When will the Government bring out a report on the financial operations of companies of special national interest?

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PRESS RELEASE

When will the Government bring out a report on the financial operations of companies of special national interest?

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The Ministry of Justice at its website has published the fourth consolidated Report on the Implementation of the Anti-corruption Programme for Majority State-owned Companies for the period 2010-2012[1]. The Report indicates that Croatia has still not initiated the restructuring and privatisation process of these companies, the financial operations of which pose a threat to the stability of public finance. An additional burden on the Budget comes from new loss-makers (e.g. Badel, Imota, etc.) which were moved to the government portfolio in 2010 and 2011, pursuant to Government decisions.

According to the Decision on a List of Companies of Special National Interest (Official Gazette 132/2009), the Government is authorised to submit reports on these companies' business performance to the Parliament by end-September of the current year for the previous year. This provision has been repealed by virtue of the Decision on a List of Legal Entities of Special National Interest (Official Gazette, 144/2010). Consequently, there are no reports for 2010 2011, neither has a public debate been held on such a report, which, along with the national budget report, represents one of the key national financial reports. Unfortunately, the new Government failed to include a mandatory publication provision in the Decision, so that the reports are still not publicly available.

In the absence of Government reports, the general public, as well experts and analysts should content themselves with the Report on the Implementation of the **Anti-corruption Programme for Majority State-owned Companies for the period 2010-2012,** prepared by the Ministry of Justice (i.e. its autonomous Anti-corruption Section) in cooperation with coordinators from the relevant ministries, notably the Ministry of Finance's Economy Directorate. The Report is based on responses to a survey on the Anti-corruption Programme implementation, encompassing 183 questions, of which 133 relate to the enforcement of anti-corruption measures (to be answered with yes or no) and 50 questions relate to quantitative and other data.

The idea was to examine the transparency of operations of 86 state-owned companies. Regrettably, as many as four companies failed to actively participate in the survey (Badel 1862, Zagreb, Imota, Imotski, IPK Osijek, Osijek and Vinka, Vinkovci). The bulk of the companies (25) fell within the competence of the Ministry of Maritime Affairs, Transport and Infrastructure. The rest were within the competence of the Ministry of Tourism (16), Ministry of Agriculture (11), Ministry of Economy (17) and Ministry of Science, Education and Sports (MZOS), Ministry of Finance, etc.

[1] http://www.antikorupcija.hr/konf-proba08

In terms of quality, the Report shows significant improvements in the operational transparency of the surveyed companies, as most of them make their business reports available on their websites. Despite the satisfactory results, it is still necessary to increase the transparency of public procurement, and to regularly publish vacancy announcements as well as the amounts and structure of expenditures, e.g. for sponsorships and donations. Some problems still exist in the financial management of companies. As little as 58% of surveyed companies have strategic development documents, setting out their strategic goals. Operational risk monitoring and analysis are highly inadequate, as risk registers are in place in only 22% of the companies. As little as 31% of the companies have properly regulated cooperation with relevant ministries with regard to the business plan adjustment, subsidy utilisation, reporting, etc.

In terms of quantitative data, the Report is deficient, because it does not help establish the financial positions of the companies. It is obvious that the Ministry of Justice and the Ministry of Finance' Economy Directorate failed to make a detailed verification of the data received from public enterprises, by comparing the information from their annual statements and survey responses/data.

This points to doubtful authenticity of the information, intended to enable the public to assess and understand the financial operations of the companies. This relates in particular to the information on the amounts of revenues and expenditures and of assets and liabilities, as there are no methodological explanations of the scope and structure of data. This deficiency is most obvious in the case of shipyards.

Now, let's start from the beginning. The report is based on an analysis of 82 (of 86) companies covered by the survey. They employ 87,514 persons. As many as 39 companies have 118 subsidiaries, most of them registered in the country and some in the former Yugoslav republics. The bulk of these entities are limited liability companies, and the rest are joint stock companies, mostly engaged in tourism. The scanty data from the Report reveal an incredible fact, namely that part of these companies realised larger profit in 2011 than in (the catastrophic) year 2009 and in (weak) 2010. The said companies' revenues and expenditures in 2011 amounted to about HRK 52.9 bn and HRK 50 bn respectively, and their pre-tax profits stood at HRK 2.9 bn. This would have been excellent news, had it represented real profit in cash and not the accounting profit. Let it be recalled that in 2009, state-owned companies made monetary losses amounting to HRK 3.5 bn.

According to the Report, enormously large profits of HRK 5.55 bn were recorded in 49 companies, led by yesterday's steady loss-makers – the *shipyards 3. MAJ (HRK 2.45 bn) and Brodosplit (HRK 1.6 bn)*. This leads to a conclusion that shipyards have been the main economic growth generators in Croatia and that their restructuring processes have finally been completed. However, a verification of the annual report data submitted by the companies reveals contradictory information, giving a widely different picture of their financial performance.

So, for example, the 2011[2] consolidated income statement of Brodosplit shows a *profit of HRK 1.72 bn,* ensued from the booking of the amount of HRK 2.51 bn, underlying the Agreement Regulating Property Relations between the Government and Shipyards, which was declared as receipts from the sale of the company's fixed assets. If these receipts are excluded from the operating income, the company made a real *loss of HRK 777 m*. According to the audited 2011 Annual Report of Brodosplit, the company's *loss exceeded the capital by HRK 2.37 bn* (HRK 3.72 bn in 2010). Short-term liabilities exceeded short-term assets by about HRK 1.1 bn, and total liabilities exceeded total assets by HRK 2.37 bn. Moreover, the company's liabilities to the Ministry of Finance, arising from called on guarantees amounted to HRK 1.98 bn at the end of 2011 (from 2009 to 2011, the Ministry settled the shipyard's loan liabilities). Consequently, the accrued accounting profit of the company (HRK 1.72 bn) actually represents a loss of HRK 777, recorded on a cash basis. Hence, it is obvious that, unless an efficient restructuring programme is undertaken, the continuation of the company' operation is questionable. A similar situation took place in the 3. MAJ shipyard.

[2] The financial statements of Brodosplit d.o.o. and 3. MAJ d.d. are available at
http://www.brodosplit.hr/ONAMA/Financijskaizvješća/tabid/3698/Default.aspx,
http://www.3maj.hr/cm/hrvatski/brodogradevna-industrija-3-maj-d-d/izvjestaji.htm

In 2011, the 3. MAJ Group representatives signed an agreement on the resolution of property issues with the Ministry of Economy, Labour and Entrepreneurship. The government took over government-backed credit liabilities of 3. MAJ as compensation for booked-out assets on the maritime property and assets covered by a Government Decision from 2000. According to the Agreement, 3. MAJ generated revenues of HRK 2.9 bn HRK, which were reported in the income statement as „other business revenues". Excluding these booked one-off revenues, the company made *a loss*. The company's total liabilities stood at about HRK 4.9 bn, and, excluding receivables for assets under the Government agreement, were 3.6 times bigger than its assets. Hence, the accounting profit of HRK 2.2 bn actually represented a monetary loss of *HRK 716 m*.

According to the Report, another 31 companies made a total loss of HRK 1.19 bn, the leader among them being Autocesta Rijeka-Zagreb (HRK 420 m), followed by Dalmacijavino (HRK 178 m) and Kraljevica Shipyard (HRK 142 m). Also included in the group were Vjesnik, the companies constituting the Croatian Railways Holding, etc.

Total assets of all the companies stood at about HRK 280.4 bn, and total liabilities at about HRK 107 bn. The liabilities of individual companies greatly exceed their respective capital and total assets. For Kraljevica Shipyard, 3 . MAJ Shipyard and Dalmacijavino, the liabilities were four times bigger than the assets and for Brodotrogir two times. The liabilities of the hotel companies Vranjica Belvedere, d.d. and Brijuni rivijera, d.o.o. exceeded their assets. However, the Report should be taken with caution, given serious methodological limitations of the data on profit and loss, as well as total liabilities.

Huge losses and accumulated liabilities show that the transformation of majority state-owned companies is far from complete, while the transformation process of the tourism and shipbuilding sectors hasn't even started yet.

Management and supervisory boards and financial management

In 82 surveyed companies, 139 members of the management boards and 409 members of the supervisory boards have been appointed. Most companies have 5 supervisory board members and one member of the management board. However, there are companies with a much larger number of supervisory board members, such as Croatia Airlines (13), or Petrokemija and Croatian bank for reconstruction and development (with 9 members each). On average, better performing state-owned companies have larger management and supervisory boards.

Average remuneration paid to a supervisory board member amounts to about HRK 2000. Supervisory board members who are government officials are not entitled to remuneration. The remuneration paid to a supervisory board member does not correlate with the company's financial position. Even if a company is in serious financial difficulties, its supervisory board members receive the same remuneration on average as those in well-performing companies.

Quality data show that, despite improvements in transparency, serious problems still persist in the financial management, strategic planning, expenditure transparency and public procurement systems. These deficiencies are further corroborated by the companies' financial performance data.

Once Croatia becomes an EU member state, its former 'business champions' will not be able to compete successfully in the EU market. This should be understood by all members of the Government, those who prepare reports, as well as those responsible for acting upon some of the report findings. Transparency improvement does not necessarily involve better understanding and implementation of best financial management practices in state-owned companies, as these tasks require adequately trained and, above all, professionally competent individuals. They should be hired through public competition, held even abroad, if necessary. The publication of the fourth consolidated Report on the Implementation of the Anti-corruption Programme for Majority State-owned Companies is more than welcome. However, in order to act responsibly, the government has also to disclose detailed information and figures on the financial operations of state-owned companies for 2010 and 2011, and ensure high-quality management.

New times require new 'business champions' and leaders, which must undergo the restructuring process. With all due respect for exceptions, most companies pose a threat to the financial position of the state, and it is realistic to expect that they will put additional pressure on the government in terms of demand for subsidies and debt write-offs, as well as new government guarantees. So far, government guarantees have covered the entire liabilities of business entities, and the continuation of such practices would lead to further growth of public debt.