an SOE director.

12. **Public disclosure.** The Solomon Islands Act requires the SOE to publish in the Gazette and in a newspaper, within one week of being tabled in the National Parliament, all of the reports and notices that are required to be tabled under Section 17, which are the items listed in the preceding paragraph. This is a commendable level of public disclosure.

13. **CSO defined.** The Solomon Island legislation clearly defines what a CSO is and in Section 8 the Act sets out the process to give a direction to undertake a CSO. The Act closely follows the Samoan legislation, including financial penalties if any person directs an SOE to undertake a CSO, or if a director approves the SOE undertaking the CSO, unless the CSO has been approved under the proper legislative process. The Regulations also provide guidance on the process to be followed to approve a CSO, which provides for the Accountable Ministers to invite an SOE to provide an estimate of the costs to deliver a defined CSO and if the cost submitted by the SOE is accepted, the Ministers then direct the SOE to provide the CSO. The Solomon Island Regulations would benefit from expanded CSO guidelines that would provide that

a. The SOE should include a profit margin in the CSO price.
b. All CSOs must be in the form of a written contract, recording the nature and quantity of the goods and or services being provided; establishing clear performance requirements and monitoring expectations; and specifying the price to be paid.
Tonga

Public Enterprise Act 2002 and Public Enterprise Amendment Act 2010

1. How are SOEs established? This is adequately covered in the legislation.

2. Principal Objectives. The Public Enterprise Amendment Act 2010 (the amendment Act) introduces the principal objective that every SOE must operate as a successful business and this is measured by being as profitable and efficient as comparable businesses that are not state owned. While this wording is very similar to the other SOE Acts reviewed in this study, Tonga departs from the others by not having any qualifiers to this principal objective.

3. Appointment process for directors. The legislation covers the basic requirements for director selection and appointment and the amendment Act introduces the requirement that the Minister shall only appoint persons who, in the opinion of the Minister, will assist the SOE to achieve its principal objective.

The amendment Act also prohibits the appointment of members of the Legislative Assembly as SOE directors, except in one case, where it is a newly established SOE and government is of the view that Cabinet Minister should be appointed for an interim period, which cannot exceed twelve months. While the amendment Act still allows the appointment of public servants, only one can be appointed to any one board and never as chair.

4. Removal of directors. Under the Act, board members can be removed for incompetency, incapacity, bankruptcy, neglect of duty, misconduct or failing to assist the SOE act in accordance with its principal objective. A director can also be removed from office if the SOE fails to comply with the obligations under Part IV (directors duties) and Part V (accountability) of the Act.

The Tongan Companies Act also contains provisions dealing with director’s duties, which apply to those SOEs that are also registered companies. Under that Act the shareholding Minister has general powers to remove directors. Section 6(1) of the SOE Act clearly states that the provisions of the SOE Act apply to Companies registered under the Companies Act 1995 in addition to and not in substitution thereof.

5. Roles and responsibilities of directors. The Act lists four specific roles in Section 13, which briefly stated are:

   a. To ensure that the SOE and its subsidiaries conduct its business and all decisions made are in accordance with the principal objective.

   b. Not act, or agree to the SOE acting, in a manner that contravenes the law or the constitution of the SOE.

   c. Not agree to, or cause or allow the business of the SOE to be carried on in a manner likely to create a substantial risk of serious loss to the SOE’s creditors.

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86 With the consent of Cabinet (Section 14)
87 In the Tongan SOE act there is just one shareholding Minister, the Minister of Public Enterprises (See 2007 amendment) and although the role of the “responsible” Minister is not defined in the Act, the Minister of Public Enterprises holds the powers normally held by the responsible Minister. Prior to the 2007 amendment to the Act the Minister of Finance was nominated as the sole shareholding Minister, but with the creation of the Ministry of Public Enterprises in October 2006 this change became necessary.
d. Not agree to the SOE incurring obligations unless the director believes at the time on reasonable grounds that the SOE shall be able to perform the obligation when it is required to do so.

The Act contains other provisions dealing with director's role and responsibilities in relation to the business plan, annual accounts and other reporting matters. The amendment Act introduces a novel concept: it applies all of the provisions in the Tongan Companies Act that deal with director's duties and obligations to all SOE directors; which brings non-company SOE directors within the ambit of the Companies Act in this important area.

6. Managing conflicts of interest. While the Act is silent on managing conflicts of interest, the Companies Act 1995 does contain provisions dealing with conflicts of interest (Sections 138-143) and as noted above the amendment Act now applies those provisions to directors of non-company SOEs.

7. Appointment of CEO. This is adequately covered under Section 26 of the Act, which not only establishes the right of boards to appoint a CEO, but goes on to identify the need to establish a contract of employment which should include (i) the objectives to be achieved by the SOE (ii) the performance expected of the SOE (iii) a review of the CEO’s performance (iv) requirement that the CEO adhere the SOE’s SCI.

8. Roles and responsibilities of the Responsible Minister. There is no definition of a responsible Minister in the Act, but the Minister of Public Enterprises has the role and powers normally exercised by a responsible minister. The Minister therefore appoints and removes directors; is consulted on the development of the business plans; and can establish new SOEs. A number of the Minister’s powers are subject to the consent of Cabinet, most notably the appointment of directors.

9. Roles and responsibilities of the Shareholding Minister. As mentioned above, there is just one shareholding Minister who is the Minister of Public Enterprises. The Tongan Act combines the roles of the responsible and shareholding Minister within the single shareholding Minister.

10. Requirements dealing with the content and approval of;

a. Business or Corporate Plan. The amendment Act renamed the Statement of Corporate intent as the Business Plan, but it substantially retains the same content requirement.

b. Statement of Corporate Intent (Business Plan). The Act covers all of the basic requirements for the preparation of an SCI, or in Tonga’s case the Business Plan (Plan), which must include detailed financial information for the first twelve-month period and also projections for the two years thereafter. Some matters of note are that;

i. The Minister cannot direct changes in the Plan. The Minister can request that the board consider changes but the board is at liberty to reject the Minister’s request.

ii. The Board can make changes to the Plan at any time, but must provide the minister with written notice of the proposed changes.

iii. The Plan must cover detailed financial information for the first twelve months and summary information for the subsequent 24 months and must also include cash flow projections for six years (Section 18).
iv. The Plan must contain a one-page summary of the objectives of the SOE; the strategies to be pursued to achieve the objective; and key performance targets.

The Tongan approach to the SCI (Plan) is consistent with the New Zealand approach in that the Minister can suggest but not direct changes whereas, as noted elsewhere, the Fiji, Samoa and Solomon Islands SOE Acts provide for the Minister to direct content of the SCI. On balance, the "suggest" rather than "direct" is preferred as it maintains the proper separation between the roles of the Minister as owner and the board as managers and stewards of the SOE. Provided the SOE Act contains clear statements concerning director’s duties; a principal objective to operate as a successful business; the requirement to consult on the content of the SCI (in whatever form that takes); and the ability of the Minister to terminate directors who act in a manner inconsistent with the requirements of the Act and SCI, in reality there is little gained through providing the Minister with the power to direct. Indeed there is significant downside: if Ministers exercise their power to direct they could be seen as acting as “deemed directors”.

c. Annual Report. The provisions covering the Annual Report are adequate. An important requirement contained in the Tongan Act is that the Annual Report must contain such information as is necessary to enable an informed assessment of the operations of the SOE including the comparison between actual performance and the planned performance contained in the Plan. This is very important as it significantly adds to the effectiveness of the Annual Report as a public accountability document (see section 20(2)). The amendment Act extends this requirement to the half-yearly report.

d. Audit Requirements. These are adequately set out in Section 24 of the Act.

e. Performance Audit. The Minister may request the Auditor General to undertake a special audit (Section 24) and the Minister can require the SOE to provide additional information (Section 23).

11. Reporting requirements to Parliament. The Act sets out clear reporting requirements for the Annual Report and half-yearly, which must be tabled in the Legislative Assembly (Section 22). There is no requirement to table the agreed Plan, but as the Annual and half-yearly reports comment on the SOE’s performance against the performance targets and objectives in the Plan, the Legislative Assembly is able to gauge performance.

12. Public accountability. The amendment Act introduces a robust public accountability regime in Section 22. The SOE must publish, in local newspapers in Tongan and English, a brief summary of the Annual Report within two months of its adoption by the board. The summary must include a comparison of revenues, net profit, return on average equity and non-financial performance targets against those targets set in the Plan. It must also include projected revenues and other financial data for the next twelve month period; where the copy of the Annual Report can be obtained; and a brief statement on all of the financial transaction between the SOE and government.

13. Other innovations. The amendment Act also provides for the potential to establish the Ministry of Public Enterprises as a holding company for all of the other SOEs. This is achieved through expanding the power to establish subsidiaries and putting in place robust accountability and governance structures between the holding company and its subsidiaries to ensure that an appropriate level of political and public accountability is maintained. For example, the brief summary described in paragraph 12 covers not only the SOE, but also each of the SOE’s subsidiaries.
14. **CSO defined.** The amendment Act has introduced a very robust definition for CSOs (Section 4A), which stipulates that

a. Cabinet must direct the CSO.

b. The CSO must be documented in an enforceable agreement that is in writing; complies with approved government procurement policies; records the nature and quantity of the goods and or services to be provided by the SOE; and specifies the total price.

c. The price charged by the SOE must include a margin to cover its cost of capital.

These provisions are further strengthened by the requirement that the SOE’s Annual Report include a statement of total revenue received in consideration for providing a CSO and the public accountability requirement mentioned above.