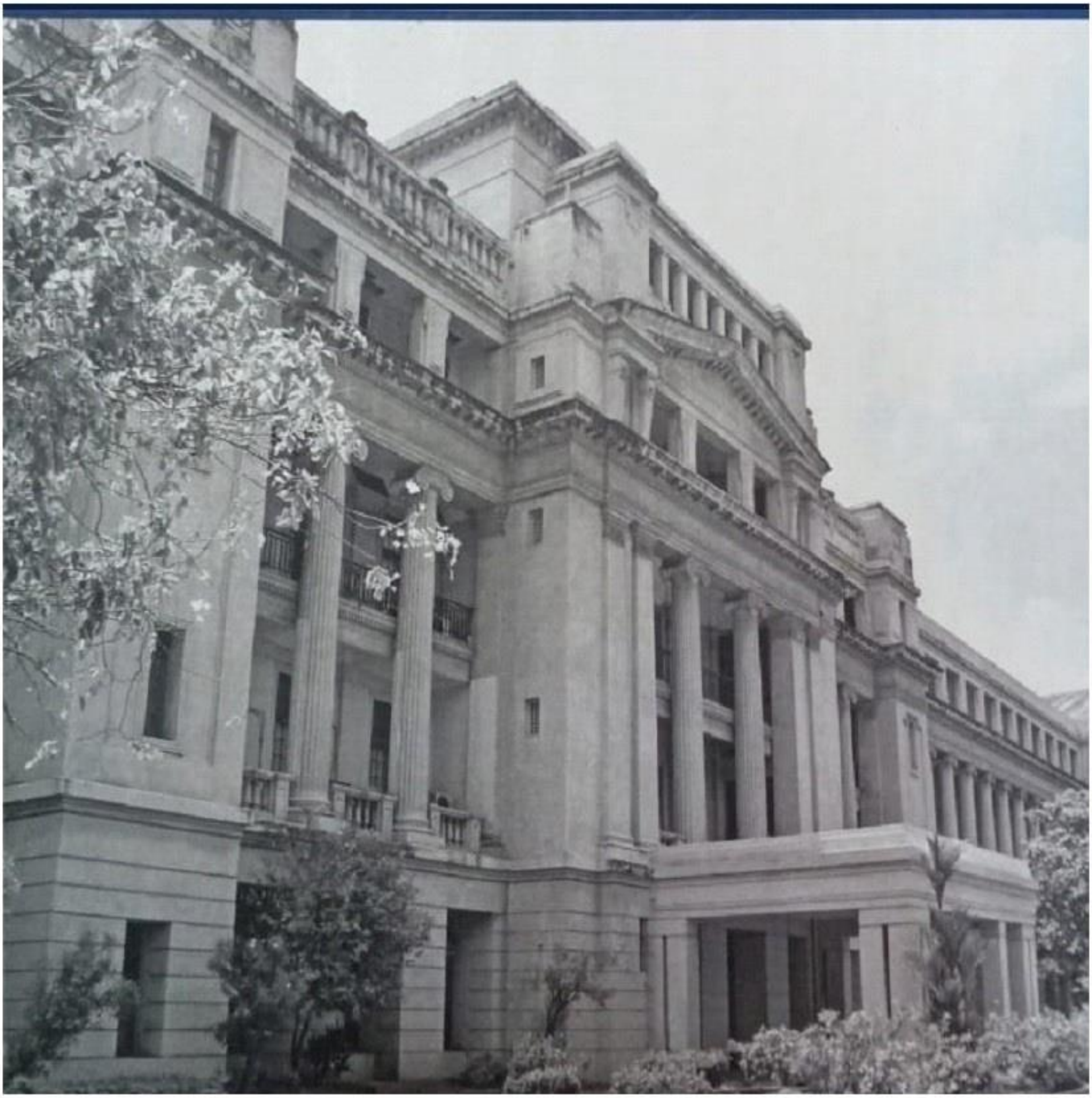
GUIDELINES ON CORPORATE GOVERNANCE FOR STATE OWNED ENTERPRISES



DEPARTMENT OF PUBLIC ENTERPRISES
GENERAL TREASURY
SRI LANKA

Message from the Secretary to the Treasury

SOEs demand urgent structural changes in their operations in line with the modern practices and market requirements. They necessitate serious commitment from the Boards and the Managements of SOEs, bearing in mind that the Board of Directors of SOEs discharge fundamentally a role of stewardship.

It is in this background that the Guidelines on Corporate Governance and Operational Manual for SOEs have been drafted to provide the required direction and framework to ensure that the operations of the SOEs are undertaken embodying the principles of good governance in a pragmatic way. This Guideline and Operational Manual provide the minimum standards of governance for the SOEs to undertake. However, SOEs have the discretion to engage in practices that are an improvement to those in the Guideline and the Operational Manual in consultation with the General Treasury. Boards are directed to continuously improve their governance structures, facilitate innovation and craft a culture of value creation.

It is my experience that nothing in these documents will be useful unless the Boards and the Managements understand the spirit in which these documents have been drafted. Therefore, the SOEs must adopt this framework at the earliest.

The Director General and the officials of the Department of Public Enterprises have led this effort diligently and meticulously together with the other Departments of the Treasury. I thank them for it.

S.R. Attygalle
Secretary to the Treasury
16.11.2021

Message from the Director General, Department of Public Enterprises

This Department has been monitoring the performance of SOEs and we have noted that over the years that the governance structure of almost all SOEs requires to be restructured, regardless of whether they are commercially orientated or not.

It is in this context, that the Guidelines on Corporate Governance and Operational Manual for SOEs have been drafted to provide SOEs with the necessary direction to organize its operations. This Guideline and the Operational Manual will replace the "Public Enterprises Guidelines for Good Governance" issued in 2003 and a number of Circulars issued in this regard.

These documents should serve as the framework within which the SOE should reorganize its operations, making every effort to expand its scope and the effectiveness of its outcomes. These guidelines have been drafted to ensure transparency, accountability, innovation and value for money. Considerable effort was taken to ensure that the operational discretion of the SOEs is assured, so as to ensure that the SOEs are able to be proactive in their decision making. A performance based culture together with use of technology is envisaged in this Guideline and Operational Manual. New areas of concern have been looked at including risk management and performance evaluations.

The SOEs are urged to cooperate with the General Treasury in implementing this Guideline and the Operational Manual and in this regard all stakeholders are requested to engage with the officials of this Department in clarifying matters so as to improve the operations of the SOEs.

I thank the Hon. Minister of Finance, the Secretary to the Treasury, Deputy Secretaries to the Treasury and my colleagues at the General Treasury specially my team at the Department for the unstinted support extended at all times.

P.A.S. Athula Kumara
Director General, Department of Public Enterprises
16.11.2021

Contents

Abbreviations

AC	–	Audit Committee
AG	_	Auditor General
AoA	-	Articles of Association
APRM	–	Annual Performance Review Meeting
AR	_	Annual Report
BoD	_	Board of Directors
CEO	–	Chief Executive Officer
COPE	–	Committee on Public Enterprises
CSE	–	Colombo Stock Exchange
CSR	_	Corporate Social Responsibility
ED	–	Executive Director
IA	_	Internal Auditor
ID	–	Independent Director
KPIs	–	Key Performance Indicators
NED	–	Non-Executive Director
OM	–	Operational Manual
PED	–	Department of Public Enterprises
RC	–	Risk Committee
SOEs	–	State Owned Enterprises

Preamble

There are 400 plus State Owned Enterprises (SOEs) with its presence in key sectors of the economy managing large asset bases including in power and energy, banking, ports and aviation in a multitude of capacities and objectives. SOEs have been established to undertake commercial as well as non-commercial activities including those of a regulator. SOEs have been established under various laws including special Acts of Parliament and the Companies Act.

While SOEs operate in many sectors of the economy, their performance in not achieving its set objectives, both commercial and non-commercial has been a cause for concern given its impact on the economy and in particular public finances. The failures of SOEs are mostly attributed to the failures in governance of SOEs coupled with policy inconsistency and a non-commercial like approach especially with respect to commercial SOEs with no timely infusion of equity and lack of autonomy to respond to market dynamics.

A careful analysis of the full portfolio of the 400 plus SOEs shows that there are a number of SOEs engaged in similar activities and therefore should be merged or required to be operated as a joint venture. Some entities have outlived their usefulness either due to the changes in the market conditions since its inception or because the SOE itself has been allowed to operate without sufficient accountability thus engaging in practices that are inimical to the growth of the economy as expected by the key stakeholder, the citizens of the country.

It is in this background that the government has taken steps to professionalize the Boards through the appointment of a selection committee to ensure that the Board of Directors (BoD) of SOEs will consist of qualified and talented personnel with the ability to make these SOEs successful ventures. While the government is keen to actively manage its portfolio of SOEs with appropriate strategies, such strategies include not only mergers or partnerships but also include the exiting of SOEs after having evaluated their overall impact on the macro-economic landscape. At the same time, the government has also incorporated new entities to not only support or complement the private sector to access new markets but also with the expectation of being able to access capital markets with better ease.

The non-adherence to best practices in governance has become a major issue as identified in many fora including the Committee on Public Enterprises (COPE) and needs to be arrested early if these entities are to turnaround. It is in this background that this Guideline is drafted. This is intended to serve as a guideline and a framework to all chairpersons and members of the BoD of SOEs and the management of the SOEs in discharging their given duties and in structuring their relationships with the stakeholders.

This Guideline should not be construed to be a hindrance to the autonomy, discretion, and independence of the BoD as provided in the Statutes or Articles of Association (AoA) of the SOE. As such, while SOEs are required to adhere by this Guideline, each SOE is encouraged to improve on their governance framework over and above this document as this Guideline is, categorically, a base document which marks only the parameters of governance. It is acknowledged that each SOE may be faced with issues unique to the SOE where the provisions of this Guideline may be inapplicable or inappropriate. In such instances SOEs are encouraged to initiate a dialogue with the General Treasury on the way forward. The representatives of the Treasury should be the catalyst between the SOE and the General Treasury.

This framework of discipline as articulated in this Guideline shall be the cornerstone of governance, but shall not in any way compromise the absolute obligation of the BoD to make proactive decisions to achieve the objectives of the entity.

Chapter 1 - General

1.1 Corporate Governance

Corporate Governance is a system by which the entities are directed, controlled and managed. It refers to the best practices and processes that directs or controls the operations and the long term sustainability of an entity. These practices and processes should fundamentally facilitate the decision making and operational capability of the entity while maintaining a healthy balance of fairness, responsibility, transparency, and accountability.

1.1.1. Fairness

All stakeholders should receive equal, just, and unbiased consideration by the BoD and Management.

1.1.2. Accountability

Directors should be held accountable for their decisions and actions to the key stakeholders submitting themselves to rigorous scrutiny. As public ownership of enterprises is vested in the government, the BoD is directly accountable to the government.

1.1.3. Responsibility

Directors should carry out their duties with honesty, probity, and integrity.

1.1.4. Transparency

Ensuring timely and accurate disclosure of all material matters pertaining to the entity including the financial position, performance, ownership and governance, so that stakeholders have access to clear and factual information.

1.2 Applicability

This Guideline is applicable to all SOEs established as Statutory Boards[1], Commercial Corporations[2] and State Owned Companies[3] except for companies listed in the Colombo Stock Exchange (CSE) and Subsidiary Companies of SOEs.

The provisions of this guideline should not be construed to supersede the provisions of any applicable law.

1.3 Effective Date

This Guideline is effective from 17.11.2021.

[1] Entities established under Special or General Acts of Parliament, and are not engaged in the provision of commercial goods or services.

[2] Entities established under Special or General Acts of Parliament and undertake a commercialized operation and expected to operate in a commercially viable manner.

[3] Entities established and operated under the Companies Act in which the state has direct controlling interest by virtue of its shareholding or otherwise or State Owned Corporations, converted in terms of the Conversion of Public Corporations or Government Owned Business Undertakings into Public Companies Act, No. 23 of 1987.

Chapter 2 - Governing Structure

2.1 General

The Board collectively and Directors individually must act in accordance with the applicable legal framework in the country. The Board is an agent of the shareholders and is responsible for the governance of the SOEs. As such, the Board is fully responsible for the management of the entity. The Board should take all decisions in particular the strategic decisions that will ensure the achievement of the objectives of the entity and also ensure that the entity meets all its statutory and regulatory obligations. The Board should use its discretionary powers in good faith to ensure that the decisions made are effective. Directors are required to take due care in making decisions, giving due consideration to matters arising from conflicts of interest ensuring the well-being of the entity.

The Board must ensure that there is a culture of good governance which is reflected in its work ethos, its values and must sanction a robust framework of accountability and transparency that is continuously tested and improved. Boards must ensure that confidentiality is maintained to secure the interests of the entity. The Directors' roles and responsibilities are noted below as a guide to instill best practices amongst the members of Boards. It is important that the Board demarcates a clear division of responsibilities amongst the management that facilitates the balance of power and authority.

(Note: Wherever the roles of Chairman and Chief Executive Officer (CEO) are combined through the relevant statute or the AoA, the relevant BoD must initiate action to split the two roles through an amendment to the statute or the AoA. However, until such amendment is effected, the BoD are required to introduce and maintain necessary controls to ensure that policy and operational roles are clearly demarcated with adequate oversight.)

2.2 Board of Directors – Role and Responsibilities

2.2.1 Strategic Directions

a) Set strategic directions through the strategic plan. In setting strategic directions, the BoD must ensure that such directions support the achievement of the objectives of the entity and are in line with the national policies and priorities.

b) Ensure that clearly defined Key Performance Indicators (KPIs) are in place.

c) Continuously review the execution of the strategic plan and take corrective measures wherever necessary, so as to achieve the set objectives.

2.2.2 Governance and Performance Driven Culture

a) Role of the Chairman

i. Chair the Board meetings and ensure that proper proceedings are followed.

ii. Ensure that Board meetings are held regularly, at least once a month in accordance with the procedures as set out in the relevant Act or the AoA. Such meetings could be held physically or if not "virtual" board meetings should be held using technology.

iii. Ensure that all Directors are made aware of their duties and responsibilities including members of all Board sub-committees.

iv. Set the agenda for Board meetings where the focus is on matters of strategic importance rather than on day-to-day matters.

v. The Chairman should ensure that the Board is provided with adequate information to facilitate effective decision making.

vi. Encourage all members of the Board to actively contribute by giving equal opportunity to express their views. If required, external expertise could be sourced[4] so as to ensure effective decision making.

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[4] In acquiring the services of experts, the Chairman and the BoD are empowered to decide on the type of expertise to be sought and the entity should bear all costs that may arise in getting such expertise.

vii. Allow and ascertain that the individual directors' views on any business matters are properly recorded in the minutes, ensuring the secure maintenance of such minutes.

b) Role of the Board of Directors

i. Ensure the establishment of a robust governance framework enshrining principles of accountability, transparency, fairness, and equity in its relationship with the stakeholders.

ii. The BoD should not authorize or empower or delegate the Chairman with any executive powers facilitating the execution of any executive role including engagement in any operational activities, unless otherwise sanctioned by any Act or AoA.

iii. Participate actively at the Board proceedings. Directors are strongly encouraged to ensure that the board papers submitted are read prior to the Board meetings.

iv. Ensure adequate delegation of authority to the management specially in making the operational decisions facilitating the effective implementation of the strategic directives.

v. Ensure that the appointments of the CEO and the immediate next senior management level to the CEO, are done taking into account the requirement of the entity and in this regard, the Boards are authorized to select a candidate from either internally or externally on merit and performance basis. The appointment of CEO and the immediate next senior management level to the CEO should not be decided by the seniority alone.

In case of internal candidates, no person with less than 3 years[5] of future service capacity (3 years to retirement or end of service or the end of the contract, i.e. a candidate appointed as a CEO should have at least 3 years of service until retirement or end of service) should be given an appointment as the CEO.

[5] While encouraging SOEs to adopt this policy immediately, considering the practical difficulties that may arise in implementing this policy immediately, the Boards should adopt a succession plan that will facilitate the adoption of this policy in full at least by 2025.

vi. The Board must also enter into a performance contract with the CEO which is a reflection of the strategic plan, against which the CEO's performances must be evaluated annually and the incentives including bonuses must be decided.

vii. Ensure that the entity is in possession of a sound and reliable Management Information System which facilitates decision making and accountability.

viii. Ensure the integrity of the accounting and financial reporting systems, control systems such as risk management & operational control, uphold compliance with the laws, regulations, and relevant standards.

ix. Ensure that the key processes and procedures including the operational, administrative, and financial processes, are properly documented and updated periodically.

x. Institutionalize support for innovations within the entity.

xi. Directors of the Board must self-regulate their actions and voluntarily recuse themselves when required in making decisions that fall within the ambit of related party transactions.

xii. Ensure the appointment and the proper functioning of Board sub-committees including Audit Committee (AC), and any other relevant Board sub-committee. The minutes of the proceedings of the Board sub-committees must be periodically reviewed and adopted.

xiii. Should ensure disclosure of maximum information of both financial and non-financial nature, to its stakeholders without compromising any statutory or operational requirements through the entity's website. Presentation of information must be user friendly.

xiv. In Overseeing Performance Excellence, the Board should:

- Institutionalize a post review mechanism within the entity taking into account the achievement of objectives of the entity and the requirements of the key stakeholders.
- Establish KPIs or a dashboard of KPIs agreed with the management addressing the requirements of key stakeholders focusing on the financial, operational, growth, and innovations. KPIs must be a reflection of the entity and the

activities[6] undertaken and must be reviewed periodically[7] and amended as required.

2.2.3 Risk Management and Internal Controls

a) Ensure that an effective system of internal controls and risk management is in place. The Internal Controls must be a reflection of the operations of the entity including any risks that may emanate from its investments in different classes of assets including in subsidiaries. Such systems should be supported by the allocation of the required physical and human resources.

b) Allocate regular and adequate time at the Board meetings for discussions about risk management, with focus not only on financial issues but also on operational issues including cyber security, sustainability issues related to the degree of mechanization, and availability of the necessary skills in the workforce etc.

2.2.4 Compliance and Reporting

a) Ensure compliance with the relevant statutory, regulatory, and administrative provisions.

b) Apart from the disclosure requirements in paragraph 2.2.4 (a), Boards must ensure that any other information that a stakeholder could expect from the entity must be shared provided that, it has no material effect on the competitiveness of the entity.

2.2.5 Managing the Relationship with the Subsidiary Companies of the Entity

a) It is mandatory to have a board approved subsidiary policy that addresses issues including dividends, changes in equity and shareholding and major transactions.

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[6] When setting KPIs particularly with regard to fund management or maintenance of portfolios, Boards must be careful as such activities are most often a function of the external market dynamics. Therefore, KPIs must be established to not penalize the fund manager for market dynaimcs and examined accordingly.

[7] In setting KPIs, SOE must be careful to ensure that they are not only linked to profitability, but also to cost reductions, revenue increases, customer satisfaction criterion, innovations, awards won etc. However, it is recommended that KPIs once established must be allowed to be in place for at least 3 years or during the lifetime of a Strategic Plan.

b) The BoD of the parent SOE should take responsibility for reviewing the affairs of its subsidiary companies within the broad regulatory and legal framework. As such, the Board of the parent SOE should;

   i. Regularly review the performance of subsidiary companies at Board meetings.
   ii. Be aware of all material risks and other issues that may ultimately affect the parent SOE arising from the subsidiary. As some of these risks may originate in subsidiary companies, it is necessary that the Parent Board is able to exercise adequate oversight over the activities of the subsidiaries.
   iii. Closely monitor intercompany transactions among subsidiary companies.

2.3 Strategic Planning

The BoD should ensure that its strategic plan is prepared to achieve its mandated objectives within a national policy framework. The finalized strategic plan together with the action plan and annual budget should be submitted[8] through the Secretary of the relevant Line Ministry, to the Director General, Department of Public Enterprises or the Director General, Department of National Budget as applicable.

The guidelines on the preparation of the Strategic Plan, Action Plan, and Annual Budget are given under ***Annexure I***.

The BoD should periodically evaluate and ensure the effectiveness of implementation of the strategic plan and should take corrective measures if required.

All Line Ministries must ensure that a robust review mechanism is in place to evaluate the performance of SOEs under their purview[9] and engage in discussion with the General Treasury when required in addressing issues pertaining to the SOEs.

[8] The strategic plans of subsidiaries are not required to be submitted to the Director General, Department of Public Enterprises or the Director General, Department of National Budget, but should be submitted to the parent company.

[9] As assigned through the Gazette notifications of HE the President. However, the performance of any SOE which has not been assigned will be overseen directly by the Department of Public Enterprises.

2.4 Disclosure Requirement of Directors

The BoD should individually declare their relationship, annually to the Secretary to the Board using the format given in the ***Annexure II***. The Annual Report (AR) of the SOE should disclose the following information in relation to each Director.

- Name, qualifications and a brief profile including the nature of expertise in relevant functional areas;
- Close family and/or material business relationships with the SOE, other Directors and employees of the entity if any;
- Whether Executive, Non-Executive and/or Independent Director (ID);
- Board sub-committees in which the Director serves as Chairman or a member;
- Names of any other entity including another SOE, in which the Director concerned is employed or serves on the Board;
- Number/percentage of Board meetings and sub-committee meetings a Director has attended during the financial year;
- Details on related-party[10] transactions;
- Any other legislative or administrative disclosure requirements as required by any law, regulation, guideline, and circulars.

2.5 Chief Executive Officer

The CEO[11] is the top executive responsible for the entity's overall operations and performance. The CEO is the leader of the entity’s business who serves as the main link between the BoD and the management. The CEO is responsible for the implementation of the strategic directions as set down by the Board. While the CEO should discharge the duties that

[10] A related party is a person or entity that is related to the particular SOE as stipulated in the relevant Accounting Standards.

[11] In certain entities the position of CEO could be equivalent to the positions named Director General, General Manager, Executive Director, Managing Director etc. This will be decided by the law or the AoA as applicable.

is normally expected of a CEO, the Board must, however, empower the CEO sufficiently providing adequate safeguards[12] to facilitate proactive decision making.

2.5.1 CEO's Role Mainly Includes:

a) Developing strategic, tactical, and operational plans that support the achievement of the objectives and KPIs, as established by the Board.

b) Engaging in a continuous, frank and open communication with the Chairman and the BoD ensuring a seamless transfer of information between the Board and the management.

c) Ensuring a sound internal environment for the implementation of strategic directions together with a robust performance evaluation and monitoring mechanism.

d) Taking prompt remedial action where necessary and informing the Board on significant changes in business conduct.

e) Continuous engagement in the assessment and management of risks through both formal and informal mechanisms.

f) Encourage a culture of innovation and learning.

2.6 Secretary of the Board

The Board Secretary is mainly responsible for guiding the Board on the discharge of its responsibilities and should ensure that all procedures are followed in compliance with statutory requirements and industry best practices. The Board Secretary should regularly review the entity's governance framework in view of emerging best practices, regulatory changes, and stakeholder interests.

The Board Secretary should report only to the Chairman and the BoD so as to ensure independence. The Board Secretary must be a member of the top management level and must be given the required physical and human resource facilities to discharge the given functions. Given the importance of the position, the Board Secretary must possess the

[12] The Boards must create an environment that allows the CEOs to take decisions so as to compete in the market, while also ensuring accountability.

required qualifications[13]. The CEO or any other employee already engaged in another function, should not be appointed as Board Secretary. In any instance when the statute itself deems the CEO to be the Board Secretary, the Line Ministry should take immediate action to amend the relevant statutes. Accordingly, SOEs could also, depending on the nature of the operations, decide to outsource this function to a person or an entity with the required qualifications.

The general duties of the Board Secretary should cover but are not limited to the following;

- Ensure that procedures governing Board meetings are followed, and guide and advise the Board on the responsibilities, rules, and regulations that impact the operations of the entity.
- Ensure that the Board papers submitted are comprehensive and include at least the following:
  - Background of the matter
  - Risk analysis (likelihood, impact, and risk mitigating strategy)
  - Impact assessment (financial, operational, environment etc.) and cost benefit analysis
  - Recommendations with signature of relevant heads of the sections and CEO
  - Board resolution for which approval is sought for
- Ensure that all Board papers to be discussed are duly circulated among the BoD at least 5 days before the Board meeting.
- Ensure no Board decision is taken by circulation, unless it is a matter of urgency (It should be an exception to the rule and not the norm).
- Formulate meeting agendas with the Chairman and coordinate with the CEO and the management on Board papers, memoranda or presentations for the meeting.
- Convene and attend Board meetings and maintain accurate minutes of Board proceedings in an appropriate manner.
- Function as the Secretary to Board sub-committees.

[13] The Board Secretary should be a qualified Chartered Corporate Secretary, Chartered Accountant, Attorney at Law, or possess equivalent professional qualifications.

- Make necessary arrangements for the conduct of General Meetings with shareholders or Annual Performance Review Meeting (APRM) as applicable.
- Coordinate the publication and distribution of the entity’s AR, accounts, and interim statements, in consultation with the entity’s internal and external advisors, in particular, when preparing the Directors’ Report.

Chapter 3 - Relations with Stakeholders

3.1 General

The BoD of every entity must have laid down clear protocols of communication having taken into account, the requirements as stipulated by various laws and regulations. In this respect, it is important that the SOE maintains continuous communication with its stakeholders at all times, including through mandatory requirements such as the AR. While the disclosure of information should be made to ensure transparency and accountability, the entity should ensure that such disclosures are made without compromising any statutory or operational requirements of the entity.

In disseminating information, all entities are strongly encouraged to maintain a user-friendly website. It must contain updated information including the profile of the entity, statement of strategic direction, the updated AoA /incorporation statute, AR[14] etc. It is important that an updated performance status which includes details of projects and work undertaken is also included on the website.

Entities are strongly encouraged to continuously improve the quality of reporting to meet best practices and the ***Annexure III*** may be used as guidance to entities when preparing the AR.

3.2 Shareholder Meetings/ Annual Performance Review Meeting

Entities incorporated under the Companies Act should ensure that General Meetings are held in compliance with the provisions of the Companies Act.

Entities incorporated under any statute other than the Companies Act must have an APRM every year where the AR is presented. This meeting should be held to discuss the performance of the entity with its key stakeholders. The Board must instruct the Board Secretary to convene the APRM and it is mandatory that the following are invited to the APRM:

[14] The website must include at least the ARs of the last 5 years.

- Secretary of the Line Ministry (Secretary may nominate a representative from the Line Ministry to attend)
- Director General, Department of Public Enterprises (DGPE)/National Budget (DGNB) (DGPE/DGNB may nominate representatives to attend)
- All Board members
- Members of the top management including the CEO, Head of Finance, Internal Auditor (IA)
- External Auditors

The APRM should be held within 5 months after the balance sheet date and prior to the submission of the AR to the Parliament. The Board must direct the Board Secretary to ensure that the following documents are submitted to the participants 5 working days before the APRM;

- Agenda of the meeting
- Minute of previous meeting
- Annual Report
- Report on the progress of the implementation of the Action Plan and Annual Budget

Chapter 4 - Internal Controls and Risk Management

4.1 General

In sustaining the operations of an entity, it is important that Boards take a proactive approach to address the risks that are associated with the entity. Given the complexities of the environment, Boards should undertake a formal risk assessment process, which needs to be institutionalized, being mindful of the entity's obligations to the stakeholders and its place in the policy framework of the country. In this respect, the Boards must ensure the adequacy of the internal control system in place and must make necessary changes as required. Entities, regardless of its size and the complexities of its operations, should ensure the prevalence of a risk culture that will facilitate to anticipate and address issues better supporting the achievement of its objectives. It is important to note that evaluation of risks or the implementation of internal controls should not compromise the entity's ability to respond to opportunities in the market or discharge its functions efficiently and effectively.

4.2 Audit Committee

The AC of a SOE plays an important role in facilitating the oversight function.

a) The AC should consist of 3 non-executive directors or 1/3rd of non–executive directors of the Board, whichever is higher, with at least one member possessing knowledge and qualifications in financial management, with such member being appointed as the Chairman of the AC. Whenever the BoD consists of a Treasury representative, such member should be appointed to the AC.
b) The quorum for the AC will be the simple majority of members.
c) The IA of the entity should convene the AC meetings, while the Board Secretary must maintain the minutes.
d) A representative from the National Audit Office/External Auditors and the Chief Internal Auditor of the Line Ministry could serve as observers.
e) The AC at its discretion may invite any officer of the entity to participate in its proceedings.

f) The Board must through its CEO inform all officers to cooperate with the proceedings of the AC.

g) The fee payable to the members of the AC and observers should not exceed the applicable Board sitting allowance that is paid to the non-executive directors of the Board.

h) The AC should meet at least once in three months and report its recommendations to the BoD soon thereafter, along with the minutes of the meeting to facilitate taking corrective measures.

i) Each AC must be guided by an audit committee charter. In the absence of an audit committee charter, the model charter available in ***Annexure IV*** may be adopted with the approval of the BoD.

4.3 Risk Committee

The Risk Committee (RC) should identify and assess the risks that could have an impact on the business operations of the entity, quantify the impact of such risks both financial and non-financial. The deliberations of the RC should facilitate the BoD to address the impact of the risks affecting the operations of the entity and take appropriate actions to mitigate any adverse impact.

While it is mandatory for SOEs[15] as identified in ***Annexure V***, to have a RC in place, all other SOEs must deliberate on the risks affecting their performance at the AC. The role of the RC should include but not limited to;

a) Identifying and evaluating the risk profile of the SOE taking into account the SOE's legal and regulatory background, macro-economic dynamics etc.

b) Develop and implement a risk management framework and internal control system including a risk rating mechanism.

c) Recommend strategies to mitigate the risks.

d) Examine and determine the sufficiency of the SOE's internal processes for reporting on and managing key risk areas.

[15] The General Treasury will from time to time issue a list of SOEs that must mandatorily have a RC, which is a Board sub-committee.

All SOEs should also disclose in the AR if it has conducted an annual review and periodic testing of the entity's internal control and risk management strategies. RC should comprise at least three non-executive directors and should meet at least quarterly. The payment of sitting allowance to the members of the RC should be on par with the payments made to the members of the AC.

4.4 Internal Audit

All SOEs should have IAs who report only to the Board through the AC. The IA for all administrative functions should report only to the Chairman. The IA must maintain his/her objectivity and independence in the discharge of his/her duties. The IA must provide key findings and information accurately and in a timely manner to the Board through the AC.

The IA must have unrestricted access to all information required to investigate any issue within the scope of the audit. IAs should monitor and assess adequacy and the robustness of the control systems. The internal audit activity must also evaluate risk exposures related to the SOE's governance, operations, and information systems, including:

- Reliability and integrity of financial and operational information
- Effectiveness and efficiency of operations and programs
- Compliance with laws, regulations, policies, procedures, and contracts

The IA should work with the AC to set priorities and develop an audit plan. To do so, the IA must have a sound understanding of the functions and the key risks faced by the entity. In addition, IA should typically be able to carry out ad-hoc investigations at the request of the AC and the Board.

Chapter 5 - Ethics for Board Members and Management

The BoD is responsible for instilling an ethical culture which facilitates all concerned to act with integrity, objectivity, competence, and due care. It must be a culture that facilitates discretion in achieving its goals and objectives within an ethical framework. The culture of the entity must celebrate creativity and innovation, especially, its employees and facilitate the use of such creativity for the betterment of the entity. The culture must also ensure that it rewards its employees, in an equitable manner giving due consideration to merit. Whistle blowing and active criticism must be allowed to support the better performance of the entity and those who engage in the same should not be penalized. However, the Board must ensure that such action is managed for the betterment of the entity and must not be one that destroys or hampers the activities of the entity. The principles of ethical business environment include;

Integrity	-	To be straightforward and honest in all business conduct.
Objectivity	-	To not allow bias, conflict of interest or undue influence of others to override business judgments.
Competence and Due Care	-	To maintain knowledge and skills at the level required to ensure that an employer receives competent services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable laws and regulations.
Confidentiality	-	To respect the confidentiality of information acquired as a result of business relationships and, therefore, not disclose any such information to stakeholders without proper and specific authority, unless there is a legal or professional requirement or duty to disclose.
Ethical Behavior	-	To comply with relevant laws and regulations and ensuring the public interest by avoiding any conduct that discredits the government.

Annexure I - Guidelines for the Preparation of Strategic Plan, Action Plan, and Annual Budget

The strategic plan for a five-year period incorporating financial forecast together with the action plan and the annual budget for the respective year should be submitted by the SOEs through the Secretary of the relevant Line Ministry, to the Secretary to the Treasury and the Director General, Department of Public Enterprises or the Director General, Department of National Budget as applicable.

The plan shall be updated each year in line with the changes in the business environment and shall be submitted to the General Treasury, not later than 15 days before the commencement of the ensuing year. The BoD of the relevant SOE shall review the performance of entities periodically at the Board meeting to assess whether the set targets have been achieved. The following key areas could be considered in preparing the strategic plan, action plan, and annual budgets.

1. Preparation of the Strategic Plan

a) The strategic planning process sets out a robust way-forward for the organization to ensure the achievement of its objectives while ensuring the optimal utilization of resources. Every SOE should take into account the broader policy framework given by the government for each sector in preparing the strategic plan. The following steps may be followed in order to have a vibrant strategic plan;

- Perform a SWOT analysis to assess the strengths and weaknesses of the organization’s internal environment and the opportunities and threats that exist in the organization’s external environment. It is preferable to use commonly accepted models which may include PESTEL analysis, Porter’s Five Forces theory, resource audit & value chain analysis etc. for analyzing the business environment. According to the SWOT analysis, revisit the vision and mission of the organization for the accomplishment of mandated objectives in line with the national policy framework and make adjustments if necessary. The mission gives an organization the reason for its long term existence and guides the strategic decisions that are taken by management in the context of the organizational functions, markets, and competitive advantages.

- Establish goals in line with the mission of the organization. A goal is a short statement of a desired outcome to be accomplished over the medium term, usually three to five years.

- Establish objectives according to the SMART[16] criteria to achieve each set goal. The objectives are quantifiable interim steps toward achieving the SOE's goals. There may be one or more objectives to achieve a goal.

- Perform a gap analysis to identify differences between the current status of business and where it should be, in line with the set objectives. There are basically two kinds of gaps which would prevail in any organization i.e. efficiency gaps and development gaps. The identified gaps need to be addressed with suitable strategies.

- Strategies should be generated to fill the identified efficiency and development gaps by way of recognizing alternative strategic options, evaluating them for suitability, feasibility, and acceptability, and prioritizing and selecting the most appropriate strategies to bridge the prevailing gap for reaching the desired objectives and as a whole in order to accomplish the related goals.

- Establishment of performance evaluation measures; the KPIs shall be established to measure the output and outcome of the business operations of the SOE. Output indicators deal with the internal critical success factors while outcome measures link with the level of public service delivery. These indicators may be linked to either financial or non-financial targets. ***(section A** has summarized the key areas of the strategy setting process)*

[16] SMART : Specific, Measurable, Achievable, Relevant and Time bound.

- The strategic plan should also comprise summarized forecasted financial statements for the period covered under the strategic plan.

2. Preparation of the Action Plan

a) An action plan articulates a set of strategies, specific activities and actions that need to be completed in order to achieve objectives. The responsibility of carrying out such activities should be assigned to relevant authorities with a timeline for completion and expected financial estimate. The action plan should; (***specimen is given in section B***);

- List the activities in logical sequence and in detail
- Link activities with the objective to be achieved
- Specify the activities and actions that need to be carried out to reach the related objective and all objectives need to be accomplished to achieve the goal
- Assign responsibility for carrying out each activity
- Indicate a specific time target for each activity (deadlines and milestones)
- Specify the financial estimates for each activity.

3. Preparation of Annual Budget and Forecasted Financial Statements

a) The annual budget allocates financial resources for the implementation of the activities of the strategic plan relevant to a specific financial year. The entity should have one master budget and separate sub-budgets for main activities such as sales, production etc. The master budget should include;

- Budgeted Income Statement
- Budgeted Statement of Financial Position
- Budgeted Cash Flow Statement
- Capital Expenditure Budget

The entity should identify the key limiting factor or market condition in order to prepare the limiting factor budget as the starting point of the budget preparation process. Subsequently, all the other sub-budgets should follow the limiting factor budget. All these budgets need to be prepared reflecting the allocation of resources on a monthly basis. The ***section C*** briefly describes the budget preparation process where the limiting budget factor is the sales.

b) Upon finalization of these budgets, the cash flow statement enables the management to assess whether the entity is in a position to implement all the strategies as initially planned. If a financial constraint is identified, strategies together with relevant budgets need to be adjusted and KPIs shall also be revisited accordingly.

4. General Guidance

a) All the unutilized or underutilized physical and human resources need to be taken into the economic activities with proper systems and procedures to ensure the value for money under the strategic plan.
b) The strategic plan should be formulated by addressing strategic level risks of the entity while operational level risks need to be addressed mainly through sound internal control mechanisms.
c) The BoD is responsible for formulating the strategic plan with the collaboration of the management team and ensuring the smooth implementation of the plan by way of having proper oversight and feedback.

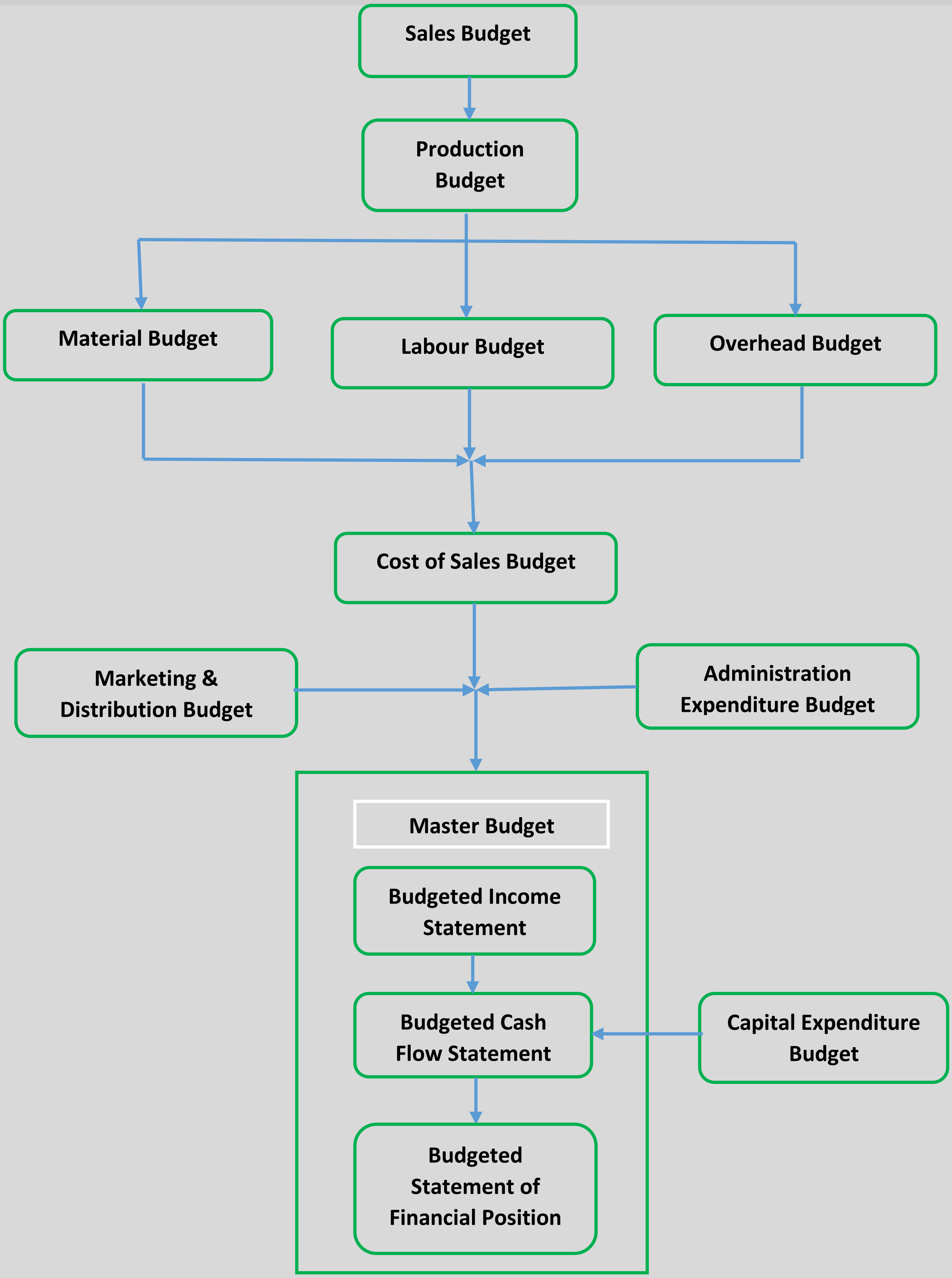
Section A – Key Areas of Strategy Setting

Strategic Plan	**SWOT Analysis**
	Vision Statement
	Mission Statement
	Organizational Goals
	Objectives to achieve each Goal
	Strategies for each Objective
	Key Performance Indicators
	Summarized Forecasted Financial Statements
Action Plan	**Action Plan**
Annual Budget	**Master Budget and Other Sub Budgets**

Section B - Specimen for Action Plan

Goal	**Objective**	**Strategy**	**Activity**	**Estimated Cost (Rs.)**	**Time Targets (in months)**					**Responsible Person**
					Jan	Feb	Mar	Apr	....	
Goal 01	Objective 01	Strategy 1	Activity 1							
			Activity 2							
		Strategy 2	Activity 1							
			Activity 2							
	Objective 02	Strategy 1	Activity 1							
			Activity 2							
		Strategy 2	Activity 1							
			Activity 2							

Section C – Budget Preparation Process (specimen), if the Budget Limiting Factor is Sales



Annexure II - Annual Declaration of Directors

I, the undersigned, am the Chairman/Executive/Non-executive, Chairman/Director of ……….. (SOE's Name) being so appointed on ………..(Date);

I honestly and solemnly declare that;

I have been/not been employed by the Entity, Subsidiary or Parent of the Entity, during the period of 2 years immediately preceding my appointment;

I had/did not have during the period of 2 years immediately preceding appointment as director, a Material Business Relationship[17] with the Entity, directly or indirectly[18];

I had/had not been an elected member of Parliament/ Provincial Council/ Local Government in the last 5 years.

I am a/am not a close family[19] relation of the Line Minister /State Minister/Deputy Minister of which the SOE coming under his or her purview.

I have/do not have any material business relationship with the SOE or related entities to the SOE (Subsidiary/Associate).

I have/do not have a close family member who is a Director or Chief Executive Officer or Key Management Personnel[20] (and/or an equivalent position) in the SOE;

I have/do not have a significant shareholding[21] of the entity or an officer of, or otherwise associated directly with, a significant shareholder of the entity;

I have/have not served on the Board of the entity for a period exceeding 9 years from the date of the first appointment;

Disclosure of such other information which the applicant believes could reasonably be construed to have a bearing on the independence of such director.
………
……………………………………

I am fully aware of the responsibilities of the directorship of the entity under applicable guidelines, rules, regulations, and laws and the information given by me above are true and correct according to the best of my knowledge.

Full Name: ……………………………..

Signature: ……………………………..

Date: ……………………………………..

[17] **Material Business Relationship** - includes any relationship that results in income/non-cash benefits greater than or equivalent to 10% of the Director's annual income.
[18] **Indirect Relationship** - includes but not limited to relationships with a partner, significant shareholder, Director, Key Management Personnel of a body that has a business connection with the entity.
[19] **Close Family Member** - shall mean and include the Director's spouse, parents, grandparents, children, brothers, sisters, grandchildren and any person who is financially dependent on such Director.
[20] **Key Management Personnel** - those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any Director of that entity.
[21] **Significant Shareholdings** - can be defined as a shareholding carrying not less than 5% of the voting rights of an entity.

Annexure III - Guidelines for the Preparation of Annual Reports

1. **Key Content of the Annual Report**

The AR should at the least comprise of the following key areas.

a) **Key businesses –** Should clearly state the overall scope of the entity (i.e., how it makes economic value addition).

b) **Risk assessment and mitigating strategies –** This deals with operational and external risk assessment. SOEs that have a RC should include a report from the RC.

c) **Analysis on financial and operational performance**- Achievement of KPIs and direction towards entity's mission needs to be described with emphasis on physical performance.

d) **Management's discussion and analysis -** Business results and achievements in the financial year describes the management and Board performance comparing the entity's performance with the industry norms and policy priorities as applicable.

e) **Statement on economic value added -** This may include analysis of the entity's performance under different aspects such as Corporate Social Responsibility **(CSR)**, human capital, social impact etc.

f) **Financial statements -** This includes the company's audited financial statements comprising the Income Statement, Statement of Financial Position, Statement of Cash Flows, Statement of Changes in Equity, notes, and the Independent Auditor's Report.

3. **Minimum disclosures required in AR**

- Mission and vision statement of the entity
- Brief profile of the BoD and key management personnel
- Chairman's review
- Directors' report
- Analysis of financial and operational performance
- Corporate Governance report
- Risk analysis and RC report, if any

- Return on Investment of surplus along with Investment Committee report if any
- AC report
- Audited Financial Statements
- Independent auditor's report
- Financial highlights in the preceding 10 years

Further, considering the evolving reporting paradigm, the SOEs can also adopt integrated reporting into their ARs.

4. Procedure on tabling the AR in Parliament

The Cabinet of Ministers at their meeting held on 27th June 2012, has emphasized the necessity of analyzing the shortcomings highlighted in the AG's report pertaining to the institutions and the remedial actions shall be taken by the relevant Line Ministry in order to rectify the shortcomings. As such, Cabinet of Ministers has instructed to include the following key components as an annexure to the Cabinet Memorandum relating to the submission of ARs;

- A summary of performance of the institution;
- The steps taken to rectify the shortcomings indicated in the audit queries and audit reports; and
- Medium term measures intended to be pursued to improve the performance of the institution.

Annexure IV - Audit Committee Charter

1. Purpose

Provide assistance to the BoD in fulfilling its responsibility for the;

- Preparation, presentation and adequacy of disclosures in the Financial Statements, in accordance with the Sri Lanka Accounting Standards;
- Compliance with financial reporting requirements, information requirements of the Establishment Acts, Companies Act, and other relevant financial reporting related regulations and requirements;
- Processes to ensure that the entity's internal controls and risk management procedures are adequate to meet the requirements of the Sri Lanka Auditing Standards;
- Ensuring performance of the entity's internal audit function;
- Identification, monitoring and management of significant business/financial risk when there is no RC in place;
- Reporting on related party transactions of Board members and key management personnel.

2. Composition

The AC should consist of 3 non-executive directors or 1/3rd of Non–executive directors of the Board, whichever is higher. The AC should be chaired by a Director with knowledge and qualifications in financial management. The committee should have an understanding of all matters that are integral to the entity's AR.

3. Meetings

The committee will meet at least quarterly, with authority to convene additional meetings, as circumstances require. Meeting agenda will be prepared and provided in advance to members, along with appropriate briefing materials. The quorum for the AC will be the simple majority of members.

4. Scope of the Audit Committee

Scope of the AC may cover the following;

a) Financial Reporting

- Review significant accounting and reporting issues, including complex or unusual transactions, highly judgmental areas, and recent professional and regulatory pronouncements and understand their impact on the Financial Statements.
- Review with management and the external auditors the results of the audit, including any difficulties encountered.
- Review the annual Financial Statements, and consider whether they are complete and consistent with information known to committee members, and ensure that the information is presented in accordance with the appropriate accounting standards and policies.
- Review other sections of the AR and related regulatory filings before the release and consider the accuracy and completeness of the information.
- Review with management and the external auditors that all matters required to be communicated to the AC have been properly communicated.
- Review interim financial reports with management and if required with the external auditor before filing with regulators, and consider whether they are complete and consistent with the information known to committee members.
- Review reports prepared by management and/or the independent auditor setting forth significant financial reporting issues, judgments made and key audit matters in connection with the preparation of the Financial Statements.

b) Internal Audit

- Approve the annual audit plan and all major changes to the plan.
- Ensure that there are no unjustified restrictions or limitations in the scope of the internal audit.
- Review the internal audit activity’s performance relative to its plan.
- Review the effectiveness of the internal audit functions.

- Consider the effectiveness of the entity's internal control system, including security and the control of information technology.
- Monitor the effectiveness, impartiality of the internal auditors, receiving regular reports from the internal audit function and addressing relevant issues concerning the subsidiaries of the SOE, if any on a regular basis.
- Ensure that the scope of the internal auditor through the review of internal matters.
- Review the procurement procedure and progress of implementation of the procurement plan.

c) Risk Management

AC should review the risk management framework of the SOE, if a separate RC is not established. The scope of the risk functions would include;

- Identification, evaluation, and assessment of the risk profile of the SOE having taken into account the SOE's legal and regulatory background, macro-economic dynamics etc.;
- Develop and implement a risk management framework and internal control system including a risk rating mechanism;
- Recommend strategies to mitigate the risks;
- Examine and determine the sufficiency of the SOE's internal processes for reporting on and managing key risk areas.

d) Relationship with External Auditors

- Understand the scope of the external auditor's review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with the management's responses.
- On a regular basis, meet with the external auditors, separately, to discuss any matters that the committee or auditors believe should be discussed privately.

e) **Compliance**

- Review the effectiveness of the system for monitoring compliance with laws and regulations, directives and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance.
- Review the findings of any examinations by regulatory authorities, and any observations of the auditors.
- Review the process for communicating the code of conduct to entity personnel, and for monitoring compliance therewith.
- Obtain regular updates from management and entity legal counsel regarding compliance matters.
- Establish a process to ensure compliance with laws and regulations relating to statutory obligations including EPF, ETF, taxes, custom duties, foreign exchange, and other levies applicable to the entity.

f) **Reporting Responsibilities**

- The AC should report its recommendations to the BoD soon thereafter, along with the minutes of the meeting to facilitate taking corrective measures.
- Provide an open avenue of communication between internal audit, the external auditors, and the BoD.
- Report annually to the shareholders, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rules and regulations.

g) **Related Party Transactions**

The AC shall review the effectiveness of the identification methodology of related party transactions and reliability of disclosures including but not limited to;

- The procedure for documenting related parties in accordance with the definitions of Sri Lanka Accounting Standards;
- The procedure to obtain a statement of related party interest from each such related party at least once a year;

- The procedure and definition of disclosures required to be made by the entity on an annual basis;
- Review and recommend to the Board the related party disclosures to be made in the AR of the entity.

5. Payment

The fee payable to the members of the AC and observers should not exceed the applicable Board sitting allowance that is paid to the non-executive directors of the Board.

Annexure V - SOEs that should have Risk Committees

1. Bank of Ceylon	12. Ceylon Petroleum Corporation
2. People's Bank	13. Sri Lanka Ports Authority
3. National Savings Bank	14. National Water Supply and Drainage Board
4. State Mortgage & Investment Bank	15. Airport and Aviation Services (Sri Lanka) Ltd.
5. HDFC Bank	16. Sri Lankan Airlines Ltd.
6. Regional Development Bank	17. State Pharmaceuticals and Manufacturing Corporation
7. Employees' Trust Fund Board	18. State Pharmaceuticals Corporation
8. Sri Lanka Insurance Corporation Ltd.	19. Lanka Sathosa Ltd.
9. National Insurance Trust Fund	20. Colombo Commercial Fertilizer Company Ltd.
10. Sri Lanka Export Credit Insurance Corporation	21. Ceylon Fertilizer Company Ltd.
11. Ceylon Electricity Board	22. Agriculture and Agrarian Insurance Board

Director General

Department of Public Enterprises

Ministry of Finance

Colombo 01

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