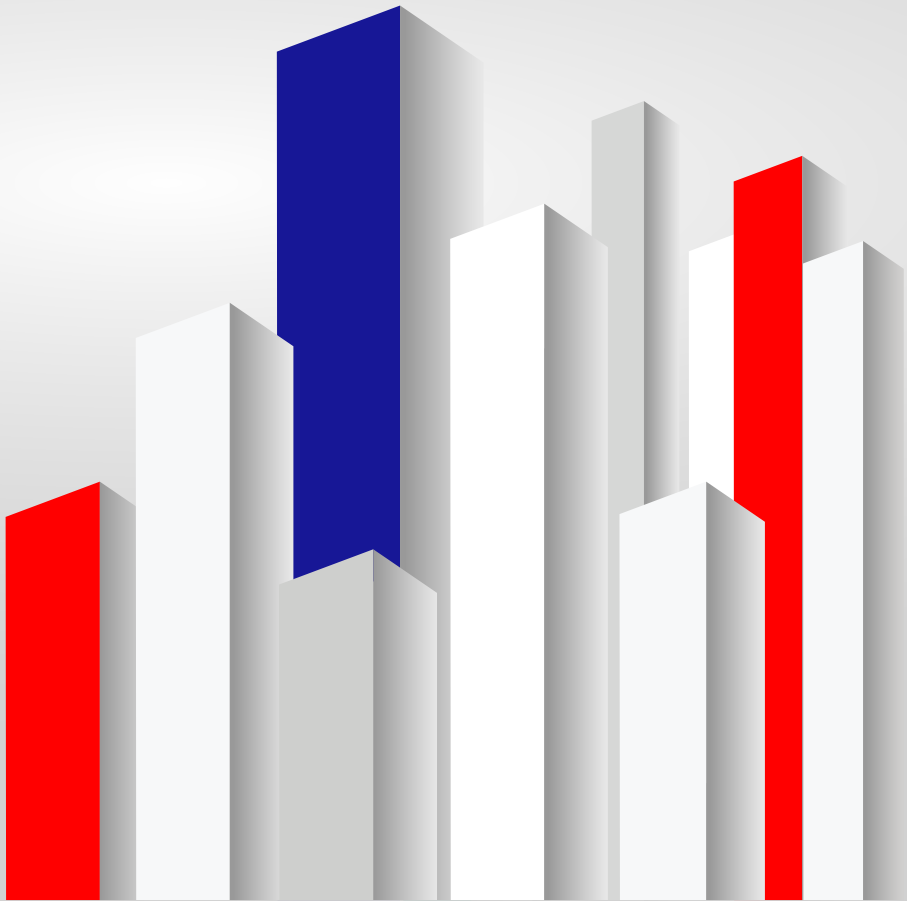
OECD Review of the Corporate Governance of State-Owned Enterprises

CROATIA



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Foreword

This report evaluates the corporate governance framework of the Croatian state-owned enterprise sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the "SOE Guidelines"). It was developed at the request of the Croatian authorities under a project supported financially by the Directorate General for Structural Reform Support (DG REFORM) of the European Commission, and implemented with the active support of the Ministry of Physical Planning, Construction and State Assets of the Republic of Croatia. The review takes place in the context of Croatia's ambition to join the Eurozone and redress a set of widely recognised policy challenges. The country entered the European ERM-II Exchange Rate Mechanism on 10 July 2020 and thus has committed to implement a number of post-entry commitments in relevant policy areas, including improving the governance of SOEs by revising and aligning national legislation with the SOE Guidelines.

This report is the seventh country review conducted by the OECD Working Party on State Ownership and Privatisation Practices (the "Working Party"), the body responsible for encouraging and overseeing the effective implementation of the SOE Guidelines. The report was produced by Arijete Idrizi, Alison McMeekin and Tanya Khavanska under the guidance of Hans Christiansen of the OECD Corporate Governance and Corporate Finance Division that provides secretariat support to the Working Party. Additional support was provided by an informal Task Force of Working Party delegates including representatives of Austria, Ireland, Lithuania, Latvia and Sweden.

Information included in this report is based on a variety of primary and secondary sources as of February 2021 (financial data is mostly from 2019). These sources include: (1) information provided by the Croatian authorities, including in response to a standard questionnaire on the SOE Guidelines; (2) information independently researched by the OECD Secretariat; and (3) additional documents and information obtained through several interactions and virtual meetings with representatives of civil society, SOEs, and government officials. The Review involved key stakeholders from Croatia, including the Ministry of Physical Planning, Construction and State Assets (MPPCSA), the Centre for Restructuring and Sale (CERP), the Ministry of Sea, Transport and Infrastructure, the Ministry of Finance, the Ministry of Economy and Sustainable Development, the Office for the Suppression of Corruption and Organized Crime, the State Commission for Supervision of Public Procurement Procedures, the State Audit Office and the Croatian Competition Agency, amongst others.

The authors would like to sincerely thank all stakeholders that have contributed to this report through information and/or other inputs and, in particular, colleagues from the Ministry of Physical Planning, Construction and State Assets and the European Commission for their active collaboration throughout this project. Further thanks to Henrique Sorita Menezes and Katrina Baker (OECD) for their excellent editorial support.

Introduction

The purpose of this report is to describe and evaluate the corporate governance framework of the Croatian state-owned enterprise sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the "SOE Guidelines"), to which the governments of all OECD's member countries adhere. Since their inception in 2005, the SOE Guidelines have provided concrete advice to countries on how to manage more effectively their responsibilities as company owners, thus helping to make state-owned enterprises more competitive, efficient and transparent. The non-binding SOE Guidelines were developed by the Working Party on State Ownership and Privatisation Practices. They complement and are compatible with the OECD Principles of Corporate Governance and the Anti-Corruption and Integrity Guidelines for State-Owned Enterprises.

The SOE Guidelines, and therefore this report, focus on SOEs held at the national level of Government (i.e. currently 59 SOEs in total, in Croatia). They are also primarily oriented to SOEs using a distinct legal form (i.e., separate from the public administration) and engaging in commercial activities, whether or not they additionally pursue a public policy objective. These SOEs may be in competitive or in non-competitive sectors of the economy. When necessary, the SOE Guidelines distinguish between listed and non-listed SOEs, or between wholly-owned, majority-owned, as well as in some cases also partly state-owned enterprises, since corporate governance issues can vary accordingly. As such, this review makes similar distinctions amongst Croatian SOEs when necessary, and also applies the SOE Guidelines, where relevant, to the subsidiaries of these aforementioned entities.

The report is structured as follows: Part I provides background information on the Croatian SOE sector, including the applicable legal and regulatory framework, while Part II provides an assessment of Croatia's existing legislation and practices relative to the standards of the SOE Guidelines. The final section sets out the conclusions and recommendations for improving the corporate governance framework applicable to the Croatian SOE sector. The recommendations, which were endorsed by the Working Party in March 2021, aim at supporting Croatia's ongoing reform efforts by suggesting potential avenues for legislative reforms in view of further aligning Croatia's SOE framework with the SOE Guidelines and best international standards and practices.

Table of contents

Tables

Figures

Boxes

List of abbreviations

AGM	Annual General Meeting
CCA	Croatian Competition Agency
CEE	Central and Eastern Europe
CEO	Chief Executive Officer
CERP	Centre for Restructuring and Sale
CNB	Croatian National Bank
CPF	Croatian Privatisation Fund
EBRD	European Bank for Reconstruction and Development
ERM	Exchange Rate Mechanism
EU	European Union
FINA	Financial Agency
FOPIP	Financial and Operational Performance Improvement Programme
GCO	Global Competitiveness Index
GDP	Gross Domestic Product
GNI	Gross National Income
HANFA	Croatian Financial Services Supervisory Agency
HRK	Croatian Kuna (i.e. the currency)
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPO	Initial Public Offering
ISA	International Standards on Auditing
JSC	Joint-stock Company
LLC	Limited Liability Company
MPCCSA	Ministry of Physical Planning, Construction and State Assets
NATO	North Atlantic Treaty Organisation
PPP	Purchasing Power Parity
PPS	Purchasing Power Standards
ROA	Return on Assets
ROCE	Return on capital Employed
ROE	Return on Equity
SME	Small-and-Medium-Sized Enterprise
SOE	State-Owned Enterprise
USD	United States of America Dollars
USKOK	Office for the Suppression of Corruption and Organised Crime
ZSE	Zagreb Stock Exchange

Part I. The state-owned enterprise landscape in Croatia

Chapter 1. Economic and political context of Croatia

The Republic of Croatia is located in Southeast Europe, on the north-western edge of the Balkan Peninsula. Formerly a constituent of the Republic of Yugoslavia, Croatia acquired its independence in 1991. It is a unitary state operating under three levels of governance: 1) the central level; 2) the regional level, consisting of 21 counties (*županija*) including the capital Zagreb[1]; and 3) the local level, consisting of 428 municipalities (*općina*) and 128 towns (*grad*) (CoR, n.d.[1]). Croatia joined the North Atlantic Treaty Organisation (NATO) in 2009 and the European Union (EU) in 2013.

Table 1.1. Selected economic and social indicators (2017-2020)

	2017	2018	2019	2020 (*est.*)
Output and labour market				
GDP, current prices (in bln USD)	55.3	61.0	60.4	56.7
GDP per capita, current prices (in USD)	13412	14920	14853	14033
Real GDP growth (annual %)	3.1	2.7	2.9	- 9.0
Inflation rate, average consumer prices (annual % change)	1.1	1.5	0.8	0.3
Unemployment rate (as % of total labour force)	12.4	9.8	7.8	9.3
General government gross debt (as % of GDP)	77.8	74.7	73.2	87.7
Current account balance (as % of GDP)	3.4	1.9	2.9	- 3.2
Social indicators				
Per capita GNI, PPP (in current USD)	26200	27630	29620	N/A
At-risk-of-poverty rate (as % of total population)*	20.0	19.3	18.3	N/A

Note: *According to Eurostat, at-risk-of-poverty rate is the share of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income after social transfers.
Source: IMF, World Economic Outlook, October 2020; World Bank; Eurostat data.

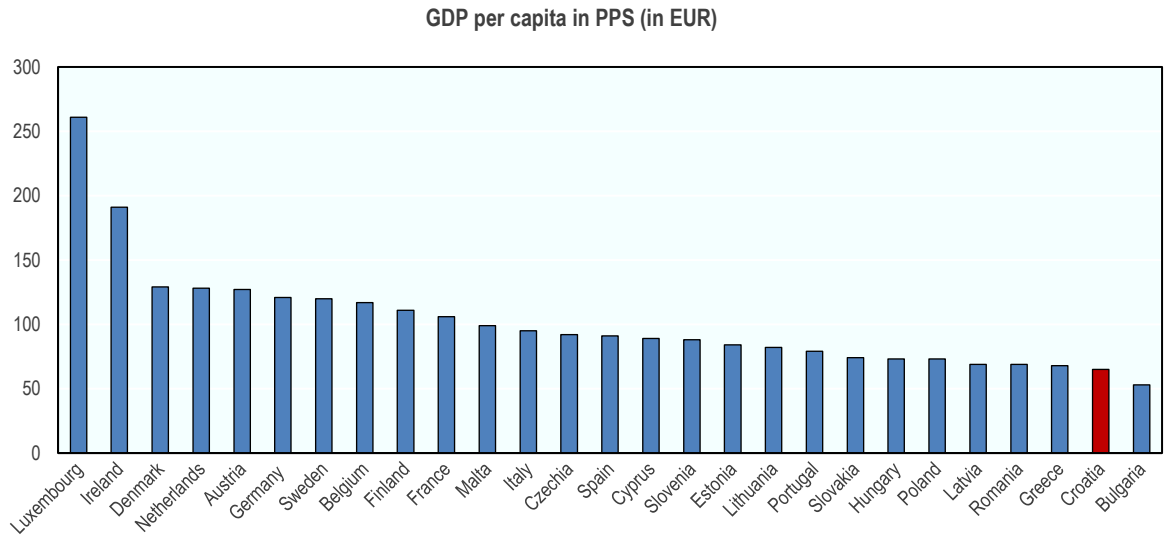
Economy. The Croatian economy has significantly improved since the end of the independence war in 1995. Driven by strong domestic demand and a growing tourist sector, Croatia's economy experienced low inflation and relatively steady and high growth levels (4-6%) between 2000 and 2007 (WTO, 2010[2]). The country was, however, severely hit by the 2008-2009 global financial and economic crisis which led to a six-year long recession and an important deterioration of economic and social indicators (World Bank Group, 2018[3]).

While economic growth resumed in 2015, several weaknesses remain, including a high poverty rate and persistent inequalities between regions - especially between the capital

[1] Zagreb has a special status, which implies that it can perform competences as both county and city. It can also perform state administrative tasks in its territory (CoR, n.d.[1]).

and the rest of the country.[2] The share of poor and vulnerable households in the population currently remains one of the highest among EU member states; and GDP per capita (in purchasing power standards – PPS) one of the lowest in the EU [see Figure 1.1]. In 2019, it represented 65% of the EU average (European Commission, 2020[4]). Despite this, Croatia boasts a relatively high Gross National Income (GNI) per capita making it a high-income country as per the World Bank's new classification.[3] It is generally considered as one of the richest and more developed countries of former Yugoslavia.

Figure 1.1. GDP per capita in PPS, 2019



Source: Eurostat data.

In 2019, GDP growth accelerated from 2.7% to 2.9%, accompanied by an increase in personal consumption and public investment (estimated at 14%) and a decrease in unemployment (7.8%), amongst other aspects. However, despite positive economic trends, the country is set for a deep recession according to the World Bank's latest predictions. The country's GDP already reduced by -6.2% in 2020 and is due to contract further in the wake of the uncertainty caused by the still-ongoing pandemic of Coronavirus disease 2019 (COVID-19). Indeed, the country has not fully diversified its sources of growth and still strongly relies on tourism (which represents around 20% of the GDP) and export of goods - making it highly vulnerable to external shocks (World Bank, 2020[5]).

Government. Croatia has a parliamentary system in which the President of the Republic is the Head of State (currently Zoran Milanović since January 2020) and the Prime Minister is the Head of Government (Andrej Plenković since October 2016). The President's role is regarded as mostly ceremonial; however the Head of State wields

[2] According to the European Commission's 2020 European Semester report: "In 2016, Zagreb accounted for 34% of national GDP, though it is home to only 19% of the country's population."

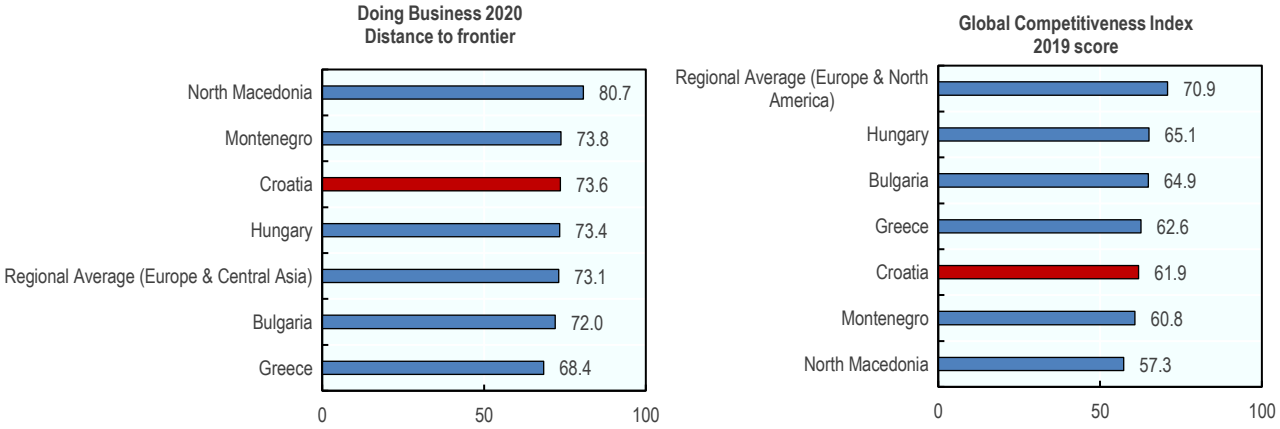
[3] The World Bank assigns the world's economies into four income groups (high, upper-middle, lower-middle, and low) based on calculation of the GNI per capita using the Atlas method, which smoothes exchange rate fluctuations by using a three year moving average, price-adjusted conversion factor.

some power in foreign policy, defence and security matters (Financial Times, 2019[6]). The President is elected directly by popular vote for a period of five years and a maximum of two terms, while the Prime Minister (usually the leader of the majority party or coalition) is nominated by the President subject to approval by the Parliament. The executive branch (generally designated as the Government of the Republic of Croatia) also includes Croatia's 16 Ministers and four state secretaries who act as deputy ministers (Vlada Republike Hrvatske, n.d.[7]).

The unicameral parliament (*Hrvatski Sabor*) holds the legislative power and controls the executive. It consists of 151 representatives, elected by popular vote for a four-year term. This includes three representatives from the Croatian diaspora and eight seats for minorities recognised by Croatia (Serbs, Hungarians, Italians, Czechs/Slovaks and other minorities). The latest parliamentary elections were held on 5 July 2020. The ruling conservative Croatian Democratic Union (*Hrvatska Demokratska Zajednica* – HDZ) won 37.3% of the votes, followed by its main opponent, the centre-left Restart Coalition (24.9%) which is led by the Social Democratic Party of Croatia (*Socijaldemokratska Partija Hrvatske* – SDP) (Izbori, 2020[8]). The HDZ and the SDP are the two main political parties in the country.

Legal system. Croatia has a civil law legal system which is based on the principles laid out in the 1990 Constitution of Croatia (amended in 2000). The Croatian legal and regulatory framework was fully harmonised with the European Community *acquis* upon completing accession negotiations in 2010 (World Bank, 2020[9]). The judiciary system is three-tiered, with the Supreme Court (*Vrhovni Sud)* being the court of highest instance, followed by county courts (15 in total) and municipal courts (67 in total). The president of the Supreme Court is nominated by the President of Croatia and elected by the *Sabor* for a four-year term. In addition, there are also courts of specialised jurisdiction, which include the High Misdemeanor Court (and 61 Misdemeanour Courts), the High Commercial Court (and 7 Commercial Courts); and the High Administrative Court (and 4 Administrative Courts) (World Bank, 2014[10]).

Figure 1.2. Business environment measures, 2019-2020



Note: 0 = lowest performance, 100 = highest performance.
Source: (World Bank, 2020[11]); (WEF, 2019[12]).

Despite significant efforts to reform Croatia's justice sector, the independence of the judiciary is still regularly put into question. According to the 2020 EU Justice Scoreboard,

Croatia scores the worst among EU member states in terms of perceived independence of courts and judges. The main reasons for this relate to the interference or pressure from government and politicians (70%) and interference from economic or other specific interests (68%) (European Commission, 2020[13]). Other weaknesses of the judiciary include a large backlog of cases arising from poor case management and delays in enforcing decisions, as well as a poor functioning of the justice system according to the World Bank's 2018 Systematic Country Diagnostic. Hence, poor governance, lack of transparency and perceived corruption remain a concern in Croatia [see section 5] as the country regularly ranks low in public governance indicators.

Business environment. The apparent inefficiency, unpredictability and slowness of the judiciary (and of commercial courts in particular) also weigh down on the business environment (World Bank Group, 2018[3]). The World Economic Forum's 2019 Global Competitiveness Index (GCI) ranks Croatia 140th out of 141 economies in terms of the efficiency of the legal framework in settling disputes and 70th in the quality of corporate governance. In addition, access to credit remains difficult and competition is weak and less effective than in other regional countries according to the World Bank's 2020 Doing Business Report. Despite this, Croatia's business environment has improved over the last years. It now ranks 51st out of 190 economies in the World Bank's Doing Business Report (compared to 58 the previous year) and 63rd out of 141 countries (compared to 68 previously) in the GC Index, making it the most improved country in the region in 2019 [see Figure 1.2]. In 2019, the Government of Croatia adopted a national reform programme aimed at meeting some of the EU's recommendations, which include improving the business environment, however the pace of reforms remains slow according to the European Commission (European Commission, 2020[4]).

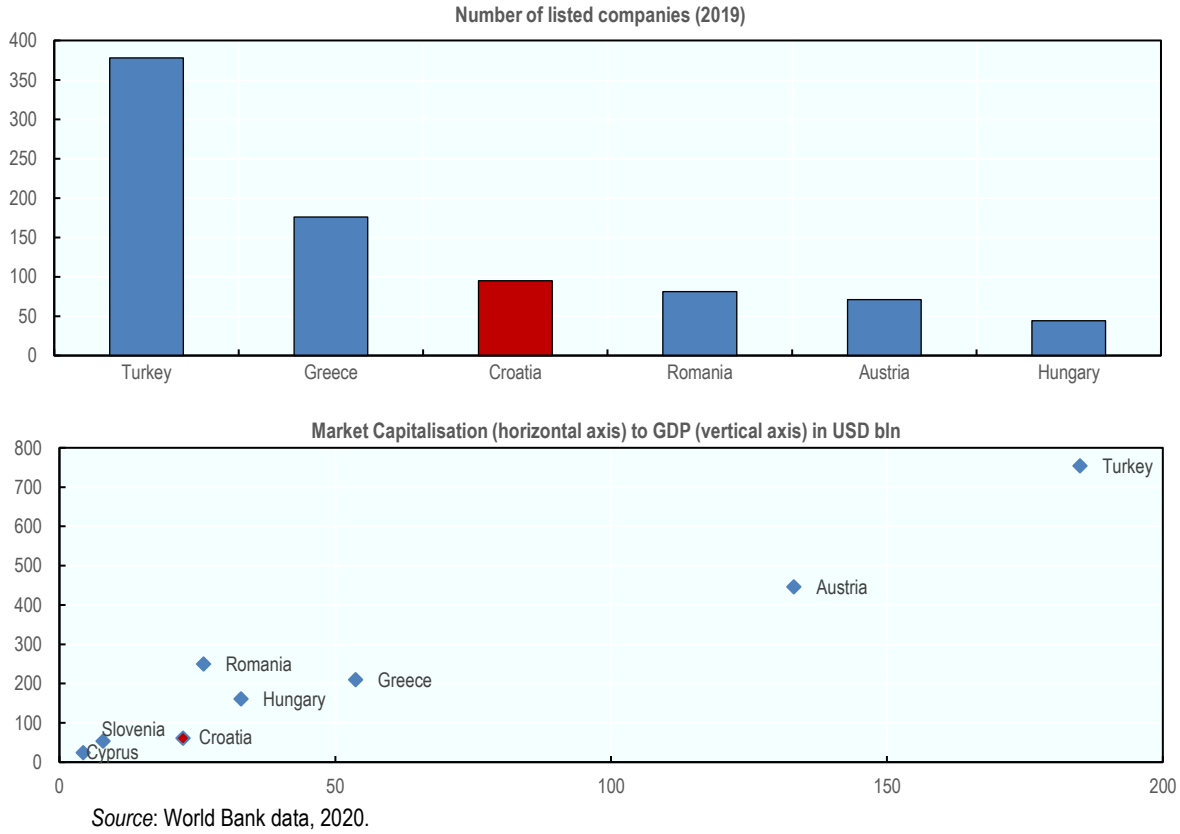
Capital Market. The Zagreb Stock Exchange (ZSE) is the only stock exchange in Croatia. It was established in 1991 as the successor of the "Zagreb Commodities and Valuables Exchange" which operated between 1919 and 1945. In 2007, the ZSE merged with the Varaždin Stock Exchange (VSE), which was established as an over-the-counter (OTC) market in 1993 and became a stock exchange in 2002 (ZSE, n.d.[14]). The ZSE is a fully private, profit-maximising corporation. According to the ownership records as of July 2020, financial companies including banks and insurance companies held 46.8% of the stock exchange's capital, followed by investment funds with 13.5%, the pension fund (10%), Baktun LLC, an American corporation (7.9%), the European Bank for Reconstruction and Development - EBRD (5.2%). The rest (16.6%) was in the hands of individuals (OECD, 2021[15]).

The ZSE operates a Regulated Market and a multilateral trading platform called Progress. The Regulated Market has three segments: the Prime Market, Official Market and Regular Market, with the Prime Market being the most demanding in terms of transparency and disclosure requirements. The Progress Market, on the other hand, is a multilateral trading facility which is registered as a SME Growth Market under EU legislation. It is an alternative market which offers lower transparency requirements compared to the Regulated Market. The ZSE publishes 14 indices including the share index CROBEX and bond index CROBIS (ZSE, n.d.[14]). In 2019, the exchange also released a new index for stocks listed on its Prime segment, CROBEXprime, and a new joint stock index between Zagreb and Ljubljana, ADRIAprime.

The Croatian capital market is rather developed at the regional level but remains small comparatively to other EU countries. Local companies still lack financial literacy and tend to resort to traditional banking solutions to meet their capital needs. Both the stock and corporate bond markets are underdeveloped and underutilised as a financing option, and

initial public offerings (IPOs) are very rare (Vienna Initiative, 2018[17]). While stock market capitalisation grew tenfold between 1995 and 2000, it significantly declined following the 2008-2009 global financial crisis. In fact, since 2008 the number of listed companies has been regularly decreasing over time (OECD, 2021[15]). More recently, the equity market was further impacted by the collapse of the Agrokor Group, one of the biggest industrial groups in Croatia, of which most subsidiaries were listed on the stock exchange (Vienna Initiative, 2018[17]). As of end-2019, the ZSE had 95 listed companies (including six majority-owned and 26 minority-owned state enterprises, 17 of which are less than 10%) for a total market capitalisation of approximately USD 22.4 billion representing around 37.2% of GDP.[4] A recent OECD publication on capital markets in Croatia found that almost all of the listed state-owned companies were in the lower segments of the stock market, although three of them currently "meet the market capitalisation and free float requirements for being eligible on the Prime Market". According to this review, transferring listed SOEs to the Prime Market would "help scale-up the market and improve liquidity conditions as well as their governance" (OECD, 2021[15]).

Figure 1.3. Market capitalisation & number of listed companies for selected regional countries



Source: World Bank data, 2020.

In addition, the OECD Review also found that "one-third of the total value of corporate bonds issued between 2000 and 2019 in Croatia was related to state-owned enterprises" (although no SOE has raised capital through corporate bonds since 2015). The most frequent corporate bond issuers have been the Croatian national energy company HEP

[4] The number of listings includes only companies.

and the Croatian Post. The only financial issuer has been the Croatian Bank for Reconstruction and Development (OECD, 2021[15]).

The financial market is overseen by the Croatian National Bank (which supervises credit institutions) and the Croatian Financial Services Supervisory Agency (HANFA) which supervises the capital market including market infrastructure and intermediaries. The Agency was established in 2005 as an independent legal person with public authority within the scope and competences laid down in the Act of the Croatian Financial Services Supervisory Agency and other laws. It is accountable to the Croatian Parliament (HANFA, n.d.[18]).

Chapter 2. Overview of the Croatian state-owned sector

2.1. Number and type of state-owned enterprises

With approximately 260 public enterprises per 1 million inhabitants, the Croatian SOE sector is in relative terms one of the largest in the EU, as well as among central and south-eastern European countries – a region generally associated with widespread public ownership and state involvement (IMF, 2019[19]). Despite the Government's plan to reduce the sector through privatisation and restructuring, SOEs still account for a sizeable share of the economy.

Table 2.1. Aggregate data on SOEs at the central level of government, 2019

1 Croatian Kuna (HRK) = 0.134300 EUR on 31/12/2019

	Majority-owned listed enterprises				Majority-owned unlisted enterprises			Statutory corporations and quasi-corporations		
	N° of enterprises	N° of employees	Value (HRK mn)		N° of enterprises	N° of employees	Value* (HRK mn)	N° of enterprises	N° of employees	Value* (HRK mn)
			Market	Book equity						
Finance	1	1264	1215	2377	1	57	136	4	4128	25477
Manufacturing	1	176	4	35	7	2613	1073			
Transportation and storage*	3	1444	5476	4530	15	24039	17638	1	1788	1071
Other activities	1	370	766	505	9	2679	333			
Construction					3	3306	81873			
Telecoms					3	1210	1053	1	2794	896
Electricity and gas					2	11559	25632			
Other utilities					2	46	28	1	1031	8340
Agriculture, forestry and fishing					2	8306	1656			
Real estate					2	129	87			
Total	**6**	**3254**	**7461**	**7447**	**46**	**53944**	**129509**	**7**	**9741**	**35784**

*Note:** Value refers to book equity.

**includes data for the Croatian Post and oil transportation companies Janaf and Plinacro, amongst others.

Source: Data provided by the Croatian authorities to the OECD questionnaire, 2020.

According to the register of the Financial Agency, the central government of Croatia holds full or majority ownership in 59 SOEs (including 6 listed companies) and minority stakes (of between 10-49%) in 10 listed companies. In addition, 938 enterprises are fully or

majority owned by local government units at the sub-national level.[5] However, this review focuses mostly on SOEs that are fully or majority owned by the central government [see Annex A for full list].

Since 2018, the SOE portfolio includes a list of enterprises which are of "special interest to the Republic of Croatia", the ownership rights of which are currently jointly exercised by line ministries and the Ministry of Physical Planning, Construction and State Assets - MPPCSA (formerly the Ministry of State Assets) on behalf of the Government of Croatia, with the purpose of improving their efficiency and governance.[6] The rest of SOEs is managed by the Centre for Restructuring and Sale (CERP) in view of their privatisation and restructuring. Currently, CERP's portfolio comprises 342 enterprises, of which 19 are majority-owned by the state [more information on the Ministry and CERP is provided in section 4.1.2 below].

The list of enterprises of special interest is highly heterogeneous but generally includes enterprises operating in sectors perceived as "strategic" or in sectors where the Government performs a price setting function (e.g. energy, transport and utilities). It typically includes enterprises for which there are long-term social needs such as the national electricity company HEP Group, the Croatian Forests Company, and the Croatian Railways (Bajo, Primorac and Zuber, 2018[20]). The Government's list of companies and other legal entities of special interest has been regularly reduced over time. From 210 SOEs in 2004, it lowered down to 59 SOEs in 2013, and currently stands at 39 SOEs as per the dispositions of the Government Decisions no. 71/18 and 20/2020 on Legal Entities of Special Interest of the Republic of Croatia (hereafter referred to as "Decision No. 20/2020 determining SOEs of special interest") [see Annex A for full list].

In addition, there are two other SOEs which do not belong to either the MPPCSA or CERP's portfolio. One of them (Croatia Banka d.d) is owned by the Croatian Deposit Insurance Agency (HAOD)[7] which is a statutory corporation and a legal entity of special interest, whose ownership rights are jointly exercised by the Ministry of Finance and the MPCSSA. The other one is the Croatian Radio-Television (Hrvatska Radiotelevizija) - a statutory corporation whose ownership rights are directly exercised by the Government of Croatia.

2.2. Size and sectorial distribution of the SOE sector

The SOE sector is an important part of the Croatian economy. According to the information provided by the Croatian authorities, the overall SOE sector (including enterprises publicly-owned at the sub-national level) is valued at approximately HRK 190 billion or EUR 25.5 billion – corresponding to 47.2% of the GDP in 2019.[8] Furthermore, the SOE sector employs 66'939 people at the national level (approx. 5.9% of total employment) which, if Croatia was an OECD member country would place it among the top-10 OECD countries with the largest central SOE sector as measured by share of national non-agricultural employment - largely above the OECD unweighted average of

[5] This data does not include minority stakes held by subnational government units.

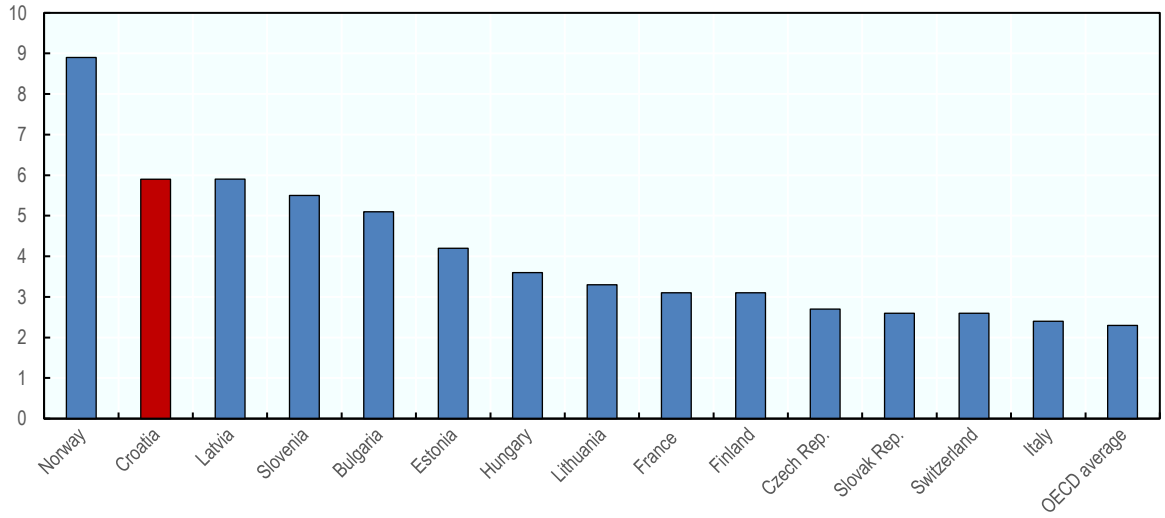
[6] Previously, enterprises in this list were referred to as "enterprises of strategic or special interest".

[7] Former State Agency for Deposit Insurance and Bank Resolution (DAB).

[8] This is an estimate of asset valuation. It does not imply that SOEs account for more than 47 percent of the national economy. Several studies report a much higher valuation, laying at approximately 80% of GDP (EBRD, 2018[27]).

2.2% [Figure 2.1] (OECD, 2017[21]). This percentage goes up to 6.5% of total workforce when including data on public enterprises held at the sub-national level (OECD estimates based on information submitted by the Croatian authorities and (EURES, 2020[22])).

Figure 2.1. SOEs' share of total non-agricultural dependent employment



Note: Data for Croatia is from 2019.

Source: OECD based on data collected for (OECD, 2017[21]) and ILOSTAT figures on non-agricultural employment in 2015.

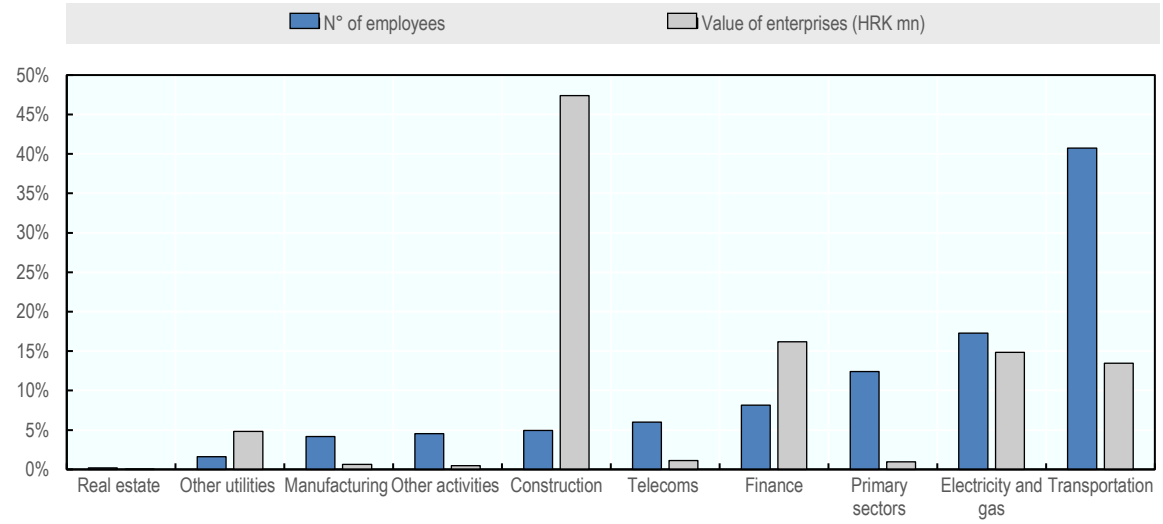
In a breakdown by sector, transportation accounts for the larger number of SOEs at the national level, followed by other activities[9] (which includes tourism), finance and manufacturing. When measured by employment, the public sector appears highly dominated by the transportation sector which accounts for 41% of total SOE employment [Figure 2.2]. However, when measured by value added, the major share goes to the construction sector (47.4%), followed by finance (16.2%) and electricity (14.8%). These results differ quite significantly at the subnational level where the water utilities sector makes up for 55.6% of total employment and 93% of total value added in public enterprises. The largest individual SOE employers are the electricity distribution company HEP group (11'520 employees); the oil multinational company INA Group (10'757 employees) and the Croatian Post (10'061 employees).

There are currently 6 listed SOEs which are majority owned by the central government of Croatia. Together they accounted for 5% of total market capitalisation in 2019 (33.57% when including minority stakes of between 10-49%).These include 1) the national flag carrier Croatia Airlines; 2) the oil transportation and storage company Janaf; 3) the Croatian Postal Bank; 4) the maritime shipping company Jadroplov; 5) the publishing company Vjesnik, and 6) the tourism company ACI. The central government also holds minority shareholdings (of 10-45%) in 10 companies which operate in various sectors of the economy. These include the oil company INA; the food and pharmaceutical company

[9] Other activities include SOEs operating in (1) Arts, entertainment and recreation; (2) Accommodation and food service activities; (3) Professional, scientific and technical activities; and (4) Wholesale and retail trade; repair of motor vehicles and motorcycles as per national classification.

Podravka; and the Palace Hotel.[10] Together, these companies account for 24'317 employees and approx. HRK 16.8 billion (around EUR 2.2 billion) of value added.

Figure 2.2. Sectorial distribution of central SOEs by employment and value (2019)



Source: Data provided by the Croatian authorities to the OECD questionnaire, 2020.

Croatian SOEs (including public enterprises at the sub-national level of government) operate therefore in many key sectors of the economy including commercial ones, where they may sometime have a dominant position – undermining therefore the competitiveness of certain industries. In the transport sector for example, the preferential treatment of the three state-owned rail companies (HŽ Infrastruktura, HŽ Putnički prijevoz, HŽ Cargo) has been often considered to prevent the development of private rail enterprises in Croatia (European Commission, 2017[23]).[11] In others, SOEs enjoy a monopoly status such as in the sectors of electricity, gas and water management and supply [Box 2.1] (OECD, 2019[24]).

[10] In addition, there are 17 companies with state ownership of less than 10%.

[11] The European Commission has repeatedly flagged the dominant position of the Croatian freight railway operator HŽ Cargo which accounted for around 91 % of total freight transport and 100% of passenger rail transport in 2016 (European Commission, 2018[58]).

Box 2.1. Activities covered by public, private, mixed monopolies or concessions

A number of activities are reserved to the Republic of Croatia, namely:

- The provision of electricity transmission which is carried out by the state-owned company Hrvatski Operator Prijenosnog Sustava d.o.o. (HOPS);
- The provision of electricity distribution, which is reserved to the state-owned company HEP-Operator Distribucijskog Sustava d.o.o. (HEP-ODS);
- The provision of wholesale electricity market supply, which is reserved to HEP Elektra d.o.o.;
- The transport of natural gas, whose monopoly is reserved to the state-owned company Plinacro d.o.o.;
- The operation of Croatia's gas storage system, which is reserved to Podzemno Skladiste Plina d.o.o;
- The wholesale gas market supply, which is reserved to HEP d.d;
- Water management, which is the monopoly of the state-owned company Croatian Waters (Hrvatske Vode);
- Water supply, wastewater treatment and sewage, which is the responsibility of local governments and provided by various public utility companies.

A few sectors are also subject to private or mixed monopolies or concessions. For example, the company Jadranski Naftovod (JANAF), which has mixed ownership but is majority-owned by the State, holds the monopoly over crude oil transportation in Croatia, while the following activities are subject to concession agreements between the private investor and Croatia: mining research and exploitation and related secondary activities (i.e. exploration and exploitation of hydrocarbons and geothermal energy), the exploitation of maritime domains and the provision of management and operation of ports.

Source: Extract from (OECD, 2019[24]).

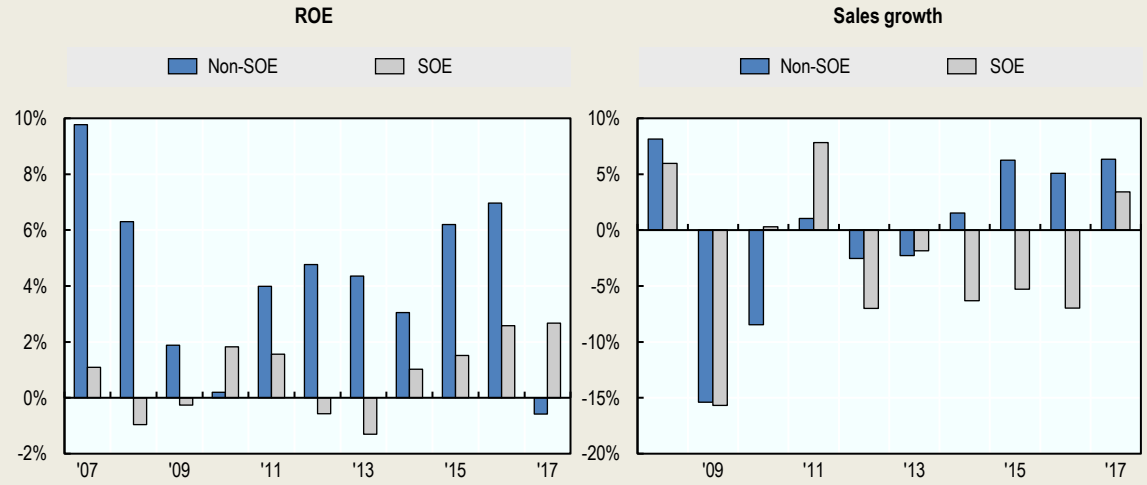
2.3. Financial indicators for SOEs

While SOEs account for a significant part of the Croatian economic activity, their performance is rather weak – including by regional standards. According to an EBRD study, the profitability of Croatian SOEs (as measured by the Return on Assets - ROA) was only one-quarter of the average ratio in Central and Eastern Europe (CEE) between 2012-2014 (World Bank Group, 2016[25]). The productivity gap between Croatian SOEs and their privately-owned peers was also found to be the widest among all CEE countries in 2014 (European Commission, 2017[23]).

This was further confirmed by a recent OECD publication which found evidence that, between 2007 and 2017, return on equity (ROE) and sales growth were both generally lower for SOEs than for private companies (Box 2.2). It also found that, even when removing large and strategic SOEs (which tend to drive up the overall performance of Croatian SOEs), more than 80% of non-strategic SOEs (i.e. minority and majority-owned SOEs centrally managed by CERP) had an ROE below the industry median in almost all years of the period analysed (OECD, 2021[26]).

Box 2.2. Performance of SOEs vs non-SOEs (2007- 2017).

In 9 out of 11 years between 2007 and 2017, SOEs had a lower ROE compared to non-SOEs. Importantly, the performance of SOEs fluctuated around zero between 2007 and 2013, before rising to around 3%. With respect to sales growth, both SOEs and non-SOEs suffered a significant contraction in 2009, during the global financial crisis. However, SOEs experienced a stronger recovery in the following two years compared to non-SOEs. Particularly in 2011, driven by the strong performance of INA Group, the national oil company, SOEs' total revenue grew by 8%. After 2013, non-SOEs outperformed SOEs in all years with respect to sales growth. Indeed, SOEs had a negative sales growth for five consecutive years up to 2017.



Source: Excerpt from (OECD, 2021[15])

A number of studies suggest that the profitability of Croatian SOEs is mainly hampered by: 1) high interest costs (as Croatian SOEs are highly leveraged); 2) issues with collecting claims[12]; and 3) high labour costs (EBRD, 2018[26]). Indeed, the average wage level in the SOE sector appears misaligned with productivity performance and is higher than in other EU member countries. Available data from 2014 show that the labour cost to operating revenue ratio of Croatian SOEs was 37.1% - that is, significantly higher than the regional average of 25.9% (EBRD, 2018[27]). This is largely attributed to a rather inflexible wage-setting system in Croatian SOEs due to the existence of collective bargaining agreements which often result in higher wages than in the private sector coupled to a wide range of benefits including generous retirement bonuses (European Commission, 2015[28]).[13]

As a result, several Croatian SOEs have been running a deficit and piling up debts for years – partly as a result of large infrastructure and development projects which were launched after the independence war in 1995. A 2015 micro data analysis led by the

[12] The collection of receivables is reportedly very slow by regional standards, taking around 50-180 days compared to 20-100 days in the four other regional CEE countries surveyed (EBRD, 2018[27]).

[13] The public sector (including SOEs) is highly unionised in Croatia. Around 70% of SOEs are unionised as opposed to 17% of companies in the private sector (European Commission, 2015[56]).

European Commission shows that corporate debt in the public sector is highly concentrated in the utility and construction sectors (in particular the road sector) and that within these sectors, debt is held by only a "handful of weakly profitable companies". This concentration, although mitigated by the quasi-monopoly status of the companies operating in these sectors, remains a source of financial and fiscal risk for the Croatian Government (European Commission, 2015[28]). Weak performance and large indebtedness of SOEs are also generally attributed to poor corporate governance and vested interests [see section 5 of this review].

2.3.1. Contingent liabilities for the Croatian Government

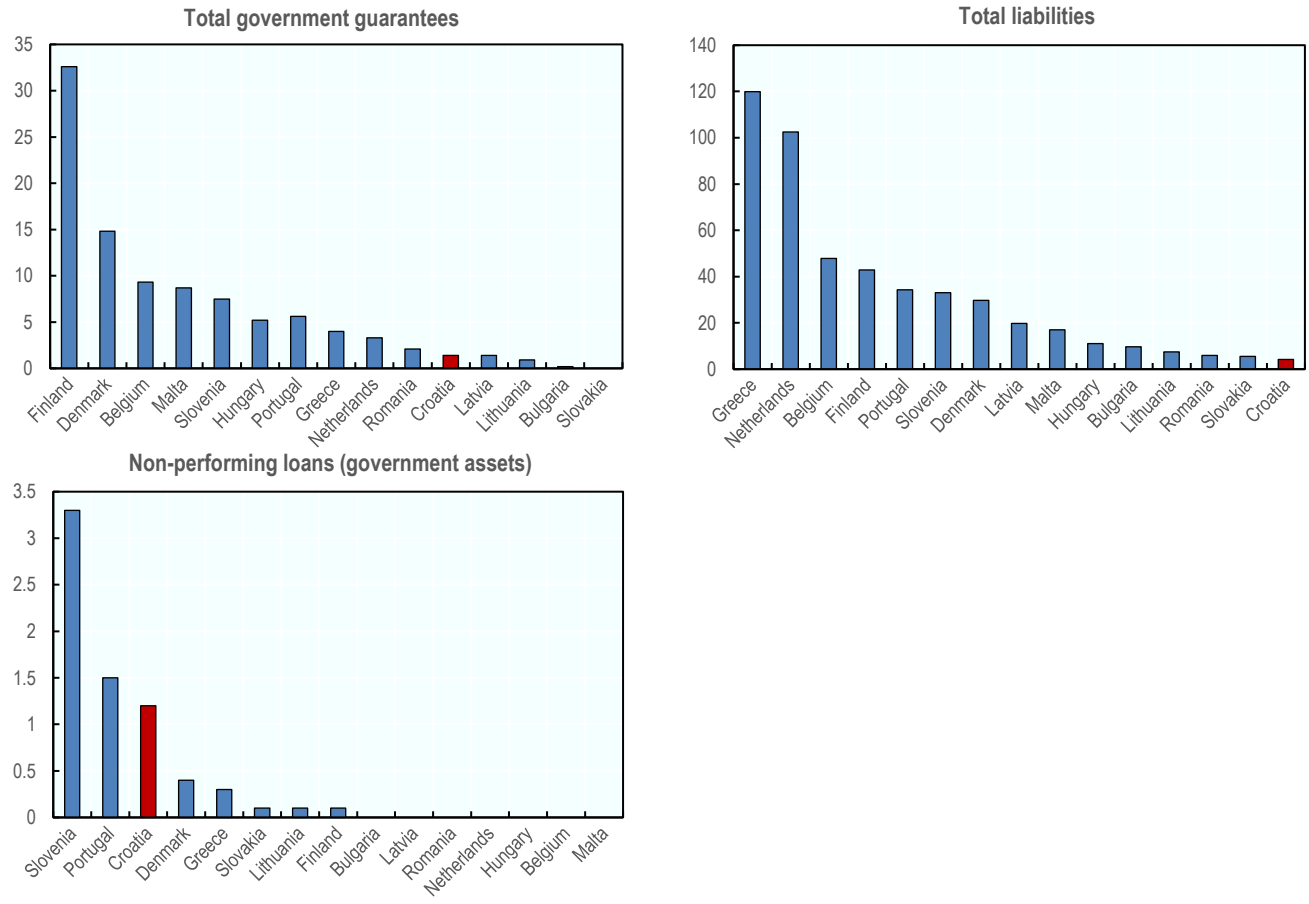
As a result of their poor performance, SOEs' contributions to the state budget remain low (less than 1% of GDP) [see Annex D for an overview of the total amount of dividends paid by SOEs between 2016 and 2020]. According to the State Budget Implementation Act (Official Gazette no. 117/19, 32/20, 42/20 and 58/20), only enterprises of special interest (with the exception of statutory corporations) are obliged to remit all or part of their profits to the state budget. The amount to be paid, methods of payment and deadlines are determined on an annual basis pursuant to government decisions. Enterprises minority-owned by the state are liable for a portion of profits corresponding to the state's ownership share in the company. In 2019, 15 SOEs were required to pay 60% of their net profits into the state budget, while two others: the Croatian Lottery and the arms dealing company Agencija Alan were required to pay 100% of their profits.[14] However, as evidenced by Bajo, Primorac and Zuber in their 2018 publication, in most cases, SOEs fail to comply with the Government's decisions and make no payments (or only in part) such as HEP whose liabilities were the highest during the period covered by the analysis (2011-2016) (Bajo, Primorac and Zuber, 2018[20]).

In addition, while SOEs' payments to the state budget remain low, some of them also require large subsidies and government guarantees for borrowing [see Annex C for more information on subsidies and financial guarantees provided to SOEs between 2016 and 2019]. According to the latest Eurostat data, total government state guarantees and liabilities were one of the lowest among EU member states in 2018, amounting to 1.4% and 4.2% of GDP, respectively. The country's stock of non-performing loans (assets) of general government was however one of the highest [Figure 2.3] (Eurostat, n.d.[29])[15] Nevertheless, while SOE's liabilities and requirements for subsidies have considerably decreased over the last decade, some of them continue to put an important pressure on public finances, contributing therefore to high fiscal imbalances.

[14] Certain SOEs may be exempt from paying their profits in a given year if prior to the adoption of the Decision, they submit a request for exemption to the relevant ministry, providing the reasons for the exemption including supporting documents. If the line ministry considers the request justified, it forwards it to the Ministry of Finance which then evaluates the request and, if necessary, conducts additional analyses before sending the proposal of the Decision to the Government of the Republic of Croatia for consideration.

[15] The figure mainly refers to the loans of the National Development Bank (also classified inside general government) (Eurostat, n.d.[29]).

Figure 2.3. Total government contingent liabilities and non-performing loans in selected EU member states, as percentage of GDP (2018)



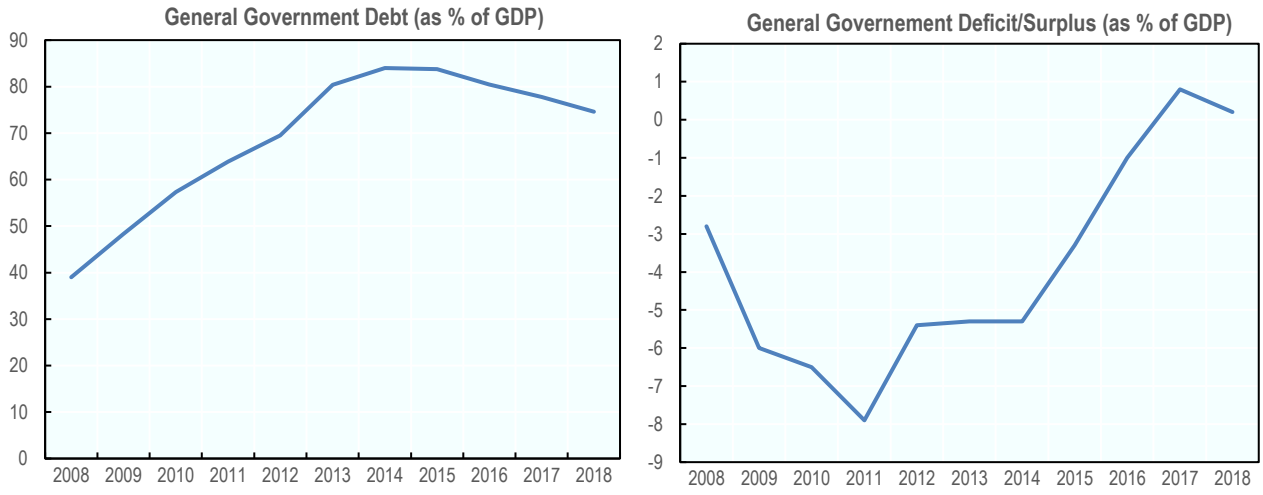
Note: Total liabilities of government controlled entities classified outside general government.
Source: Eurostat data.

Public finances were hit particularly hard during the recession but started improving in 2016 [figure 2.4]. In particular, general government debt sharply rose between 2008 and 2015, largely due to high government deficits and "off-budget transactions including the rising net borrowing of SOEs classified in the general government sector – most of which were running deficits - and the take-up of debt by the state upon repeated calls on guarantees to public corporations" according to the European Commission (European Commission, 2017[23]). In addition, the deficit was aggravated by the accumulation of debt at the subnational level where counties and municipalities own a significant number of public enterprises. In fact, due to restrictive debt limits set by the Budget Act, local government units have relatively little direct debt, with the exception of the City of Zagreb, however they are generally able to circumvent these restrictions by borrowing through local public enterprises and by providing guarantees for utility companies' loans (World Bank, 2016[30]).

Public debt, which reached 85% of GDP in 2014, started improving in 2016, mainly due to a declining deficit and recovering GDP growth. The number of SOEs operating at a loss also continuously decreased since then due to cost-cutting and restructuring measures amongst other aspects (Bajo, Primorac and Zuber, 2018[20]). In 2017, the

Government issued a EUR 1.25 billion bond to refinance the debt of some of its SOEs.[16] It also made some progress in reinforcing the framework for public debt management by notably increasing the size of the public debt management body and upgrading its status to a Directorate operating within the Ministry of Finance (OECD Commission, 2018[31]). The debt-to-GDP ratio was of 73% in 2019. Following the COVID-19 crisis, it is forecasted that Croatia's general government debt will increase to 90% of GDP by the end of 2020 (European Commission, 2020[32]).

Figure 2.4. General government debt and deficit/surplus, 2008-2018.



Source: (IMF, 2018[32]) and Eurostat data, 2018.

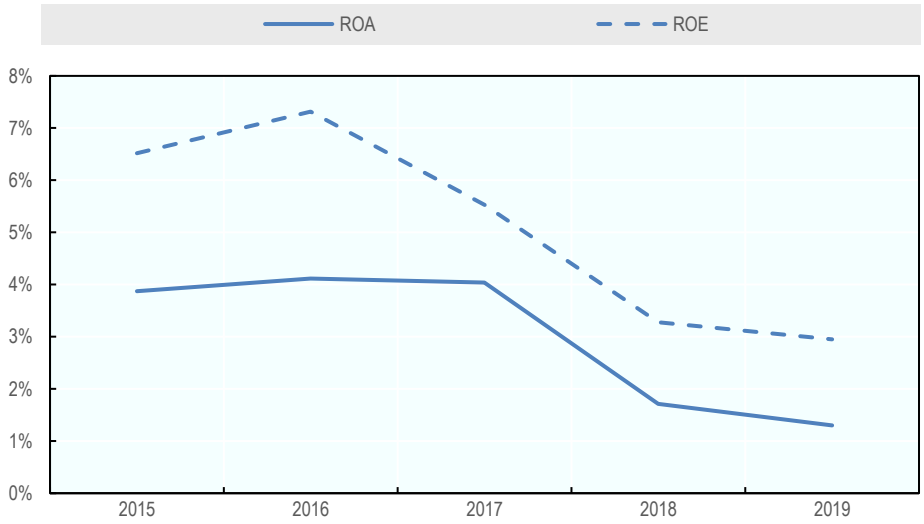
2.3.2. A granular look at SOE performance

Aggregate data for the 11 largest SOEs[17] in Croatia suggest a general decline in performance and profitability as measured by median ROA and ROE over the last few years (Figure 2.5].

[16] This resulted in reduced interest rate and extended maturities, which enabled the authorities to concentrate a higher share of general government debt under the Treasury (European Commission, 2020[40]).

[17] These include 1) Croatian Roads (Hrvatske Ceste d.o.o) 2) HEP d.d.; 3) Croatian Motorways (Hrvatske Autoceste d.o.o); 4) the railway infrastructure operator (HŽ Infrastruktura d.o.o); 5) the transmission system operator (Hrvatski Operator Prijenosnog Sustava d.o.o); 6) Jadranski Naftovod d.d.; 7) the oil transportation company Plinacro d.o.o; 8) the distribution system operator (HEP – Operator Distribucijskog Sustava d.o.o); 9) the Croatian Postal Bank (HPB d.d.); 10) Croatian Forests (Hrvatske Šume); and 11) the Croatian Bank (Hrvatska Posta d.d.).

Figure 2.5. Performance of Croatia's largest SOEs (2015-2019)



Source: OECD based on information provided by Croatian authorities, 2020.

When taken individually, SOEs present highly heterogeneous results. For example within the portfolio of enterprises of special interest, only two SOEs accounted for 63% of total revenue in 2019 – one of which contributed a staggering 42%. These were (in order of importance):

1. The oil company INA (which is minority-owned by the state but tightly monitored by the Government as a company of "special interest"), and;
2. The electricity utility company Hrvatska Elektroprivreda (HEP).

At the other end, 1) Croatia Airlines; 2) the freight railway operator HŽ Cargo; and 3) the Croatian Roads company (Hrvatske Ceste) all suffered losses in 2019 (MPPCSA, 2020[35]). All of these companies have been operating at a loss for years, even though some of them had undergone restructuring such as Croatia Airlines (Bajo and Primorac, 2015[34]). [Further illustrative examples are provided in the form of individual financial data for 11 of the largest Croatian SOEs in Annex B].

The difference in performance can be attributed to some extent to their respective activities, however all SOEs of special interest are said to perform public policy objectives (in addition to commercial objectives in most cases) which may have an impact on their operational efficiency. It is unclear how public policy objectives are defined for individual enterprises (with the exception of statutory corporations for which public policy objectives are generally laid out in their respective founding acts).[18] However, according to Croatian authorities, SOEs that engage in both public policy and competitive activities are required to exercise a structural separation of those activities as per the Act on the Transparent Flow of Public Funds (OG no. 72/13 and 47/14). In particular, Article 5 of the Act requires SOEs (under the denomination of "Public Undertakings") to keep separate accounts and identify public funds granted by authorities and the use thereof. This includes information about operating loss coverage, grants, loans and compensations for financial burdens

[18] Some SOEs may also refer to sectoral objectives elaborated by their line ministries and/or government annual and long-term strategic plans.

amongst other aspects. This information is then compiled by the Ministry of finance and submitted to the European Commission as per standard procedure.

Broad mandates and objectives, including financial targets, capital structure objectives and risk tolerance levels are defined unilaterally by SOEs without prior approval or consultation with their line ministries. However, these generally take into account strategic plans issued by their respective line ministries (e.g. strategic plan for the development of the railway network). Since 2018, SOEs are required to report on their financial performance and strategic plans using the so-called Guidelines for Tracking Business of State Companies and Legal Entities" which have been developed with the assistance of the EBRD as part of an EU-funded project. Through this system, SOEs inform the Ministry of Finance and the Ministry of Physical Planning, Construction and State Assets (or CERP, if they are not "of special interest") of their performance via quarterly and annual reports, as well as annual and mid-term plans. However, these documents do not need to be submitted to their line ministries, which in general do not actively monitor the performance of their SOEs. There are certain exceptions such as the Ministry of Sea, Transport and Infrastructure which has developed its own monitoring system consisting of a set of indicators which SOEs are required to report on twice per year.

2.4. Evolution of the SOE sector: a historical perspective

In the wake of Croatia's declaration of independence from Yugoslavia, the country adopted the 1991 Law on the Transformation of Socially-Owned Enterprises as a first step towards restructuring its economy and transitioning from a socialist to a liberal market system.[19] The Law envisaged the transformation of socially-owned enterprises into joint-stock or limited liability companies with defined ownership structures. The Croatia Privatisation Fund (CPF) was established to manage the process which took place in two stages. The first stage (1991-1993) sought wide participation from company workers and managers who were offered preferential rights for acquiring shares at a significant discount. As a result, some 600 000 small investors acquired shares in a total of more than 2500 enterprises. The second stage of the privatisation process (1993-1997) was implemented through mass voucher privatisation. Indeed, a third of remaining shares of enterprises which had not been privatised were remitted to the state-owned Croatian Pension Funds, with the remainder going to the CPF. The CPF started distributing vouchers to certain categories of the population, mostly individuals affected by the independence war (1991-1995) such as veterans and their families. In total, more than 500 companies would have their shares sold through voucher privatisation (WTO, 1998[35]).

In practice, the methods of privatisation led to the nationalisation of a significant part of former social assets, as large public enterprises were left out of the scope of the Law. As a result, the Croatian state took full ownership of a large number of enterprises, including some of the largest infrastructure and utility companies, which as of 1995 represented approx. 40% of the privatisable equity and 30% of total employment (Crnković, Požega and Sučić, 2014[36]). In 1995, Croatia adopted a new Law on Privatisation with the objective of accelerating the privatisation process. Most utilities and banks were,

[19] The Law replaced the Federal Privatisation Law of 1989 which launched wide social and economic reforms under former Yugoslavia.

however, excluded from its application and were to be privatised under a separate legislation, with the Government retaining 25% of the capital in most cases (Franičević, 1999[37]). By the end of 1995, 1145 enterprises (out 2500) had been completely privatised following their conversion into joint-stock companies. Most of these companies were small and medium-sized enterprises with dispersed ownership. The lack of a strong majority owner and large residual state holding is said to have inhibited the pace of company restructuring, as the CPF and pension funds (the largest shareholders in many privatised companies) did not take an active role in enterprise management and restructuring. The privatisation process in Croatia also drew criticism for being opaque and benefitting a small group of politically well-connected people who were sold important enterprises at below-market prices (Jeffries, 2002[38]).

As a result, the privatisation of large SOEs was practically at a standstill during the second half of the 1990s. By the end of 1999, the state still retained stakes in 1610 enterprises of which more than half were loss-making. To reduce the fiscal burden, a new legislation on Foreign Direct Investment was passed in 2000 with the purpose of speeding up the privatisation process and liberalising the investment regime. The privatisation process gained particular momentum in 1999 with the privatisation of the Croatian Telecom (which was 51% sold to Deutsche Telekom in two steps in October 1999 and October 2001), followed by the privatisation of INA in 2002 (Jeffries, 2002[38]). However, privatisation revenues started declining in 2006-07 partly because of the Government's decision to adopt a list of "companies of strategic or special interest" in 2004, which included some of the largest companies in the country (Bajo, 2011[39]). During this period, several restructuring programmes were also launched with an initial focus on the railway and shipbuilding industries, which eventually resulted in the privatisation of a few loss-making and heavily subsidised shipyards in 2013, right in time for Croatia's accession to the EU.

In 2010, the CPF (which was already in charge of the privatisation process) became the Agency for Management of the Public Property (*Agencija za upravljanje državnom imovinom* - AUDIO) and acquired new competences relating to the management of assets and legal entities owned by the state. Following the adoption of the Act on Management and Disposal of State Assets in 2013, these competences were separated and vested in two new entities: 1) the State Office for State Property Management (*Državni ured za upravljanje državnom imovinom* - DUUDI) in charge of managing companies of strategic and special interest; and 2) The Centre for Restructuring and Sale (*Centar za restrukturiranje I prodaju* - CERP) in charge of managing non-strategic and minority-owned companies (which became the legal successor of the AUDIO) [see section 4.1.2 for more information on these institutions]

Overall, however, progress with restructuring and privatisation of SOEs has been slow. The European Commission and international financial institutions have repeatedly urged Croatia to speed up the pace of reforms. The Croatian Government has recognised the importance of reducing state ownership and has committed to "divesting some of its minority shares with no strategic value for the state and no economic rationale for government ownership" as part of its ERM-II prior-commitments. This objective also figures prominently in the EU's country-specific recommendations and Croatia's National Reform Programme 2019, of which one of the main priorities was to "accelerate the sale of SOEs and unproductive assets". Despite this, however, only limited progress has been made last year according to the 2019 EU country report for Croatia which cites "substantial delays to the introduction of measures aimed at speeding up the activation of assets and the disposal of minority shares in SOEs". As of July 2020, shares and

business interests in 26 companies (out of 90 planned) were sold in three rounds between August 2019 and March 2020 for a total of HRK 4.5 million or approximately EUR 600 000. Most of these companies belong to the manufacturing and tourism sector (European Commission, 2020[40]).

Table 2.2. Overview of CERP's portfolio, 2013-2019.

Description	2013	2014	2015	2016	2017	2018	2019
Total companies; of which	582	531	491	445	415	387	342
- Minority shareholdings of up to 49.99%	529	488	454	401	374	352	323
- Majority shareholdings above 50%	40	37	32	31	31	27	19
- Inactive companies	13	6	5	13	10	8	N.A
Total amount of sales, in HRK	N.A	N.A	N.A	799.072.448	315.917.324	446.111.315	277.308.296

Source: State Property Management Strategy for the period 2019 –2025.

According to the State Property Management Strategy 2019-2025, the number of companies in the CERP-managed state portfolio is "not reducing fast enough, since sales are made difficult by the low interest of potential investors, existing reservations/provisions blocking the sale[20], rights of pre-emption, portfolio increase due to acquisition of shares from pre-bankruptcy settlement as well as the economic and financial status of the companies" [Table 2.2].

[20] According to the State Property Management Strategy 2019-2025, "of the total of 379 actives companies, 214 have a full or partial reservation recorded".

Chapter 3. Legal and regulatory framework

3.1. Main laws and regulations on corporate governance

Companies Act

The Companies Act (Official Gazette no. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19) is the main law governing the corporate sector in Croatia. It contains dispositions on the establishment, organisation, dissolution and status changes of companies and affiliated companies, and applies to all companies, including SOEs (with the exception of statutory corporations to whom only select provisions apply). Pursuant to the provisions of the Companies Act, a company may be established as a public company, a partnership, a joint stock company (JSC), a limited liability company (LLC) or an economic interest group.

The Companies Act does not explicitly mention any issues in regards to state ownership and does not provide any definition of state-owned companies. However, it does establish certain corporate governance requirements in regards to the rights and responsibilities of the shareholders, the rules of corporate management, including the composition and structure of supervisory boards, as well as the rules on transparency, auditing, and accountability which also apply to SOEs. According to the Croatian authorities, the two-tier structure of the management board and the supervisory board is predominantly used in Croatia, however, the Companies Act allows companies to define in their Articles of Association that, instead of a management board and a supervisory board, they have a governing board (supervisory board). Pursuant to the Companies Act, the management board may issue by-laws.

The Companies Act has been amended numerous times, including in order to harmonise its content with the EU *aquis communautaire*. It was last amended in April 2019 with the main goal to ease the incorporation and termination of LLCs and simple limited liability companies (SLLC), and to implement the EU Directive 2017/828 on the amendment of the EU Shareholder Rights Directive, which aims to improve corporate governance for JSCs whose shares are admitted to trading within an EU Member State.

Laws and regulations on capital markets

The Croatian capital market is regulated by the Capital Market Act (Official Gazette no. 65/18 and no. 17/20), and the Act on the Takeover of Joint-Stock Companies (Official Gazette no. 109/07), last amended in 2013. Both Acts apply to listed SOEs (currently 6 majority-owned and 10 minority owned (10-49%) at the central level of government). The Capital Market Act regulates all aspects of investment and security services and defines the responsibilities of the Croatian Financial Services Supervisory Agency (hereinafter “HANFA”), which is in charge of supervising the fulfilment of the obligations of issuers listed on the regulated market of the Zagreb Stock Exchange.

The law enumerates the rights and obligations of companies listed on the regulated market of the ZSE, including enhanced disclosure requirements. Insider information and the prohibition to use, disclose and recommend such information is stipulated by the provisions of the Capital Market Act and applies to all financial instruments on a regulated market and multilateral trading facility (MTF), irrespective of the place where the transaction was performed.

The Act on the Takeover of the Joint-Stock Companies regulates the conditions governing the publication of takeover bids for offeree companies, the takeover procedure (and its supervision) as well as the rights and obligations of participants in the process.

The Corporate Governance Code

The Croatian Corporate Governance Code was adopted by the HANFA and ZSE in October 2019. The current Code replaced the previous 2010 edition, and applies as of 1 January 2020. It applies to JSCs, whose stocks are listed on the regulated market of the ZSE, with the exception of closed-end Alternative Investment Funds (AIFs). It is published on the websites of HANFA and ZSE along with the compliance questionnaires, guidance on how to complete them, as well as information on when and how they should be submitted and published. Companies are required to report annually on their compliance based on a "comply or explain" principle.

The Code lays down the foundations for the development of corporate relations within the companies. The principles of the Code include ensuring transparent business operations, defining detailed work procedures for the issuer's management board and supervisory boards, avoiding conflicts of interest and establishing efficient internal controls and accountability mechanisms. The Code also prescribes corporate social responsibility, i.e. the obligation to adopt policies related to assessing the impact of a company's activities on the environment and the community and managing related risks; including provisions related to preventing and sanctioning bribery and corruption.

The Code has been written to be applied by companies with two-tier board structures. However, it is appended with a number of provisions that are specifically addressed to the companies with a single supervisory board and provides guidance on how such companies should interpret the Code and its provisions.

Some parts of the Code overlap with other mandatory legal provisions and ZSE rules. In most of these cases, the provisions in the Code are either more detailed or set higher standards than the relevant mandatory legal provisions or ZSE requirements. Therefore, compliance with the law or ZSE rules may not on its own be sufficient to comply with the provisions of the Code. Likewise, complying with the Code does not remove the requirement on companies to comply with other applicable laws or ZSE rules.

Laws and regulations on banking institutions

The Croatian National Bank (CNB) is the central bank of Croatia. It operates on the basis of the Act on the Croatian National Bank (Official Gazette no. 75/2008, 54/2013 and 47/2020) and is responsible for the supervision of banks and credit institutions. The majority of quantitative requirements for credit institutions is set out in EU Regulation No. 575/2013 (the so-called Capital Requirements Regulation). Other quantitative and qualitative requirements are regulated by the Credit Institutions Act (Official Gazette no. 159/2013, 19/2015, 102/2015, 15/2018, 70/2019, 47/2020 and 146/2020), transposing EU Directive 2013/36 (the so-called Capital Requirements Directive), as well as specific

ordinances and regulations issued by the CNB. Corporate governance provisions of the Companies Act apply to the credit institutions unless otherwise stated in the Credit Institutions Act. Listed credit institutions are also subject to the requirements set by ZSE Rules, the Corporate Governance Code and relevant provisions of the Capital Markets Act on transparency and issuers' obligations.

The Credit Institutions Act (CIA) prescribes, in addition to provisions laid down in the Companies Act, additional competences, duties and responsibilities for members of the supervisory board (Articles 48 and 49). It also requires prior approval from the CNB for appointment of board members and of the chairperson (Article 39) in order for CNB to perform due diligence checks, and sets out requirements for the establishment of board committees, including nomination, risk and remuneration committees. The CIA also regulates reporting obligations to the CNB as well as public disclosure requirements which are more stringent than those established by the Companies Act. Currently, the law applies to two state-owned banks: the Croatian Postal Bank - HPB (market share around 5%) and Croatia Banka d.d. (market share around 0,5%).[21]

The Act on the Croatian Bank for Reconstruction and Development (Official Gazette no. 138/06 and 29/13), creating the Croatian state-owned development bank (HBOR) also contains certain corporate governance requirements. In particular, it stipulates that the supervisory board of HBOR consists of ten members: six ministers of the Croatian Government, three members of the Parliament and the Chairman of the Croatian Chamber of Economy. The supervisory board monitors and controls the legality of operations of the management board and appoints and revokes the president and members of the management board. The supervisory board determines the principles of business policy and strategy, supervises the bank's business operations, establishes the credit policies of HBOR, prepares the annual financial statements and considers the reports of internal audit, external independent auditors and reports of the State Audit Office.

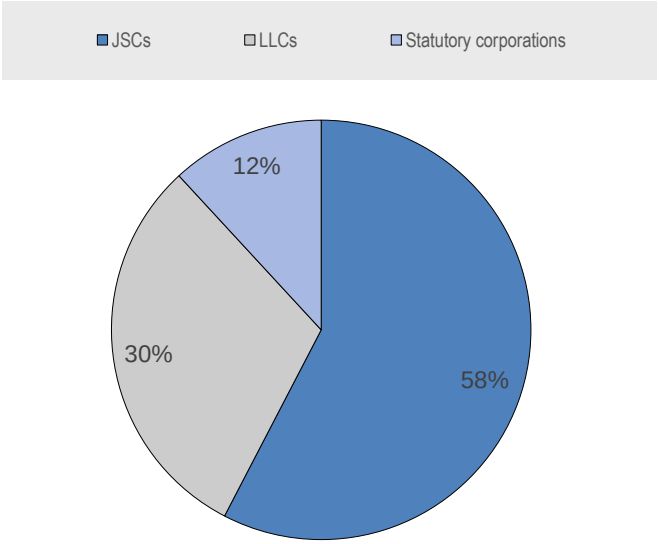
3.2. Legal forms of Croatian SOEs

Pursuant to the Companies Act, SOEs in Croatia are primarily established as joint-stock companies or limited liability companies. There are also SOEs, which operate as statutory corporations. These are legal entities with public authority, established pursuant to a special law. Out of the 59 fully or majority-owned SOEs: 34 are limited liability companies; 18 are joint-stock companies – 6 of which are listed on the Zagreb Stock Exchange; and 7 are legal entities (i.e statutory enterprises and quasi-corporations) [Figure 3.1]. At the sub-national level of government there are 938 public enterprises, out of which 888 are majority-owned unlisted enterprises (established mostly as LLCs) and 50 statutory corporations or quasi-corporations.

The majority-owned SOEs that have been established by special laws are CERP, Jadrolinija, the Financial Agency, the Croatian Deposit Insurance Agency (HAOD), the Croatian Bank for Reconstruction and Development (HBOR), Croatian Waters and the Croatian Radio-Television. These companies account for 9.66% of total employment within the SOE sector, and approximately 16.9% of economic value.

[21] In July 2020, an Invitation for Expression of Interest for the purchase of 100% shares of Croatia Banka d.d. was issued to potential investors.

Figure 3.1. Fully or majority-owned state enterprises by legal form, 2019.



Source: Ministry of Physical Planning, Construction and State Assets, 2020.

As mentioned, there is a list of 39 companies and other legal entities of special interest (including one minority-owned SOE, INA) which is defined by the Government Decision on SOEs of special interest (Official Gazette no. 71/18). The Decision defines general criteria for determining such entities [Box 3.1] and applies to "any legal entity in which the Republic of Croatia holds a certain ownership interest and over which it exercises or wishes to exercise a certain degree of control, regardless of the size of its ownership interest". Although these companies generally abide by the same rules and regulations as other companies, they are also subject to a set of specific regulations – including a specific procedure for the selection and appointment of board members amongst other aspects.

Box 3.1. General criteria for the determination of enterprises of "special interest"

Pursuant to the Government Decision on the Criteria for Determining Legal Entities of Special Interest to the Republic of Croatia

The general criteria, of which at least one must be met in order for a legal entity to be determined as being of special interest for the Republic of Croatia, are as follows:

1. The principal activity of the legal entity consists of managing common goods and goods of interest for the Republic of Croatia, which are determined as such by specific regulations (e.g. water, forests, agricultural land, maritime domain, roads, railways);

2. The description of the legal entity's activity includes the management, maintenance and improvements of infrastructures and distribution networks where physical infrastructure represents a natural monopoly, rendering the development of market competition impossible (e.g. transport, electronic communications, energy), and which activities are important for unhindered movement and supply of the population and economic operators;

3. The legal entity provides a universal service under a public service obligation in accordance with the legislation of the European Union and the Republic of Croatia, such as electricity

generation and distribution, postal services, electronic communications services and other activities carried out within the scope of public services, which provide the customer with the right to receive a public service of quality in the entire territory of the Republic of Croatia at real, comparable and transparent prices;

4. The legal entity is obliged to apply legislative and regulatory acts that aim to reduce energy poverty, that is to protect vulnerable consumers who, due to their poor financial situation, are facing difficulties in accessing and using public services within the scope of the universal service;

5. The principal activity that the legal entity is engaged in is of particular relevance for the Republic of Croatia and relates to the management of real estate and other property owned by the Republic of Croatia, the provision of services exclusively to competent public administration bodies (e.g. preparation of official documents, IT security), defence industry, oil and gas production and distribution, medicinal products, electronic communications, finance, banking, computing, games of chance, tourism, road, rail, air and sea transport.

In addition, if the legal entity does not fulfil any of these general criteria or if the activity that the legal entity is engaged in is not covered by these general criteria, the following special criteria can be taken into consideration: (1) positive financial effect on the state budget of the Republic of Croatia; and (2) significance and size of its market share.

Source: Excerpt of the Government Decision on the Criteria for Determining Legal Entities of Special Interest to the Republic of Croatia.

3.3. Legal and regulatory framework applicable to SOEs

3.3.1. General legal framework

In addition to the general laws and regulations on corporate governance enumerated in section 3.1 above, the general legal and regulatory framework applicable to SOEs also includes SOE-specific laws such as the 2018 Act on State Property Management and the 2020 Act on the Internal Organisation and Scope of State Administration Bodies – which are the two main laws regulating state ownership and management in Croatia. A non-binding Corporate Governance Code for SOEs was also adopted in 2017 [they are all described in further details in section 3.3.2 below].

In Croatia, there is no single legislation which consolidates practices on state ownership. The laws and their separate provisions described below cumulatively establish main requirements with regards to the development and implementation of the ownership policy and objective-setting for SOEs, as well as aspects relative to the coordination between various entities exercising state ownership, development of aggregate reporting and establishment of professional boards, amongst other aspects.

Relevant laws of the public sector include:

- The Civil Servants and Officials Act;
- The Conflict of Interest Prevention Act (Official Gazette no. 26/11, 12/12, 126/12, 48/13, 57/15 and 98/19); (discussed further in section 5)
- The Act on the Right of Access to Information (OG 25,13, 85/15); (discussed further in section 6, part II)

- The Act on the Transparent Flow of Public Funds (Official Gazette no. 72/13 and 47/14); (discussed further in section 3, part II)
- The Act on the State Audit Office (Official Gazette no. 25/19); (discussed further in section 5, part II)
- The Act on the Internal Control System in the Public Sector;
- The Accounting Act (Official Gazette no. 78/15, 134/15,120/16,116/18, 42/20 and 47/20);
- The Public Procurement Act (Official Gazette no. 120/16);
- The Concessions Act (Official Gazette no. 143/12);
- The Act on Public-Private Partnership (Official Gazette no. 78/12 and 152/14), and;
- The Act on the State Commission for Supervision of Public Procurement Procedures (Official Gazette no. 18/13, 127/13 and 74/14).

Most of these laws will also be discussed in relevant sections of this report. In addition, there are other relevant regulations and decisions of the Government which aim at streamlining corporate governance practices and requirements, such as the:

- Regulation on the conditions for the selection and appointment of members of the supervisory boards and management boards of legal entities of special interest for the Republic of Croatia and on the manner of their selection (Official Gazette no. 12/2019);
- Decision on the obligation to introduce the compliance monitoring function in majority state-owned legal entities (Official Gazette no. 99/2019);
- Decision on the monitoring of business plans and reports of companies and legal entities constituting state property (Official Gazette no. 71/2018);
- Decision on the amount, manner and deadlines for the payment of funds of SOEs into the state budget of the Republic of Croatia (Official Gazette no. 88/20).

Finally, these are complemented by the relevant regulations and decisions of individual ministries responsible for exercising ownership rights in SOEs as well as the founding acts of certain SOEs, where applicable.

According to Croatian authorities, SOEs do not have any legal privileges and are subject to the same legal provisions as privately owned legal entities. In addition, members of the management board and supervisory board do not have immunity from lawsuits. Issues relating to the treatment of employees, including remuneration, pension and job protection, are regulated by the Labour Act (Official Gazette no. 93/14, 127/17, 98/19), subordinate legislation such as labour ordinances, as well as branch or collective agreements, where they exist, at the individual company level.

However, several tax exemptions exist (e.g. CERP). Individual cases of tax exemption are generally subject to individual state aid applications [see section 3.5, Part B for more information on tax exemptions for SOEs].

Bankruptcy and insolvency procedures are regulated by the 2021 Deposit Insurance System Act, the Bankruptcy Law (Official Gazette, no. 71/15, 104/17), the Law on Compulsory Liquidation of Credit Institutions (Official Gazette, no. 146/20), the Financial Agency Act (Official Gazette no. 117/01, 60/04, 42/05), and the Act on the Execution of the State Budget for 2020 (Official Gazette no. 117/19, 32/20, 42/20 and 58/20). Such

procedures may be executed against a legal entity (regardless of the type of ownership), unless otherwise stipulated by law [see section 2.1, part B for detailed information]. The sections that follow provide more details on the content of individual laws and regulations, which apply to SOEs.

3.3.2. Main individual laws applicable to SOEs

Act on State Property Management

The Act on State Property Management (Official Gazette no. 52/18) regulates the management of property owned by Croatia. Importantly, it also regulates the competencies and powers of the Ministry of Physical Planning, Construction and State Assets in the management of state property, as well as the organisation and work of the Centre for Restructuring and Sale (CERP), which are two key state institutions in the ownership structure of Croatia [Further information can be found in section 4 of this document on ownership arrangements and coordination].

This Act transposes the provisions of Directive 2014/42/EU of the European Parliament and of the Council of 3 April 2014 on the freezing and confiscation of objects and proceeds of crime in the European Union (OJ L 127, 29.4.2014) into national legislation of Croatia.

Article 3 of the Act defines the terms “state property” as follows:

- Stocks and shares in companies whose holder is Croatia, the Croatian Pension Insurance Fund and/or the Croatian Deposit Insurance Agency, if these were acquired in the process of bank resolution and privatisation;
- Founding rights in legal entities of which Croatia is the founder;
- Real estate, namely: construction land and buildings, special parts of real estate, on which the ownership of Croatia has been established;
- Land, including real estate, on which a camp is located, and on which the ownership of Croatia has been established, regardless of whether it is located in a construction zone, on agricultural land, or in a forest or on forest land owned by Croatia.
- Mountain lodge or house with land used as part of the regular use of the real estate, built on land registered as property of Croatia, regardless of whether they are located in a construction zone, on agricultural land or in a forest or on forest land, if ownership was not acquired by other persons in the process of transformation of social ownership or based on special regulations;
- Movables entrusted to the management of the MPPCSA or CERP;
- All subjective civil (private) rights of Croatia that have a monetary value, and which relate to any of the property listed above.

Importantly, subsidiaries of SOEs (including majority-owned ones) do not fall within the definition above and therefore are not considered state property, but are property of their parent company (and thus are included in their parent company’s annual consolidated reports and plans, under certain conditions). While SOEs’ subsidiaries apply legislation applicable to other JSCs and LLCs in line with their corporate legal form, some public sector laws do not apply to them in the same manner as to their parent companies. They

are also not monitored by any public authority [This is further described under subsections covering these individual laws].

The Act entrusts the MPPCSA and CERP with the exercise of ownership powers in relation to the state property (Article 4). It also regulates the development, adoption and reporting of state property management documents (Articles 18-20), and stipulates that a decision on legal entities of special interest to Croatia is issued by the Government on the proposal of the MPPCSA (Article 12).

Act on the Internal Organisation and Scope of State Administration Bodies

The Act on the Internal Organisation and Scope of State Administration Bodies (Official Gazette no. 85/20) establishes state administration bodies and determines their scope. It regulates, *inter alia*, issues related to state property management by line ministries, including management of SOEs entrusted to them by special laws. The responsibilities of the line ministries vis-à-vis SOEs are not clearly defined by the Act, with the exception of the MPPCSA whose activities include the development of proposals for the State Property Management Strategy, the Annual State Property Management Plan and Annual Report; and proposals to the list of SOEs of special interest [Box 3.2]. The Ministry is also responsible for the general harmonisation of policies and guidance on management of SOEs, which fall within its remit, including offering trainings for the members of the supervisory boards.

By contrast, line ministries of SOEs of special interest are empowered to:

- propose to the Government to appoint members of general meetings, supervisory boards and management boards;
- propose to the Government to adopt decisions on the manner of disposing of shares or holdings; and
- participate in the restructuring, recapitalisation and other similar procedures for these SOEs.

The Corporate Governance Code for SOEs

The Corporate Governance Code for SOEs (full name: Code of Corporate Governance for Companies in which the Republic of Croatia has Stock or Shares) was adopted in 2017. This non-binding Code establishes a set of principles on business conduct and good practices aiming at ensuring an efficient and responsible governance of the state's portfolio. The Code is primarily intended for SOEs and other legal entities of special interest for Croatia, although its application is recommended for all companies in which Croatia has stocks or shares that are not primarily in pursuit of public policy or service objectives.

The Code provides guidance to both state ownership entities and SOEs, covering: basic principles of corporate governance (I); challenges with, and guidelines for, managing portfolios (II, III); recommendations for the supervisory and management boards (IV, V); guidance on collaboration and relationships between supervisory and management boards (VI); audit and internal audit mechanisms (VII); and reporting (VIII).

SOEs adhering to the Code must provide in their annual report, if not earlier, information on its application and justify any deviations. The competent ministry can request additional information regarding the application of the Code and its provisions. The Code obliges line ministries to inform the public at least once a year of the corporate

governance of SOEs in their portfolios. In practice, however, no state institution has been granted authority to monitor its implementation. The Code is an initiative of the MPPCSA, who continues to be the main promoter, however to the authors' knowledge, it has not been taken up by most of the competent ministries for their SOEs' adoption. Thus, despite its existence, its patchy implementation means that SOEs are not challenged to adhere to the standards of privately listed firms in practice. In a few cases, SOEs have voluntarily aspired to improve corporate governance – not in response to line ministries' requests to adopt the Code for SOEs, but rather in pursuit of aligning with the Code for listed companies issued by ZSE and HANFA.

The MPPCSA is working to establish complementary initiatives that could, if well implemented, bolster the aims of the Code. Namely, the MPPCSA is in the process of creating a commission seated with representatives of multiple line ministries, and potentially externals such as head-hunters, to improve the consultative nature of board nominations in an attempt to shift away from one ministry exercising sole authority. Moreover, the ministry is working to establish clearer board criteria, including on independence, but recognises the definition for independence in Croatia differs from the international consensus. It also aims to create templates to streamline common processes including assembly sessions and establishment of work programmes. Finally, a new questionnaire including corporate governance aspects has been recently developed within the framework of the ongoing EC/EBRD project of "Restructuring SOEs. The questionnaire which was first launched in December 2020, is to be filled by all (fully or majority-owned) SOEs. It includes questions on the role and responsibilities of the supervisory board, its composition, internal and external audits as well as on issues relating to transparency and anti-corruption amongst other aspects. The usefulness of such a questionnaire would depend on its deployment through competent line ministries and not only the MPPCSA.

Accounting Act

The Accounting Act (Official Gazette, No. 78/15, 134/15, 120/16, 116/18, 42/2020 and 47/20) regulates amongst other aspects the accounting practices and the classification of undertakings according to their size and the nature of their activities. It applies to all companies, including SOEs and their subsidiaries, as well as to any natural and legal person if it is subject to profit tax with regard to its entire activity.

Box 3.2. SOEs that fall within the definition of a Public-Interest Entity

Pursuant to the Accounting Act, the definition of a "public-interest entity" covers the following SOEs:

- All SOEs whose securities are admitted to trading on a regulated market;
- All SOEs of special interest to the Government of Croatia, with the exception of legal entities which keep their business books and draw up their financial statements in accordance with the regulations governing budgetary accounts or non-profit organisations' accounts;
- All SOEs which, either alone or with their subsidiaries, fulfil in the preceding financial year one of the following conditions:

  1) They employ more than 5,000 workers (on average) in Croatia;

  2) Their assets exceed HRK 5 million on the last day of the financial year.

The following aspects are of particular relevance to the SOE sector and should be highlighted:

- The classification of undertakings is made according to four categories – micro, small, medium-sized and large – established by the Act, based on their assets, revenue and average number of workers.
- The Croatian Financial Reporting Standards apply to micro, small and medium-sized undertakings and others which cannot be classified by reference to the criteria set out in the Act. Large undertakings and public-interest entities, which include SOEs of special interest, should apply International Financial Reporting Standards for their annual financial statements. Subsidiaries apply the same standards as their parent companies.
- Financial statements of micro and small undertakings should include a balance sheet, a profit and loss account and notes to the financial statements. Annual financial statements of other undertakings should additionally comprise a statement of other comprehensive income; a cash-flow statement, and a statement of change in equity.
- Members of the management (*and supervisory boards, where applicable) or executive directors and the administrative board, within the scope of their respective competences, responsibilities and due diligence as established by law, shall be responsible for annual financial statements. They should be signed by the chairman and all members of the management board, or all executive directors of the undertaking (in entities without a management board or executive directors, annual financial statements shall be signed by the persons authorised to represent them).
- Annual financial statements and annual consolidated financial statements of public-interest entities, large and medium-sized undertakings, and of LLCs and limited liability partnerships, which meet a certain criteria (in assets, revenue and workers), shall be subject to an annual audit.
- Annual management reports should be prepared by medium-sized and large undertakings. Management reports of listed public-interest entities should contain a statement on the application of the Corporate Governance Code.
- Large undertakings, which are public-interest entities with more than 500 workers, shall include in their management report a non-financial statement

containing information relating to environmental, social and worker matters, as well as respect for human rights, anti-corruption and bribery matters.

- Public-interest entities active in the mining and extractive industry or in the logging of primary forests shall include a report on payments to the public sector in their annual report. Members of the management and supervisory board, or executive directors and members of the administrative board shall be held jointly and severally liable for the legality, veracity, accuracy and completeness of the reports on payments to the public sector.
- The Register of Annual Financial Statements is supervised and operated by the Financial Agency on behalf of the Ministry of Finance.

The Financial Agency has the authority to initiate misdemeanour proceedings against an undertaking and its responsible person if they fail to submit the documents for the purpose of public disclosure or fail to submit financial information for statistical and other purposes in accordance with this Act. Sanctions for violation of this Act include fines.

Chapter 4. Ownership framework and responsibilities

4.1. Ownership arrangements and coordination

4.1.1. Ownership policy and framework

There are two different ownership arrangements in Croatia:

(1) A mostly decentralised model applicable to enterprises "of special interest" whereby line ministries exercise state ownership functions over SOEs together with the Ministry of Physical Planning, Construction and State Assets (MPPCSA). In practice, however, line ministries have more extensive powers than the MPPCSA whose role essentially focuses on monitoring SOE performance and management.

(2) A more centralised model applicable to the rest of (mostly minority-owned) enterprises whose ownership rights have been vested in the Centre for Restructuring and Sale (CERP) with a view to their privatisation and restructuring.

While the adoption of the 2018 Act on State Property Management allowed to clarify the overarching responsibilities of relevant governmental institutions in charge of managing and/or overseeing SOEs, it does not prescribe any form of coordination between them which may lead to an overlapping of responsibilities and a general lack of policy coherence. In addition, the fragmented nature of the ownership framework in Croatia – coupled to the frequent changes in government - renders coordination between relevant stakeholders challenging and therefore very limited in practice as well.

Croatia has yet to develop an ownership policy. This task is however foreseen within the MPPCSA's responsibilities [Box 4.1] and should be developed in the near future. As it currently stands, the legal and institutional framework builds on a number of documents establishing policy priorities in the area of state ownership and management. These include:

(1) *The Strategy for the Management of State Assets* which is adopted by the Parliament at the proposal of the Government. The draft proposal of the Strategy is developed by the MPPCSA. Other ministries and public bodies may participate in the development of the draft strategy which defines the state's mid- to long-term objectives relative to the management of state assets, taking into account the economic and development priorities of the Republic of Croatia. The strategy is issued for a 7-year period – the latest version of which was adopted in 2019 for the period 2019-2025 (Official Gazette no. 96/19).

(2) *The Annual State Assets Management Plan* is adopted by the Government pursuant to the Strategy mentioned above, and at the proposal of the

MPPCSA. The MPPCSA may include other ministries and government bodies in the drafting of the Proposal of the Annual State Assets Management Plan. The document contains specific objectives, projects and activities for the subsequent year in view of ensuring the implementation of the strategy. The Government reports on the Implementation of the Annual State Assets Management Plan (as prepared by the MPPCSA) to the Croatian Parliament by 30 September for the previous year.

(3) Other documents such as the *National Reform Programme* (which is issued on an annual basis) and the *Convergence Programme of the Republic of Croatia 2019 – 2022* may also establish SOE-related objectives.

In addition, SOEs also abide by sectorial policies (e.g. the Transport Development Strategy of the Republic of Croatia 2017–2030) and/or individual statutory acts defining SOEs' activities and governance arrangements (e.g. the Act establishing the Croatian Bank for Reconstruction and Development - HBOR).

Box 4.1. The Croatian Government's main policy priorities for SOEs

The SOE reform figures prominently in the Government's official documents. Main priorities include:

State Property Management Strategy 2019-2025:

- "*Continuation of the privatisation of enterprises owned by the Republic of Croatia and enhancement of the Governance of SOEs of Special Interest for the Republic of Croatia*" which encompasses the reduction of state ownership through restructuring, recapitalisation or (partial or full) privatisation of SOEs that do not pursue infrastructure, energy or other economic activity of special interest.
- *"Effective management of real estate owned by the Republic of Croatia*". This objective includes the reduction of the real estate portfolio managed by the MPPCSA and CERP through sale, dissolution of co-ownerships and donations in favour of local and regional self-government units, amongst other aspects. It also includes the increase of investment projects for the activation of unused state property through the establishment of rights to build and/or use, easements, donations, and leases.

National Reform Programme 2020:

- *"Activation and improvement of state assets management*". This includes improving competences of supervisory board and audit committee members, establishing a monitoring system with the aim of a timely identification of risk in the operational and financial business activities of majority-owned SOEs, as well as through the reduction of the State portfolio managed by the MPPCSA and the CERP;
- *"Restructuring and development of a sustainable transport sector*": aims at ensuring the financial sustainability of SOEs in the rail transport sector and the technical-technological reinforcement of business processes, as well as the implementation of business restructuring of the road sector in order to ensure the financial stability of state-owned road enterprises. The plan also includes the objective of finding a strategic partner for the Croatian air transport company Croatia Airlines d.d.

4.1.2. The main institutional actors

The Ministry of Physical Planning, Construction and State Assets: The Ministry was established in July 2020, following the merger of the Ministry of State Assets and the Ministry of Construction and Physical Planning. Together with line ministries, it exercises ownership rights over SOEs of special interest, however its role is essentially limited to the regular monitoring and reporting of state assets (including SOEs) management. Its responsibilities may also include (1) monitoring financial targets and capital structure objectives of individual SOEs; and (2) maintaining dialogue with external auditors – although these activities are not common practice in Croatia [Table 4.1]. The Ministry also exercises direct ownership over *Državne Nekretnine d.o.o* (the SOE in charge of managing the Government's real estate) and CERP the SOE in charge of managing non-strategic SOEs – on which more information is provided below).

Table 4.1. Separation of ownership powers regarding SOEs of special interest

Main powers attributed to line ministries	Main powers attributed to the MPPCSA
● Exercise state representation at the General Assembly; ● Lead the nomination process for Management and Supervisory Board members and appoint them. ● Approve major SOE decisions; ● Set SOE objectives; ● Propose to the Government to adopt decisions on the manner of disposing of shares or holdings; and ● Participate in the restructuring, recapitalisation and other similar procedures for SOEs	● Regularly monitor and assess SOE financial performance; ● Set SOE governance policies; ● (Monitor financial targets and capital structure objectives of individual SOEs); ● (Maintain dialogue with external auditors)

Source: Act on State Property Management, 2018.

In addition, the MPPCSA is also responsible for EU coordination and for drafting key policy papers, annual reports, and other publications on state property such as the State Property Management Strategy and the Criteria for defining enterprises of special interest, amongst other aspects [Box 4.2]. Since 2018, the Ministry also issues an annual aggregate report on SOEs of special interest. The latest version was published in December 2020 (see section 6.3, Part B for more information). Finally, the MPPCSA also performs administrative and other tasks related to physical planning, construction and housing, property valuation, utility management and energy efficiency and renovation in the buildings sector, in accordance with the Act on the Organisation and Scope of State Administration Bodies (Official Gazette no. 85/20).

Until 2018, the former Ministry of State Assets (which was established in 2016 as the successor of the State Office for State Property Management - DUUDI)) had more powers (including to appoint board members in SOEs of special interest) and a more coordinated approach when it came to SOE management. It was also responsible for establishing, maintaining and publishing a State Property Registry listing all the financial and non-financial assets owned by the state and by local self-government units. However, in 2018 the Act on State Property Management transferred part of these powers to line ministries and the management of the Registry was transferred to the Central State Office for the Development of the Digital Society.

Figure 4.1. Organisational chart of the Directorate responsible for SOE' and state assets management at the MPPCSA.

Source: MPPCSA, 2020.

The Ministry is organised into several directorates - one of which is in charge of state-owned enterprises and strategic planning of state assets including coordination with the EU [Figure 4.1]. The entire directorate employs approximately 44 people, 18 of which work in the sector dealing with SOEs which is divided into three different services: 1) the service for monitoring the operation of state-owned legal persons; 2) the service for analysis and reporting and 3) the service for improvement of corporate management.

Box 4.2. Main competencies and responsibilities of the Ministry of Physical Planning, Construction and State Assets

According to the Act on the Organisation and Scope of State Administration Bodies (Official Gazette no. 85/2020) adopted in July 2020, the responsibilities of the MPPCSA include, *inter alia*:

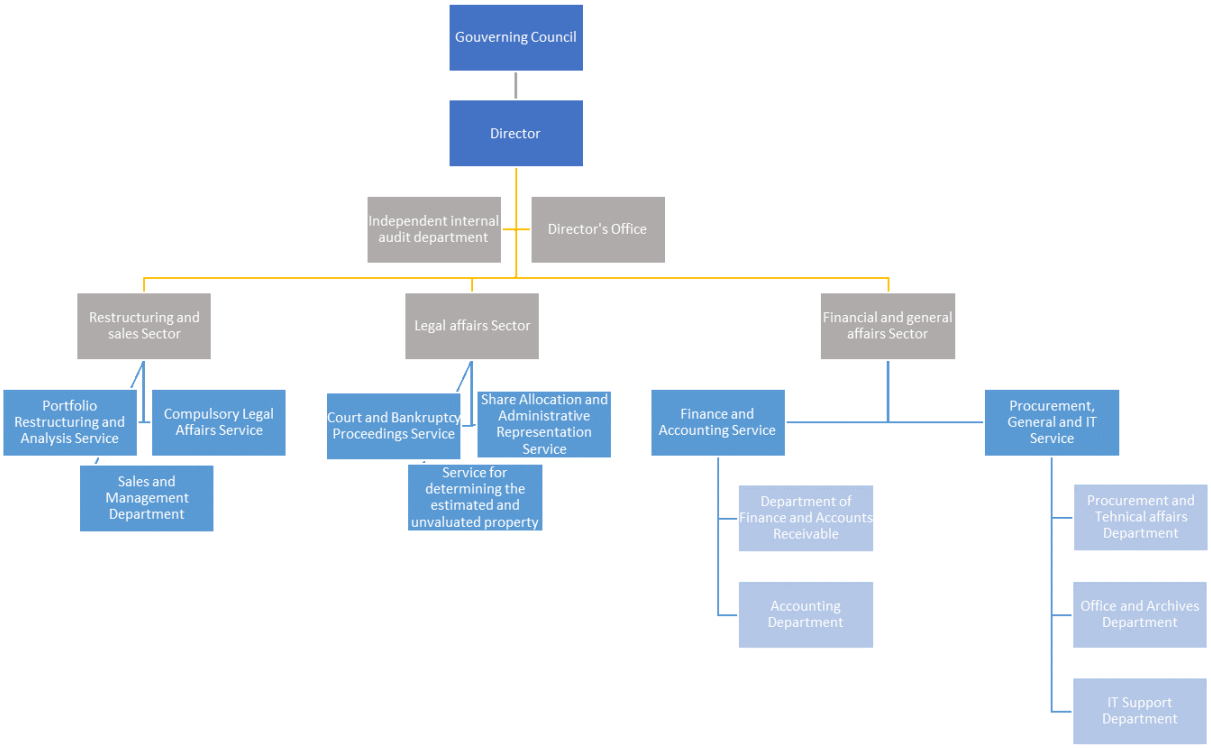
- Exercise ownership rights on behalf of the Republic of Croatia, in accordance with a special law regulating the management of state property;
- Prepare a draft proposal of the State Property Management Strategy, the Annual State Property Management Plan and of the Report on the Implementation of the Annual State Property Management Plan;
- Perform specialist activities related to the coordination and harmonisation of criteria for the management of enterprises of special interest to the Republic of Croatia; and monitor the work, management, development and implementation of the strategic policy in the aforementioned companies;
- Submit a proposal to the Government relative to the decision on determining the list of legal persons of special interest to the Republic of Croatia;
- Perform activities for the improvement of corporate governance of legal persons owned by the Republic of Croatia; which includes training members of supervisory boards on rights and responsibilities.

The Centre for Restructuring and Sale (CERP): established in 2013, CERP is a self-funded SOE whose ownership is exercised by the MPPCSA. It is responsible for managing shares and stakes in enterprises owned by the Republic of Croatia and which are not defined as enterprises of special interest, as well as shares and stakes in enterprises owned by the Croatian Pension Insurance Fund and the State Agency for

Bank Deposit and Bank Resolution.[22] As mentioned earlier its portfolio currently consists of 342 active SOEs (including 19 majority-owned) which are organised as joint stock companies or limited liability companies [Table 4.2 for 2019 data].

Its financial resources derive from the sale of SOE stocks and shares and compensation from the shares CERP manages for the Government of Croatia. It may also receive donations, loans and funds from international assistance and EU programmes in accordance with the Act on State Assets Management. This particular arrangement allows the MPPCSA to oversee also other state assets, including stocks and shares in SOEs.

Figure 4.2. Structure of CERP



Source: MPPCSA, 2021.

It is governed by a supervisory board (called Governing Council) composed of 9 members. It includes relevant line ministers (finance, economy, tourism, sea, transport and infrastructure, agriculture, energy, and justice) and one representative of the Office of the Prime Minister of Croatia. It is chaired by the Minister of Physical Planning, Construction and State Assets, and includes also one representative of the Trade Union Association and one representative of the Employers' Association but without voting rights. Together they work to reach strategic objectives, which are defined in the Government's official policy documents. The main responsibility of the Governing Council is to carry out the Government's annual plan on privatisation, restructuring and management of SOEs. The Director and Deputy-Director of CERP are appointed and

[22] Provided these shares and stakes were obtained in the process of resolution and privatisation of banks, and provided that managing such property was not entrusted to another body by way of special legislation.

dismissed by the Government of Croatia, upon the proposal of the Governing Council, for a period of four years.

Table 4.2. Separation of powers between CERP and line ministries

Main powers attributed to line ministries	Main powers attributed to CERP
● Nominate SOEs for restructuring and participate in the elaboration of the restructuring plan (together with CERP); ● Set SOE objectives	● Exercise state representation in SOE boards and Shareholders Meetings; ● Appoints members of the Management and Supervisory Board* as well as auditors; ● Monitor performance of SOEs; ● Participate in the restructuring process of SOEs; ● Acquire stocks and shares in SOEs; ● Participate in pre-bankruptcy proceedings; ● Approve major SOE decisions

Note: *in consultation with line ministries.
Source: Act on State Assets Management, 2018.

Unlike the MPPCSA, CERP directly exercises ownership rights over SOEs in its portfolio. Concretely, it represents the state at shareholders' meetings and decides on the nomination of supervisory and management board members as well as auditors in SOEs (upon proposals of line ministries and/or the Director of CERP) amongst other aspects. The CERP is also involved in the sale of shares/stock of SOEs in its portfolio and participates in the restructuring of those companies as well as in pre-bankruptcy proceedings pursuant to regulations governing financial operations and pre-bankruptcy settlements.

The primary objective of CERP is to support the state's exit from the ownership of companies in its portfolio and in this regard may also be involved in other activities such as denationalisation, transfer of shares to Croatian disabled war veterans, and termination of shares/stocks reservations due to unresolved property ownership rights, amongst other aspects.

Table 4.3. Breakdown of CERP Portfolio as of 31 December 2019, in HRK

Description	No. of companies	Total nominal value of share capital	Total nominal value of CERP-Managed State Portfolio
I Total minority shareholdings of up to 49.99%	332	49,652,458,278	2,549,375,422
- of which companies fully available for sale	152	10,817,029,955	1,084,590,635
- of which 'reserved' companies	96	12,958,887,526	153,549,695
- of which companies partly available for sale and partly 'reserved'	84	25,876,540,797	1,311,235,092
II Total majority shareholdings exceeding 50%	21	2,473,118,010	2,289,193,940
- of which companies fully available for sale	16	1,511,710,100	1,474,001,060
- of which companies partly	5	961,407,910	815,192,880

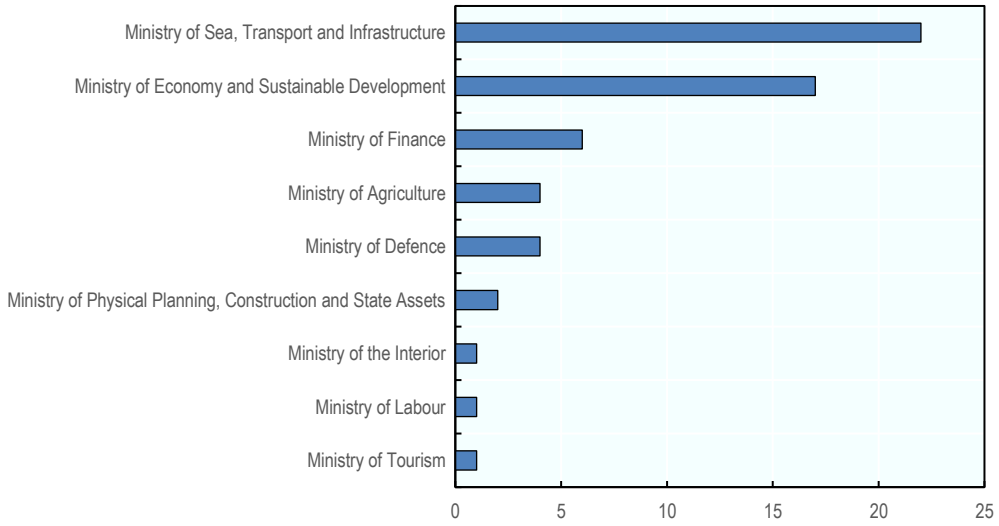
available for sale and partly 'reserved'			
SUBTOTAL	353	52,125,576,288	4,838,569,362
- inactive companies	5	15,673,390	1,166,043
TOTAL	358	52,141,249,678	4,839,735,405

Source: State Property Management Strategy 2019-2025.

Line ministries: Line ministries in Croatia are mainly responsible for (1) representing the state and exercising voting rights at the General Assembly; and (2) overseeing the nomination procedure for the management and supervisory boards, and appointing them (except in SOEs managed by CERP). Their ownership rights may, however, overlap with regulatory functions as most ministries have been tasked with developing industrial, regional, and/or sectorial public policies (in line with government priorities) in accordance with the Act on the Organisation and Scope of Ministries and Other Central State Administration Bodies.

The number of SOEs under each ministry varies significantly. Some ministries have ownership rights over a large number of enterprises such as the Ministry of Sea, Transport and Infrastructure, while others have only one SOE under their purview such as the Ministry of Interior.

Figure 4.3. Number of SOEs per ministry, 2019.



Source: Ministry of Physical Planning, Construction and State Assets, 2020.

The Ministry of Finance: the Ministry of Finance has an important role to play vis-à-vis SOEs. In particular, the Ministry is responsible for tracking and analysing annual and quarterly financial reports of all 39 enterprises of special interest. It is also involved in the adoption of the (annual) decisions relative to the state dividend policy and participates in all decisions and procedures that have a fiscal impact on the Treasury, including the issuance of state guarantees for SOE loans. The Ministry is also competent for implementing concession policies and (together with the Ministry of Economy) plays a key role in the preparation and implementation of public-private partnership projects

(PPPs) by approving them based on their financial and fiscal sustainability and compliance with budget forecasts and plans, fiscal risks and limitations stipulated by special regulations.

The Ministry of Finance holds ownership rights over 6 SOEs: the Croatian Lottery, the Financial Agency, the Croatian Deposit Insurance Agency (HAOD), the Information System and Technologies Support Agency (APIS IT) as well as two state-owned banks: the Croatian Postal Bank and the Croatian Bank for Reconstruction and Development (HBOR).The latter focuses on supporting sectors like construction and infrastructure; promoting exports and supporting the development of small and medium-sized enterprises.

Ministry of Economy and Sustainable Development: This new Ministry was established in 2020 following the merger of the Ministry of Economy and the Ministry of Environmental Protection and Energy; which was carried out in order to "reconcile the economy with sustainable development". Following its transformation, the Ministry acquired responsibility over a large number of sectors such as environmental protection, energy, climate change, economy, as well as entrepreneurship and trade. It has now ownership rights over 17 SOEs including some of the largest ones such as the electricity utility group HEP, the water management company Hrvatske Vode and the energy companies INA and Janaf [Table 4.4].

In addition, the Ministry plays a significant role within the framework set by the Public Procurement Act, according to which it is responsible for the supervision and implementation of public procurement contracts. It is also, with the Ministry of Finance, one of the key institutional supporters of PPPs in Croatia, as it is responsible for developing economic and industrial policies, which include PPP investment projects.

Table 4.4. SOEs of special interest under the Ministry of Economy and Sustainable Development

Name	Main sector of operation	No. of employees	State ownership
Hrvatska Elektroprivreda d.d.	Electricity, gas, steam and air conditioning supply	10 925	100%
Hrvatski Operator Tržišta Energije (HROTE) d.o.o.	Electricity market operator	40	100%
Imunološki Zavod d.d.	Pharmaceutical manufacturing	N/A	N/A
INA – Industrija Nafte d.d.	Energy Manufacturing	10 880	44,84%
Janaf d.d.	Energy Transportation and storage	391	95.67%
Narodne Novine d.d.	Publishing and printing	474	100%
Hrvatske Vode	Water management	990	100%

Source: Ministry of Physical Planning, Construction and State Assets, 2020

The Ministry of Sea, Transport and Infrastructure (MSTI): The MSTI is one of the largest and arguably most important ministries in Croatia. It plays a key role in implementing large transport infrastructure projects most of which are supported financially by the EU. It is the main body responsible for strategic and investment decisions related to airport

and port infrastructure, as well as state road and railway networks. Those are guided by important sectorial policies and programmes developed by the Ministry, such as the Strategy for Infrastructure Development and the four-year plan for the construction and maintenance of public roads which is adopted by the Croatian Parliament. According to the Ministry, these strategic objectives are communicated to SOEs via their boards or Shareholders' Assemblies.

Table 4.5. SOEs of special interest under the Ministry of Sea, Transport and Infrastructure

Name	Main sector of operation	No. Employees	State ownership (in %)
ACI d.d.	Arts, entertainment and recreation	370	77.43
Autocesta Rijeka-Zagreb d.d.	Construction	38	100
Croatia Airlines d.d.	Transportation and storage	981	97.20 (99.7)
HP- Hrvatska pošta d.d.	Transportation and storage	10 042	100
Hrvatska kontrola zracne plovidbe d.o.o.	Transportation and storage	753	100
Hrvatske ceste d.o.o.	Construction	466	100
Hrvatske autoceste d.o.o.	Construction	2831	100
HŽ Cargo d.o.o.	Transportation and storage	2195	100
HŽ Infrastruktura d.o.o.	Transportation and storage	6316	100
HŽ Putnicki prijevoz d.o.o.	Transportation and storage	2578	100
Jadrolinija	Transportation and storage	1732	100
Odašiljaci i veze d.o.o	Transportation and storage	299	100
Plovput d.o.o.	Transportation and storage	289	100
Zracna luka Dubrovnik d.o.o.	Transportation and storage	489	55 (100)
Zracna luka Osijek d.o.o.	Transportation and storage	65	55 (100)
Zracna luka Pula d.o.o.	Transportation and storage	159	55 (100)
Zracna luka Rijeka d.o.o.	Transportation and storage	68	55 (100)
Zracna luka Split d.o.o.	Transportation and storage	413	55 (100)
Zracna luka Zadar d.o.o.	Transportation and storage	167	55 (100)
Zracna luka Zagreb d.o.o.	Transportation and storage	6	55 (100)
Total		30 257	

Note: Ownership in brackets represents the ownership of the Rep. of Croatia including stakes held by local government units and other SOEs.
Source: Ministry of Physical Planning, Construction and State Assets, 2020.

The Ministry relies on a certain number of SOEs to manage the construction, maintenance and operations of various networks such as the Croatian Roads (Hrvatske Ceste), the Croatian motorways (Hrvatske Autoceste) and the Croatian Railways (Hrvatske Željeznice - HŽ). Having massively invested in infrastructure in the last 20 years, most of these companies have accumulated large debts, all of which were fully guaranteed by the state, which has led to a drain on the public budget. In 2017, the Government launched large restructuring projects backed by a consortium of international financial institutions with the objective of putting the sector on a financially sustainable path and ultimately reducing the need for state fiscal support (around 0.9% of GDP per year). The Government has also issued a euro-bond to reschedule debts in

the road sector, however most of these companies still generate losses and continue to rely heavily on government guarantees (World Bank, 2017[41]).[23]

4.2. Description of selected Croatian SOEs

4.2.1. Hrvatska Elektroprivreda (HEP)

Hrvatska Elektroprivreda d.d. (HEP Group d.d.) is Croatia's state-owned energy supplier. It is a vertically integrated company with a strong presence across the entire energy value chain as it engages in generation, transmission, distribution, supply and trade of electricity, thermal energy and natural gas. The company has a natural monopoly in the electricity transmission and distribution segments – however, despite the liberalisation of Croatia's electricity market, the Group still holds a dominant position in other segments as well, as it currently owns 95% of generation capacity and retains a large market share (at around 85-90%) in the supply segment (ING Think, 2018[42]).

The HEP Group is one of the largest business groups in Croatia. It is 100% state-owned through the Ministry of Economy, and Sustainable Development and the Ministry of Physical Planning, Construction and State Assets (as an enterprise of special interest to the Republic of Croatia). It is organised in the form of a Group, with a large number of connected (daughter) companies, whom assets belong to HEP but have been contractually transferred to the subsidiaries for management [Table 4.6]. Since HEP has been unbundled to meet the requirements of the Electricity Market Law, subsidiaries dealing with regulated activities (transmission and distribution) are clearly separated from companies that conduct non-regulated activities (generation and supply).

Table 4.6. HEP Group subsidiary companies

	Name	Main sector of operation
Subsidiaries fully-owned by HEP d.d.	HEP-Proizvodnja d.o.o. - *CS Buško blato d.o.o*	Generation of electricity and heat Lake Reservoir
	HEP-Operator distribucijskog sustava d.o.o. - *HEP Nastavno-obrazovni centar*	Distribution System Operator (DSO) Education and training
	HEP Elektra d.o.o	Electricity supply
	HEP-Opskrba d.o.o.	Electricity supply
	HEP-Trgovina d.o.o. - *HEP Energija d.o.o. Ljubljana (Slovenia)* - *HEP Energija d.o.o. Mostar (Bosnia and Herzegovina)* - *HEP Energija d.o.o. Beograd (Serbia)* - *HEP Energija sh.p.k. Priština (Kosovo).*	Trade Electricity Supply
	HEP-Toplinarstvo d.o.o.	Generation, distribution and supply of heat energy
	HEP-Plin d.o.o. - *Plin VTC d.o.o.* - *Prvo Plinarsko Društvo - Distribucija Plina d.o.o.* - *Prvo Plinarsko Društvo – Opskrba Kucanstava d.o.o.*	Natural gas distribution and supply Gas Distribution Gas Distribution Household Supply
	HEP ESCO d.o.o.	Energy services
	HEP-Upravljanje imovinom d.o.o.	Asset Management

[23] Government support is only provided to companies operating in the liberalised market in accordance with applicable EU rules on State Aid.

	Plomin Holding d.o.o. *- Sunčana Elektrana Poreč d.o.o.*	Infrastructure
	HEP-Telekomunikacije d.o.o.	Telecommunication
	Energetski park Korlat d.o.o.	Responsible for the delivery of the Korlat Wind Farm Project.
Companies in mixed ownership	NE Krško d.o.o. - co-owned by the Republic of Slovenia	Nuclear Power Plant
	LNG Hrvatska d.o.o. - co-owned by Plinacro d.d	Infrastructure
Independent Transmission Operator	Hrvatski operator prijenosnog sustava d.o.o.	Transmission System Operator (TSO)

Note: Companies which appear in italics are owned by subsidiaries mentioned above.
Source: (HEP Group Companies, n.d.[43])

The Group has been showing positive financial results in recent years. According to the company's latest financial report: "despite being faced with market challenges resulting from the rise of electricity prices on power exchanges and increasingly complex customer demands in 2019, the HEP Group recorded a net profit of HRK 1.10 billion in 2019, that is – a 2.8% increase from 2018" [Table 4.7]. The profit was earned from electricity, while other activities reported a loss. In 2019, the group launched a cycle of significant investments in renewable energy sources which included the acquisition of several solar power plants (HEP Group, 2019[44]).

Table 4.7. Financial indicators for HEP (consolidated data, in HRK)

	2015	2016	2017	2018	2019
Turnover	9,516,865,329	8,856,568,510	8,823,844,235	9,413,863,610	10,519,884,837
EBITDA	1,376,768,117	928,421,473	185,218,478	177,569,463	595,198,609
Net Profit	1,624,338,909	1,323,818,373	364,022,458	353,976,075	1,107,307,661
Dividends*		607,000,000	794,291,024	218,413,475	212,385,645
Assets	35,081,636,950	35,510,796,121	34,367,807,336	34,371,920,107	35,106,700,189
Equity	24,825,486,122	25,581,761,092	25,149,872,953	25,217,255,323	26,158,879,035
Provisions	211,589,550	212,605,551	217,014,030	221,244,278	223,593,493
Long-term debt	6,105,874,986	5,196,179,343	5,154,937,223	4,881,746,244	4,617,932,686
ROA	4.63%	3.73%	1.06%	1.03%	3.15%
ROE	6.54%	5.17%	1.45%	1.40%	4.23%

Note: * Dividends based on previous year(s) net profit.
Source: Data provided by the Croatian authorities to the OECD questionnaire, 2021.

The Group is governed by a 5-member supervisory board (including one employee representative) directly appointed by the line ministry through the General Assembly, as well as a management board of 6 members, all of which are appointed and may be dismissed by the supervisory board, upon suggestion of the line ministry. Members of the supervisory board include one member of another SOE's executive team, one state official, one employee representative and two independent members from the private sector and/or academia. All daughter companies reportedly have their own supervisory boards consisting mostly of management staff from the parent company, which is considered good practice.

The company has an internal audit department which carries out internal audits in line with the Strategic Plan and the Department Annual Plan adopted by the management board of the company, with the consent of the Audit Committee, to which it is

accountable. In 2019 the company implemented the Corporate Governance Code for SOEs with the exception of: (1) the dividend policy whose execution was left to the Republic of Croatia as the owner of the company; (2) the introduction of a compliance officer (still to be implemented); (3) the employee reward and motivation system, which includes aspects about salaries and remuneration; and (4) the evaluation of the management board by the supervisory board based on company targets (HEP Group, 2019[44]).

4.2.2. Hrvatske Ceste (HC)

Hrvatske Ceste – HC (Croatian Roads) is a 100% state-owned company in charge of the management, construction and maintenance of state roads in Croatia. It was established in 2001 as one of two legal successors of the former Croatian Road Administration (*Hrvatska uprava za ceste*), the other one being Hrvatske Autoceste *(*Croatian Motorways). The company is mainly financed through proceeds from fuel tax and a few other fees related to vehicle use, however it still heavily relies on government support. Similarly to other SOEs operating in the transport sector, the company contracted a large number of loans from commercial and international financial institutions (IFIs) for the development of its network following the independence war – which ultimately resulted in a large amount of debt (World Bank, 2017[41]).

In 2018, HC went through a business and financial restructuring as part of the project on "Modernisation and Restructuring of the Road Sector". As a result, the company managed to refinance part of its loans worth EUR 1.14 billion and to save EUR 26 million annually. The indebtedness was also reduced 5% from the previous year, however business indicators continue to show poor liquidity and a negative working capital (World Bank, 2017[41]).

Table 4.8. Financial indicators for Hrvatske Ceste (consolidated data, in HRK)

	2015	2016	2017	2018	2019
Turnover	194,888,900	181,343,600	173,239,500	183,856,700	202,699,332
EBITDA	22,660,600	21,344,300	20,398,400	24,024,400	29,801.300
Net Profit	-514,200	-287,900	-473,700	-308,700	-355,858
Dividends*	0	0	0	0	0
Assets	71,720,124,300	73,543,679,600	73,663,706,900	75,686,343,200	76,745,369,851
Equity	61,096,216,600	62,951,338,300	63,437,465,600	65,096,968,600	65,791,184,194
Provisions	158,808,200	159,285,100	169,348,200	160,901,900	159,463,425
Long-term debt	8,428,124,700	7,915,494,200	8,834,097,600	9,006,025,000	9,005,245,300
ROA	0.00%	0.00%	0.00%	0.00%	0.00%
ROE	0.00%	0.00%	0.00%	0.00%	0.00%

Note: * Dividends based on previous year(s) net profit.
Source: Data provided by the Croatian authorities to the OECD questionnaire, 2020.

The Republic of Croatia as the sole owner of the company exercises its ownership rights through the Ministry of Sea, Transport and Infrastructure (MSTI), and the Ministry of Physical Planning, Construction and State Assets. The supervisory board has 4 members including one employee representative, while the management board has 4 members. All board members including members of the management board are elected and may be dismissed by the company's General Assembly at the proposal of the MSTI,

with the exception of the employee representative which is elected according to the dispositions of the Labour Law.

4.2.3. INA – Industrija Nafte

INA-Industrija Nafte d.d. is a multinational vertically-integrated company operating in oil and gas exploration and production, as well as in refining and marketing of oil products. It was founded on 1 January 1964 with the merger of Naflaplin (a company involved in the exploration and production of oil and gas) and the oil refineries of Rijeka and Sisak which continue to operate (INA, n.d.[45]). INA's shares have been listed on the Zagreb Stock Exchange since 1 December 2006. Its largest shareholders are the Hungarian national oil company MOL (49%) and the Republic of Croatia (44.84%). The INA Group is comprised of several affiliated companies which are wholly or partially owned by INA. Apart from Croatia, INA has business operations in Angola and Egypt, and runs a network of 489 petrol stations in Croatia, Bosnia and Herzegovina, Slovenia and Montenegro, amongst others.

In 2019, the Croatian Parliament amended the so-called INA Privatisation Law of 2002 to align it with EU legislation. The Law was, in fact, violating the EU rules on the freedom of establishment and free movement of capital as it granted the Croatian state special powers including the right to veto INA's decisions relative to the sale of shares or assets above a certain value. The state could also oppose important company decisions such as changes in the company's activities or the granting of concessions amongst other aspects.

Table 4.9. INA's subsidiaries companies

	Name	Main sector of operation
Subsidiaries in Croatia	CROSCO Naftni Servisi d.o.o	Drilling and well services
	STSI, Integrirani Tehnicki Servisi d.o.o	Technical services
	INA MAZIVA d.o.o	Oil export and manufacturing
	Hostin d.o.o.	Tourism
	Top Racunovodstvo Servisi d.o.o	Accounting and tax services
	INA Maloprodajni Servisi d.o.o.	N.A
	Plavi Tim d.o.o	Information technology services
	INA Vatrogasni Servisi d.o.o	Fire services
Subsidiaries abroad	INA Slovenija d.o.o, Ljubljana	Retail distribution
	INA BH d.d. Sarajevo	Retail distribution
	INA d.o.o Beograd	Retail distribution
	INA-Crna Gora d.o.o Podgorica	Retail distribution
	Holdina d.o.o Sarajevo	Sale of oil and oil derivatives
	Adriagas S.r.l Milano	Natural gas distribution and marketing
	Energopetrol d.d.	Trade

Source: (INA, n.d.[45])

INA is the only minority-owned company in the list of "enterprises of special interest" and is thus monitored by the MPPCSA. Although minority-owned by the state, INA is one of the most profitable companies in the Government's portfolio. The company was severely hit by the 2008 economic crisis and took years to recover. It notably incurred heavy losses worth billions EUR between 2013 and 2016 which exerted a significant impact on the profitability of the Government's portfolio. Since 2016, however, the company has been

reporting profits – of around HRK 1.177 billion and HRK 489 million in 2018 and 2019, respectively [Table 4.10]. More recently, INA reported a consolidated net loss of HRK 965 million (USD152 million or EUR 128 million) in the first half of 2020, from a profit of HRK 188 million in the same period last year, with net sales shrinking 28% due to plummeting oil and gas prices as a result of the Coronavirus pandemic (Pavlova, 2020[46]).

Table 4.10. Financial indicators for INA Group (consolidated data, in million HRK)

	2016	2017	2018	2019
Revenue	15,535	18,582	22,349	22,597
EBITDA	2,112	3,215	3,489	2,859
Profit	95	1,222	1,177	489
Assets	20,292	19,263	20,742	21,532
Equity	10,597	11,526	11,823	11,216
Provisions	194	3,119	3,462	3,716
Long-term debt	3,653	3,380	3,602	4,117
ROA		6.33	5.64	2.27

Source: INA financial Report 2017 and 2019.

The fate of INA has long been a source of contention in Croatia. The privatisation of the company was indeed marred by corruption scandals, accusing then Prime Minister Ivo Sanader of accepting significant bribes in exchange of MOL's acquisition of INA's management rights in 2009. In 2019, and after years of unsuccessful attempts at resolving the case, a Court in Zagreb found Ivo Sanader and MOL's Chief Executive Zsolt Hernádi guilty of corruption (Financial Times, 2019[6]). In recent years, the relationship with the Hungarian owner has worsened over accusations that MOL had made market manipulations (Balkan Insight, 2011[47]) and failed to comply with agreed investments (Reuters, 2014[48]) amongst other aspects. As a result, Croatia has repeatedly stated that it would buy back MOL's shares, without much advancement. In 2017, the Government even floated the idea of selling 25% of its shares through an IPO of the electricity company HEP to help fund an INA buyout, however this project never materialised.

INA's supervisory board has 9 members – 5 of which are appointed by MOL; 3 by the Government of Croatia and 1 by the employees of the company. The management board has 6 members, 3 of which are appointed by MOL (including the President) and the rest by the Croatian Government. This structure was formalised and approved in the First Amendment to the Shareholders' Agreement in 2009 to reflect INA's change in ownership.

The company has an audit committee of three members, which are appointed by the supervisory board and confirmed by the General Assembly. Given the fact that INA is a listed company, it applies the ZSE Corporate Governance Code, as well as its own Code of Ethics which defines the basic values and principles of conduct of the company.

4.3. Financial controls in the SOE sector

SOEs in Croatia are subject to several external and internal control mechanisms, including those undertaken by state bodies, internal units of the SOEs, and independent

external auditors. They are subject to the several laws regulating these issues, some of which have been already described in Chapter 3 of this report on legal and regulatory environment. The sections below will focus on the main functions of the state bodies, internal units and external auditors when ensuring financial controls in the SOE sector.

4.3.1. The State Audit Office

The State Audit Office is the Supreme Audit Institution (SAI) of Croatia, which is autonomous and independent in its work. The tasks of the State Audit Office are prescribed under the Act on the State Audit Office (Official Gazette no. 25/19) and include: examination of documents, papers, and reports relating to the internal control systems, accounting, financial and other procedures that are subject to audit. The SAI has the authority to conduct financial, compliance and performance audits.

According to Article 9 of the Act on the State Audit Office, entities that are subject to a state audit include, *inter alia*, legal entities founded by the Republic of Croatia or by a local community and legal entities in which the Republic of Croatia or a local community has shares or stakes. State audits are to be conducted in compliance with the procedures and standards set forth by the International Organisation of Supreme Audit Institutions (INTOSAI) and the Code of Professional Ethics of State Auditors. The final report of the state auditor should be delivered to the audited entity and the Croatian Parliament and posted on the website of the State Audit Office. It should also be delivered to the relevant authorities when irregularities which constitute a misdemeanour or criminal offence, have been identified during the audit.

The State Audit Office plans and conducts audits to the extent foreseen by the Annual Programme and Work Plan, and at the request of the Croatian Parliament, insofar as the Auditor General assesses that such a request is justified. In the performance of its tasks, the State Audit Office cooperates with other state administration bodies, in such a manner that does not compromise its independence and autonomy.

In conducting audits of entities at the national level, the State Audit Office examines and assesses whether the entity acted in accordance with its obligations and authorities when performing certain activities and/or projects financed via the ministry. In this context, the State Audit Office applies an audit approach based on a risk assessment. Specific goals in the audit of SOEs are to verify:

- whether the decisions and guidelines of the Government are being enacted;
- whether operations and policies are aligned with the fundamental goals set by the Government of the Republic of Croatia;
- whether operations are performed according to the principles of efficacy, purposefulness and economy, and in line with the regulations; and
- whether sufficient information is provided that would enable the appropriate authorities and the public to assess the level of achievement of operational goals.

The scope for audits of SOEs is determined *ex ante*, at the time of adoption of the decision on conducting the audit, and is listed in the report upon its completion. According to Croatian authorities, when performing SOE audits, the State Audit Office directs particular attention to the application of the principles of good governance and internal control systems, assesses the work of internal audits and audit boards, and verifies the activities of SOEs based on the requirements contained in their Anti-Corruption Programme.

4.3.2. Additional external audit requirements

According to Article 20[1] of the Accounting Act, all legal entities of special interest to the Republic of Croatia, and other SOEs that fall within the categories of medium and large enterprises are obliged to audit their financial statements. The selection of an independent auditor should take place at least three months before the end of the reporting period. Articles 48–51 of the Audit Act describe the auditor's independence requirements and how such independence is achieved with regard to the audited entity. In particular, the external auditor must be independent from the audited entity and may not be involved in the audited entity's decision-making process. The external auditor shall, when performing auditing services, take all reasonable steps to ensure his/her/its independence and remove any possibility of potential conflict of interest or risk of jeopardising its independence and objectivity. Members or shareholders of an audit firm, as well as members of the management board, supervisory board and supervisory board of the audited firm or a related company may not intervene in the statutory audit process or the preparation of the auditor's report in any way which would jeopardise the independence and objectivity of the certified auditor who carries out the statutory audit on behalf of the audit firm.

The audit committee, when in place, is required, *inter alia*, to select the external auditor and monitor its activities as well as its independence and objectivity.

The auditor that is carrying out an external statutory audit of a public-interest entity, shall submit an additional report to the company's audit committee, management board or supervisory board in accordance with Article 11 of Regulation (EU) No 537/2014, and Article 67 of the Audit Act.

Since the adoption of the so-called " Guidelines for Tracking Business Plans and Reports of State Companies and Legal Entities" in 2018, the recipients (the MPPCSA, Ministry of Finance, and CERP) can request the reporting subject (and where necessary at their own discretion) to enable communication with an external auditor, via the audit committee of the reporting subject (or the supervisory board if the reporting subject does not have an audit committee). Furthermore, since these instructions only became applicable in September 2018, maintaining dialogue with external auditors was not the practice in the past two-year period. Continuous dialogue is also not a practice within the line ministries, though there is dialogue in individual cases.

4.3.3. Internal audit units and committees

According to the Audit Act, all legal entities of special interest to the Republic of Croatia, as well as public-interest entities with over 5000 employees and with assets exceeding HRK 5 million are required to have an audit committee, which may be a stand-alone committee or a committee of the supervisory board. The audit committee, *inter alia*, informs the supervisory board about the outcome of the statutory audit and explains how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process.

Members of the audit committee shall be appointed from the ranks of members of the supervisory board and/or non-executive members of the supervisory board and/or other members appointed by the General Assembly of the audited entity. At least one member of the audit committee shall have competences in accounting and/or auditing and members of the audit committee as a whole shall have competences relevant to the sector in which the audited entity is operating (Article 65 of the Audit Act).

In addition, according to the Public Internal Financial Control System Act, all SOEs shall establish an internal audit function to evaluate the adequacy, efficiency and effectiveness of internal controls and to provide, on the basis of objective evidence, a sufficient level of safety that the implementation of the existing risk management processes, controls and management, i.e. corporate governance, is functioning towards achieving the company's objectives. This Act further stipulates that the internal audit shall organisationally and functionally report to the responsible person (i.e management board) and that, if a supervisory board or an audit committee exists, the internal audit shall functionally report to them as well.

The audit committee and the supervisory board should effectively cooperate in planning the activities of the internal auditor. The company's by-laws must determine that the internal auditor's employment contract may not be terminated without the approval of the supervisory board. This is also recommended under the Code of Corporate Governance for SOEs (Item VII, paragraph 5).

Under the Ordinance on internal audits in the public sector (Official Gazette No. 42/16), SOEs with up to 50 employees and income of up to HRK 400 million are not required to have an internal audit unit, but internal audit activities will be performed for them by the internal audit of the public entity that has the largest share in its ownership (e.g. ministry, county, city). When auditing financial statements, the internal audit shall cooperate with external auditors.

4.3.4. The Financial Agency (FINA) and the Ministry of Finance

The Ministry of Finance through its Directorate for Financial Management, Internal Audit and Supervision, is responsible for the supervision of the application of regulations governing the material and financial operations of fully or majority-owned state enterprises. Pursuant to the State Assets Management Act, legal entities under state ownership are required to submit their quarterly financial statements, annual plans, annual reports, mid-term plans, mid-term reports and other ad hoc reports as needed to the Ministry of Finance, the MPPCSA and CERP. The Ministry of Finance can monitor the effects and accomplishments of planned targets via the received performance reports. This is primarily done via a set of financial indicators, such as liquidity, profitability and indebtedness. Line ministries, with the exception of the MPPCSA, do not have access to these sets of indicators.

The Ministry of Finance also monitors the disclosure of non-financial reports and publishes the list of enterprises who have not published the non-financial report on their websites as per Articles 40-41 of the Accounting Act. Enterprises who fail to publish their non-financial reports are subject to a fine between HRK 10,000 and HRK 100,000 (Article 42).

In addition, all companies in Croatia, including SOEs, are required to submit their annual financial statements and consolidated financial statements with the accompanying auditor's reports (if they are subject to such a requirements) to the Financial Agency (FINA) for statistical purposes and public disclosure. FINA keeps a register of annual financial statements of business entities in electronic form, which is publicly available on FINA's website. Furthermore, FINA is also required to submit to the Ministry of Finance the list of enterprises that have published the non-financial report, and those that have not. SOEs whose stocks are listed on the ZSE are also obliged to submit their financial statements to the Croatian Financial Services Supervisory Agency (HANFA) and publish them within the prescribed period in accordance with the Capital Market Act.

The financial reporting of statutory entities classified as extra-budgetary users (i.e. statutory corporations such as Hrvatske Vode, CERP, HAOD), is regulated by the Ordinance on Financial Reporting in Budgetary Accounting (Official Gazette no. 3/15, 93/15, 135/15, 2/17, 28/17, 112/18 and 126/19), which prescribes the form and content of financial statements as well as the obligations and deadlines for their submission. Such entities are required to publish annual financial statements on their websites or the website of the competent body eight days after submitting them to FINA. They are also required to submit annual financial statements to the authorised district office of the State Audit Office which do not publicly disclose them (they only serve as a foundation for any future audits).

4.4. Supervisory board of SOEs

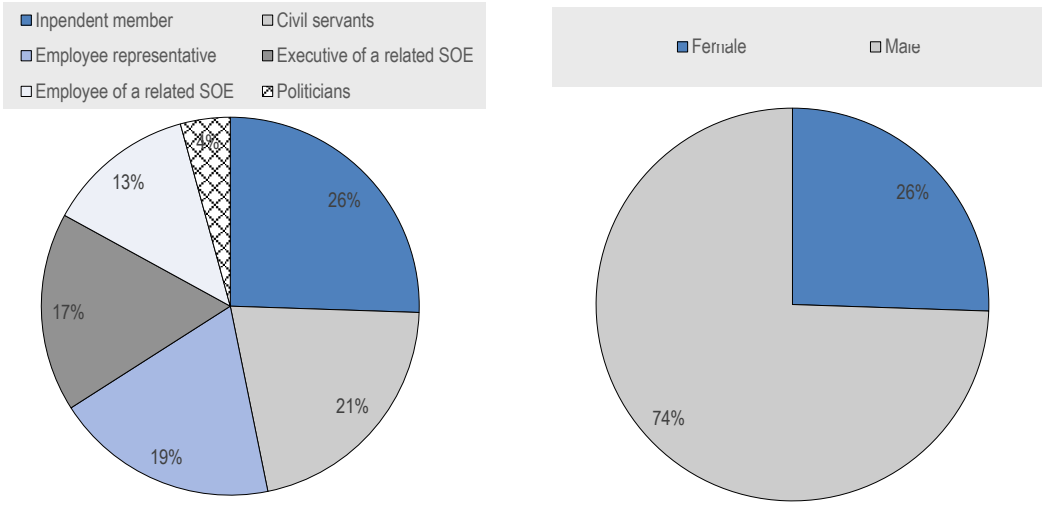
4.4.1. Structure and composition of SOEs

Pursuant to the provisions of the Companies Act, the owners of Croatian companies can decide to establish either a unitary or a two-tier supervisory board. In practice however, they tend to have predominantly two-tiered boards. The management board can have one member or more, while the supervisory board must have at least three members or more provided that their number is always odd (Art. 254[1] of the Company's Act). In practice, SOEs have on average 5 members in their supervisory boards. SOEs which were established under a special law (i.e. statutory corporations) may have different board structures and compositions. They generally consist of one or several government-appointed managers (management team) reporting directly to the line ministry.

Information provided by the Croatian authorities on the 11 largest commercial SOEs (in terms of equity value and employment)[24] shows that most large SOEs (if not all) have adopted a two-tiered board system. Their size varies between 3-7 members, with a majority of SOEs having 5 members. Their composition is varied including about 21% of public officials and 19% of employee representatives (1 per SOE in general). Although there is no requirement for independent board members, in most SOEs, the data suggests that about 1/4 of all board members are independent from the state (i.e. not in a contractual relationship). Their level of independence may however vary as board members are all appointed directly by the state without clear definition or criteria of independence established in the law and/or applicable regulations. In practice, several of such independent board members are reportedly members of the ruling party and/or parliamentarians at the local level for example. About one-fourth of all board members are either executives (17%) or employees (13%) of another related SOE – usually either the parent company or an SOE operating in the same sector. About 26% of board members are women.

[24] The sample includes information from the following SOEs: 1) Hrvatske Ceste d.o.o; 2) HEP d.d.; 3) Hrvatske Autoceste d.o.o; 4) HŽ Infrastruktura d.o.o; 5) Hrvatski Operator Prijenosnog Sustava d.o.o; 6) Jadranski Naftovod d.o.o; 7) Plinacro d.o.o; 8) HEP-Operator Distribucijskog Sustava d.o.o; 9) HPB d.d; 10) Hrvatske Šume; 11) HP d.d.

Figure 4.4. Board composition in the 11 largest SOEs in Croatia.



Source: Information provided by the Croatian authorities to the OECD questionnaire, 2021.

4.4.2. Board nomination procedure

According to the Companies Act, members of the supervisory board are freely elected by shareholders at the General Assembly. In certain industries, the appointment of supervisory boards may be regulated by industry specific laws (e.g. Credit Institutions Act) and for example require regulatory approval.

The 2019 Regulation on the Conditions for the Selection and Appointment of Members of Supervisory boards and the Management (Official Gazette no. 12/19) (hereafter "2019 Regulation on the selection and appointment of board members") distinguishes between the election and nomination procedure of management and supervisory board members in SOEs of special interest. While the Regulation contains dispositions applicable to SOEs under CERP's portfolio, the selection and nomination procedure for the latter is determined by the Act on State Property Management. In addition, it is worth noting that the Regulation does not apply to statutory corporations which may, by virtue of special law, organise their board selection and nomination procedure in a different way.

Board selection

According to this Regulation, line ministries of SOEs of special interest shall follow a specific procedure for the selection of management and supervisory board members, including assessing candidates against a predetermined set of criteria; conducting interviews (Article 6); and publishing their names (during approx. 15 days) for public consultation with the interested third-parties (Article 7). After this, line ministries are required to deliver their opinion on the candidates and send their proposal for the selection or appointment of candidates (including all relevant documentation) to the Government of the Republic of Croatia. Only positions in the management board are subject to an "open competition". Although the selection procedure does not apply to CERP's portfolio (for which the selection procedure is not regulated), the conditions that candidates must meet to be elected are the same for all SOEs.

Board appointment

Board members in SOEs of special interest are appointed by the Croatian Government, at the proposal of the line ministry; and their names are published on the websites of the competent authority. For SOEs under the competence of CERP, board members are appointed by CERP's board of directors at the proposal of its director-general, as stipulated in Art. 31[5] of the Asset Management Act. The line ministry may propose a candidate, however, his/her selection and appointment will be determined by CERP.

A different procedure is also foreseen for financial institutions which are subject to the Credit Institutions Act. According to this Act, board member appointments require the prior approval of the Croatian National Bank (Article 46), amongst other aspects. In addition, credit institutions are also required to have a Nomination Committee. Its competences include proposing members of the management board; regularly reviewing the structure, size and composition of the management board (and if necessary, propose changes); and assessing the knowledge, skills and experience of individual members of the management board and supervisory board, amongst other aspects.

This new framework was established in 2019 to improve a nomination process which was otherwise known for lacking accountability and transparency, and tended to favour political appointees (European Commission, 2015[28]). It is currently being reviewed within the framework of an EU-financed project (led by the EBRD) aiming at improving the competences of SOE boards and audit committees in Croatia. It is unclear however whether such changes will be mandatory and thus truly change-inducing.

According to Article 14(1) of the Act on the Prevention of Conflict of Interest, public officials (largely defined as parliamentarians, ministers, and mayors) may not be members of the management board or supervisory board of a SOE – with the exception of supervisory boards of so-called extra-budgetary funds (i.e. statutory corporations) which are of special interest to the state or to a local or regional self-government. In fact, in certain SOEs, including SOEs of special interest, ministers are board members by virtue of their position if requested by special law (e.g. Croatian Bank for Reconstruction and Development, HAOD, Hrvatske Vode and CERP). Ministers are however not entitled to remuneration for their representation on boards, except for the reimbursement of travel and other justifiable expenses (Article 14[2]). Furthermore, according to the Civil Servants and Officials Act, a civil servant may not participate in the supervisory board of a SOE which is supervised by the body in which he/she is employed (Article 35[1]), i.e. they cannot come from the department within the competent ministry that is involved in policy-setting for the sector in which the SOE operates). A regulation on membership in SOE boards by state officials and civil servants is currently being prepared under an EU-funded project, in cooperation with the EBRD.

4.4.3. Criteria for board member selection

According to the 2019 Regulation on the selection and appointment of SOE board members, candidates to the supervisory board shall fulfil the following conditions:

- He/she must have completed a graduate university programme, [...] or an equivalent study programme in a relevant discipline;
- He/she must have at least 5 years' professional experience gained in management positions for legal entities of special interest in which the Government of Croatia holds a majority share and whose consolidated revenue in the preceding financial year is below HRK 750 million; or 10 years'

professional experience gained in management positions for legal entities of special interest in which the Republic of Croatia holds a majority share and whose consolidated revenue in the preceding year exceeds HRK 750 million.

- He/she must have knowledge of corporate governance, finance and accounting;
- He/she must have no conflicts of interest in accordance with the specific regulations governing the prevention of conflicts of interests between public and private interests in public office and in accordance with the rules of the Corporate Governance Code for Companies in which the Republic of Croatia holds Shares or Interests (i.e. Code of Corporate Governance for SOEs).

Similar criteria apply to candidates applying for a position to the management board, with slight variations (e.g. the candidate must have at least 10 years of professional experience in positions that require an appropriate qualification level, including at least 5 years of professional experience in management positions).

As mentioned, there is no widespread practice of nominating independent or non-executive members in SOE boards. Non-executive directors are more common in companies with a unitary board which is rather rare in Croatia. Only listed SOEs are required to have independent board members as per the provisions of the Code of Corporate Governance of the Zagreb Stock Exchange. In particular, Chapter 4 of the Code requires a majority of board members (including its Chairperson or Deputy Chairperson) to be independent following the definition provided in Box 4.3.

Credit institutions of a significant size are also requested to have a “sufficient number of independent members” as per Article 45[3] of the Credit Institutions Act. The definition of independence for these institutions is provided in a specific Decision adopted by the Croatian National Bank.

Box 4.3. Definition of the independence of members of the supervisory board and its committees according to the ZSE Code of Corporate Governance

A member of the supervisory board or one of its committees cannot be classified as independent if he/she:

- is or represents a significant shareholder or a member of the group of significant shareholders; or is a spouse, close relative or in-law to a significant shareholder;
- has been a member of the management board of the company or any related companies within the previous three years; or is a spouse, close relative or in-law of any of the members of the management board;
- has been an employee of the company or of any of its dependent or related companies, within the previous three years;
- has been appointed as an employee representative;
- receives other payments from the company in addition to the remuneration received for carrying out its supervisory board activities;
- is or has been, within the previous three years, in a significant business relationship with the company or its affiliated companies, directly or indirectly as a partner, shareholder, member of the supervisory or management board or a senior manager of an organisation which has significant business relations with the company;
- is or has been within the previous three years, a partner or an employee of an audit company which provides or provided audit or non-audit services to the company or its associated companies;
- has significant relations with members of the company's management board through his/her involvement in other companies, bodies or organisations; or has been a member of the supervisory board for more than 12 years.

According to the Code, however, "supervisory boards seeking independent members should treat this definition as an initial assessment of independence only. A candidate's ability to make an independent and effective contribution to the supervisory board will also be influenced by factors such as their past experience, their character and their personal values. Nomination committees should assess these factors when considering candidates".

Employee representation is mandated by the Labour Act which in Article 164 stipulates that SOEs and public institutions should include one employee representative in their boards to be appointed and dismissed by the Employees' Council or through direct voting from employees when there is no such Council. The employee representative has the same legal status as other board members. An exception applies to credit institutions, as Article 45[4] of the Credit Institutions Act stipulates that "employees of a credit institution may not be appointed to the supervisory board".

4.4.4. Board role and competencies

The duties and responsibilities of the supervisory board are not specifically defined for SOEs. These are generally stipulated in the Companies Act (Article 263) and the Credit Institutions Act for financial SOEs although they may apply to other SOEs as well depending on their legal form [Table 4.11].

Table 4.11. Board role and competencies.

Supervisory Board	Management Board
● Supervises the management of the company's operations; ● Demands the auditor to review annual financial statements of the company and the group; ● Submits a written report on its supervision of the company's business operations to the General Assembly; ● Represents the company in relation to the members of the management board: ● Reviews and examines business records and documentation; ● May revoke a member of the management board; and appoint its members as deputy members of the management board for members who are absent or unable to perform their functions; ● May convene a General Assembly meeting, when it is necessary for the benefit of the company.	● Manages the company's operations at its own responsibility; ● Represents the company in legal affairs, before the court and other authorities; ● Prepares and executes decisions and contracts made by the General Assembly; ● Submits reports to the Supervisory board; ● Submits an annual report on the company's status to the General Assembly.

The responsibility and autonomy to define strategies for the company lies with the management board which generally develops the strategy independently before presenting it to the supervisory board and the General Assembly. Management and supervisory board members are then required to reach an agreement on the determination and implementation of strategic goals. Therefore, the role of supervisory boards is generally limited to monitoring, whereas management boards have a stronger role especially in cases where the supervisory board operates only as a formal body and has little influence in the state-owned enterprise's decision-making process.

According to the Croatian authorities, civil servants when elected in SOE boards, act independently and do not receive instructions on how to vote on the agenda. They do however generally take into account the Governments' official position (in line with existing policies and strategies) when taking decisions. In particular, the Code of Corporate Governance for SOEs prescribes that board members should make objective and independent decisions primarily based on the benefit of the company and may not make any decisions based on their personal interests (Chapter IV). In practice, however, SOEs boards frequently include representatives of the line ministry which may have specific strategic or public policy objectives to implement. In such cases, the supervisory boards is reportedly informed accordingly through the General Assembly. In certain cases, such as for the statutory company Jadrolinija, board members are specifically requested to "act upon instructions issued by the Minister of Sea, Transport and Infrastructure" in accordance with the Act on Jadrolinija, Rijeka.

Board members, including state representatives may receive a remuneration for their work. This remuneration is defined under the company's statute and may be approved by its shareholders. According to the Companies Act and the ZSE Code of Corporate Governance, the remuneration of board members must reflect their time commitments and responsibilities. It should not include variables or other elements associated with success of operations. Furthermore, according to a 2009 Government Decision on the remuneration for SOE board members and executives, remunerations for supervisory board members cannot exceed the amount of HRK 2,000 net per month in fully or majority-owned SOEs. The implementation of this directive is also recommended for establishing the remuneration of state representatives in companies minority-owned by the state. The fact that SOE board member' remunerations are capped at this level is generally considered an issue to attract highly qualified professionals and may create a situation in which outside candidates would be not willing to apply for such vacancies even in open competitions, and only candidates with vested interests would be willing to

take up these posts. In any case, the pay should reasonably correspond to the level of responsibilities vested to the board members.[25]

All public interest entities as defined in Article 3[1] of the Accounting Act, as well as SOEs with more than 5,000 employees and assets exceeding HRK 5 million for the financial year are required to have an audit committee. It may be a stand-alone committee or a committee of the supervisory board (Article 65[1] of the Audit Act). Its main role is to inform the supervisory board about the outcome of the statutory audit and explain how it contributed to the integrity of the financial reporting. Credit institutions of a significant size are also required to establish a remuneration committee, a nomination committee and a risk committee. The Croatian Government is currently working on regulating the introduction of such committees in SOEs – which are currently only optional according to the Companies Act.

Since January 2020, the Croatian Government is working with the European Commission and the EBRD on a project named "Enhancing competences of the supervisory board and audit committees in SOES" which aims at (i) improving the framework for enhancing the composition of SOE supervisory boards and audit committees and improving their effectiveness and (ii) strengthening the authorities' capacity to address issues of effectiveness with the board and the committee (EBRD, 2019). Through this project, the Government of Croatia also adopted a Decision establishing mandatory trainings for state representatives in SOE boards and audit committees. A certain number of workshops and training events have thus taken place in September and October 2020 gathering a total of 79 participants. Additional workshops are scheduled to take place in 2021.

[25] There are plans to modify the current remuneration framework as part of the ongoing EU-funded project with the EBRD on "enhancing the competences of the supervisory board and audit committees in SOEs". This could include *inter alia* the recommendation to make payment of the liability insurance policy premium as part of the remuneration of supervisory board members, as well as the recommendation to establish remuneration committees in certain SOEs.

Chapter 5. Anti-corruption and integrity in SOEs

5.1. Background: corruption and integrity concerns

In the late 2000s, Croatia adopted a comprehensive Anti-Corruption Programme for SOEs. The programme ran from 2010 to 2012 and set four objectives: 1) strengthening of integrity; 2) accountability and transparency in the work of SOEs; 3) creation of preconditions for the prevention of corruption at all levels of companies; and 4) affirmation of a "zero tolerance" approach to corruption). It defined 18 measures, which had to be transposed into action plans of majority state-owned companies. The ambition of the reform, however, diminished after Croatia's accession to the EU. The programme was not extended beyond 2012 (OECD, 2016).

In 2012, the European Commission stressed that "Croatia needed to ensure that a strong system was in place for preventing corruption in state-owned companies" (EC, 2012). The Monitoring Report of March 2013 noted that there was no further progress. In 2014, the EU Anti-Corruption Report reflected results of two Eurobarometer surveys, according to which Croatia was among the countries lagging behind in terms of both perceptions and actual experience of corruption. In this report, the EC suggested that Croatia should, *inter alia*, establish an effective mechanism for preventing corruption in SOEs, including with regards to donations and sponsorships; and ensure implementation of effective anti-corruption action plans within SOEs to promote comprehensive prevention policies, effective reporting mechanisms and high accountability standards; as well as access to public interest information relating to these companies presented in a user-friendly format (EC, 2014).

Since then, Croatia has taken new steps towards improving the framework for SOEs. In 2018, work began to develop a new programme for the period 2019-2020. Other overarching anti-corruption measures have been implemented over the years that should have a positive impact on the integrity of SOEs, such as the introduction of the Whistleblower Protection Act, which should cover SOEs; newly adopted regulations to introduce the disclosure of beneficial owners, including those of SOEs; and proactive enforcement of criminal liability for corruption committed by legal persons, including SOEs, amongst other aspects.

However, there is a general perception that Croatia has fallen back on some of its anti-corruption gains since its accession to the EU. According to a recent OECD publication, reforms aimed at improving the governance and fostering integrity of SOEs have advanced slowly. Many SOEs still suffer from political board appointments without transparent and competitive selection procedures.

Recent controversies involving SOEs highlight a lack of political will for reform and the will of political elites to exploit SOEs for personal or party gain. While corruption or related irregularities are not the main focus of this particular review, the controversies in Box 5.1 highlight grave weaknesses in corporate governance – namely, the autonomy of the SOE

from the state shareholder – that can mean serious repercussions for the financial and non-financial performance of SOEs. Such scandals have shown how public trust in SOEs and the state or local governments as owners can be damaged by unethical practices in the SOE sector (OECD, 2019[24]). The OECD Anti-Corruption Network for Eastern Europe and Central Asia noted that while according to Transparency International's Corruption Perceptions Index, corruption perception in the region had improved. In contrast, corruption perception in certain countries, including Croatia has deteriorated (-4) (OECD, 2020).

Box 5.1. Recent public controversy involving state-owned enterprises in Croatia

This box is based largely on media reports and the information has not been independently verified by the OECD. Where investigations or court proceedings are involved they have mostly not been concluded or adjudicated.

At the time of writing, Croatian media had broken a story about a filmed conversation in which a member of parliament and ruling party member allegedly offered an independent counsellor, inter alia, a position in a sub-nationally state-owned company. The counsellor released the video "in the public interest", to which the President reacted by welcoming the transparency around political parties' "methods". He publicly referenced that there is no need to use public tenders for filling SOE leadership positions because it is already known how people are placed in SOEs – that is, at the behest of Government. Media reported that Parliamentary representatives called on the President to identify which capable nominees were not selected in previous public tenders where he or his party were appointed instead.

Yet more recently, a former Deputy Prime Minister (and ruling party member) was appointed by the Prime Minister as the CEO and chair of the management board of the Podravka pharmaceutical food company, despite an alleged lack of experience in the sector. The state owns 25.5% of Podravka and thus the direct appointment of the CEO by the Prime Minister runs counter to the obligations and international standards for fair treatment of non-state shareholders that, in this case, include pension funds (52.2%), treasury shares (1.8%) and private investors (20.5%).The media reported on speculation that the supervisory board would oppose the move during the relevant session, but her position was unanimously confirmed.

In September 2020, the then CEO of Croatia's oil pipeline operator (JANAF) was arrested by the Office for the Suppression of Corruption and Organized Crime (USKOK) on suspicion of influence peddling, bribery and illicit preferential treatment. According to media reports, the former CEO of JANAF asked the CEO of a private electrical installation firm working almost exclusively with SOEs for HRK 1.9 million to secure a contract with JANAF. Bribes allegedly changed hands in a private club owned by the former CEO that high-ranking political figures have publicly acknowledged visiting. Following the arrest of the former CEO, who is a member of a different political party, a representative from the ruling party was appointed as the new JANAF CEO.

In 2019, the former Prime Minister (PM) was found guilty of accepting a EUR 10 million bribe from Hungarian oil company MOL for a controlling stake in INA – a state oil company. This bribe required modification of the shareholder's agreement. Another of the former PM's indictments came after his central role in orchestrating the so-called 'FIMI-Media' affair. The former PM, Government ministers and other heads of state institutions instructed SOEs to contract the marketing firm, FIMI-Media, which was established by the ruling party in order to siphon off SOE funds in various directions including to the party's Slush Fund and for the Prime Minister's personal gain to the tune of HRK 15 Million. The contracts were not subject to open tender and FIMI-Media's invoices were bloated to allow for the excess finances to be redirected. The political party was also judged as responsible for the crime.

Source: Mission team research and interviews.

Parts of the Government have gradually, albeit slowly, tried to tackle the issues of mismanagement and vested interests in SOEs through the adoption of measures aimed at strengthening their integrity. The OECD Recommendations of the Investment Review encourage Croatia to continue its anti-corruption efforts, notably by improving its public integrity framework as foreseen in the Anti-Corruption Strategy 2015-2020, as well as by effectively implementing the Anti-Corruption Strategy for SOEs (OECD, 2019[24]). Croatia's interest in acceding to the OECD Anti-Bribery Convention also requires compliance with a set of anti-corruption standards, including on liability of legal persons for corruption offences that should cover SOEs, its officials, as well as officials of ownership entities.

Box 5.2. Policy Recommendations of the 2019 OECD Investment Policy Review.

- Continue efforts to improve the corporate governance framework for state-owned enterprises (SOEs) with the objective to improve their integrity, transparency and professionalism. Reforms aimed at fostering the governance and integrity of SOEs are progressing, though more slowly than scheduled.

- Take action, as appropriate in cooperation with business organisations and other stakeholders, to improve awareness among companies throughout Croatia, including state-owned enterprises and small and medium enterprises, which are traditionally at high risk of bribe solicitation by public officials, of Croatia's new legislation regarding whistleblower protection, and to advise and assist companies in their efforts to establish internal channels for reporting irregularities through, for example, the development of seminars, guidelines and other forms of guidance. Making anti-corruption compliance part of one's corporate culture is the best way to prevent corrupt acts before they happen.

Source: Excerpt from OECD, 2019.

5.2. State policy response

Croatia has responded to integrity and corruption challenges by developing a comprehensive anti-corruption policy framework, which defines state's expectations on integrity and anti-corruption towards the ownership entities and the SOEs, and aims to establish high integrity standards applied to the state across the board. In particular, the Anti-Corruption Programme for companies under majority state ownership for 2019-2020 (Official Gazette no. 48/19) was developed and adopted within the framework of the overall Anti-Corruption Strategy for the period 2015–2020, adopted by the Parliament in 2015 (Official Gazette no. 26/15), as one of the measures of its 2017–2018 Action Plan, which was adopted by Government's Decision in 2017 (Official Gazette no. 60/17).

According to Croatian authorities, the Anti-Corruption Programme has been designed to take into account the analysis of implementation of the previous policy document. While the previous document focused on building the institutional and legal framework, establishing coordinated inter-departmental work processes, and combating and prosecuting corruption, the new one focuses primarily on prevention by detecting corruption risks and eliminating the remaining legislative and institutional shortcomings.

The Anti-Corruption Programme envisages new anticorruption mechanisms for SOEs, including the incorporation of rules on the prevention of conflict of interest into the codes of ethics and internal acts of SOEs, the requirement for all SOEs to implement internal control of business operations, independent monitoring of sponsorship and donations and of public procurement procedures – including control mechanisms for irregularities. It also recognises the role of employees in detecting and reporting evidence of bribery by requiring SOEs to provide channels for communication by, and protection of, persons willing to report breaches of the law or professional standards or ethics occurring within the company.

It is structured around seven horizontal strategic areas and seven special priority areas in which it proposes measures for the management of identified corruption risks. Furthermore, the strategic goals should be achieved by implementing the activities contained in the accompanying implementation documents (action plans) in accordance with measures set in each strategic area.

The following bodies are responsible for monitoring the implementation of the Anti-Corruption Strategy and of the Anti-Corruption Programme:

- The Ministry of Justice and Administration as the initiator of the Anti-Corruption Strategy and the Anti-Corruption Programme;
- The Croatian Parliament as the enactor of the Anti-Corruption Strategy, through the National Council for Monitoring the Implementation of the Anti-Corruption Strategy;
- The Council for the Prevention of Corruption as the working body of the Government, which is in charge of monitoring of the implementation of anti-corruption measures;
- The Ministry of Physical Planning, Construction and State Property as the implementer of certain measures relating to state-owned enterprises.

The MPPCSA submits reports on the implementation of measures to the Ministry of Justice and Administration and to the National Council for Monitoring the Implementation of the Strategy of the Parliament. Coordination between state bodies is carried out through meetings of the Council for the Prevention of Corruption, which consists of 23 representatives of state bodies, 3 representatives of local and regional self-government communities and 4 representatives of civil society. The Council for the Prevention of Corruption submits reports on the implementation of anti-corruption measures to the Government.

All reports for the period from 2015 to 2020 have been published on the website of the Ministry of Justice and Administration. At the end of the implementation period, the Ministry of Justice and Administration will prepare a consolidated report that will be submitted to the Government. The Ministry of Justice and Administration, when necessary, communicates with individual SOEs regarding the implementation of the Anti-Corruption Programme.

In order to monitor implementation of the Anti-Corruption Programme and regularly improve and adjust measures aimed at its implementation, all majority-owned SOEs are required to prepare their own internal anti-corruption action plans. The plans can be moreover used as control mechanism to determine whether a specific action from the Anti-Corruption Programme has been fully implemented or if it should be redefined according to new needs. SOEs are also obliged to publish these internal anti-corruption action plans, as well as periodic reports on their implementation. Furthermore, SOEs are

obliged to submit links on periodic reports to the competent ministries and the Ministry of Justice and Administration electronically.

5.3. Anti-corruption and integrity measures and mechanisms

The Croatian Government has also introduced a number of anti-corruption and integrity mechanisms and tools into its SOE regulatory framework. Some of these have been introduced as part of the implementation of the Anti-Corruption Programme, others predate it or have been adopted separately. Key instruments and mechanisms, which have been recently introduced or have most relevance in the context of anti-corruption and integrity of SOEs, are highlighted below.

5.3.1. Compliance monitoring function within SOEs

In order to implement the Anti-Corruption Programme and to align it with the OECD Guidelines on Corporate Governance of SOEs, the Government of Croatia adopted the 2019 Decision on the requirement to monitor the compliance of operations in legal entities under majority state ownership. This Decision mandates all majority state-owned legal entities to introduce a compliance monitoring function into their organisational structure and to define such function in a relevant regulation of the legal entity.

Within the meaning of the above Decision, the compliance monitoring function covers all tasks related to aligning the functioning and operations of the legal entity with legal regulations and its by-laws, risk assessment in the functioning and operations of the legal entity, commitment to good business practice, and the prevention of conflicts of interest and corrupt practices. In particular, such compliance monitoring function should contribute to:

- overcoming the risk of non-compliance and risk of generating significant financial loss;
- strengthening corporate culture and company reputation;
- protecting from illegal operations;
- preventing conflicts of interest; and
- reducing corruption and other risks that the company may suffer due to non-compliance with the regulations, standards and codes, as well as internal acts.

SOEs are obliged to notify the MPPCSA and CERP on the introduction of the compliance monitoring function, in accordance with the above Decision [the integration of the compliance function in SOEs and the effectiveness of the mechanisms for verifying implementation are explored in section 5.3.2, Part B of this review]. The Corporate Governance Code for SOEs states that the supervisory board shall ensure that there are effective structures, policies and procedures in place to identify, report, manage and monitor the risks facing the enterprise and to ensure the independence and effectiveness of internal and external audit functions. It also states that the company shall maintain an efficient risk management system that is adequate for its objectives, size and scale of activities. The system must include procedures that ensure *inter alia* reliable risk identification, risk measurement, risk response, and it must include external risks, as well as financial and operational risks.

Similarly, the Code of Corporate Governance for listed companies, requires establishing efficient internal controls and accountability mechanisms. In particular, it prescribes the

obligation to adopt policies related to assessing and managing risks, *inter alia*, related to preventing and sanctioning bribery and corruption, and requires the commitment of the supervisory board and management board to identify key stakeholders for these purposes. Article 22 of the Accounting Act prescribes that public-interest entities with securities listed on a regulated market shall include a corporate governance statement in their management report. Article 17 of the Accounting Act regulates the application of financial reporting standards.

Alignment of these requirements with those assigned to the compliance function, is important for ensuring that the SOEs understand their various obligations and are not placed under competing requirements for similar functions.

5.3.2. Code of Ethics for SOEs

The Anti-Corruption Programme also prescribes SOEs to adopt a Code of Ethics. Such Code should define the ethical policies and the procedure for implementing them, the disciplinary actions to be taken in the case of their violation, as well as other mechanisms on its implementation. Key elements of such Code of Ethics are described in the Anti-Corruption Programme.

SOEs are required to adopt the Code of Ethics with a view to fulfil their company's vision, mission and strategy and to become reputable and recognisable companies through the integral way of conducting business, business performance and quality of the services provided. The Code of Ethics should be publicly disclosed on the company's website and should cover principles in the field of morality and professional ethics that management board members, executives of the company and other employees of the company at all levels and positions must adhere to in the performance of their duties. Its primary purpose should be to integrate these principles within the company's business processes and work environment, so that these principles become regular behaviour for all employees of the company, in line with ethical and professional standards and the generally accepted societal values.

The implementation of the Code of Ethics should be monitored by the Ethics Committee that:

- promotes ethical conduct in relations between employees, as well as towards service users and suppliers;
- advises employees on ethical conduct;
- receives complaints from employees, service providers and suppliers regarding unethical and possibly corrupt conduct of employees; and
- carries out the procedure for examining the merits of the complaint.

If the Committee finds that a violation of the Code of Ethics has occurred, it should, in its decision, specify all the facts indicating that a particular employee has violated the Code of Ethics, and it should propose to the company's management board to take action to reprimand the employee, or in order to prevent further violations of the Code of Ethics.

5.3.3. Declaration of Assets by key management of SOEs and other restrictions

Under the Conflict of Interest Prevention Act, the chairpersons and management board members of majority-owned SOEs have a status of officials and therefore are required

to submit their declaration of assets, which also includes information on their salary. This information is published on the website of the Commission for Conflict of Interest.

While this is undeniably a good anti-corruption practice in the general sense, and is further promoted by the OECD Guidelines on Anti-Corruption and Integrity in SOEs, how this legal requirement is applied in practice vis-à-vis the SOE sector needs more attention. According to the OECD forthcoming report, in 2019, a total number of declarants in Croatia amounts to 2158 and the number of actual submitted declarations was recorded at 941. This constitutes the smallest percentage of basic legal compliance among the 10 countries for which such data was available, with only Serbia having a lower number of actual submissions versus number of legally obliged declarants (OECD, 2020).

Data provided by Croatian authorities suggests that there is a certain degree of enforcement of these requirements vis-à-vis the chairpersons and management board members of majority-owned SOEs. In particular, three persons have been sanctioned for violation of Article 10 and Article 27 of the Conflict of Interest Prevention Act in connection with the submission of Reports on the assets of public officials (Property card).

Similarly, sanctions for violation of some other restrictions contained in the Conflict of Interest Prevention Act have been imposed on the chairpersons and management board members of majority-owned SOEs. In particular, in 2018-2020, five persons have been sanctioned for violating Article 14 (prohibition of membership in the administrative bodies and supervisory boards of companies, management boards of institutions, supervisory boards of extra-budgetary funds and the performance of management activities in business entities), one for violating Article 7c (abuse of special rights of public officials arising from or necessary for the performance of duties), two persons for violation of Article 11 (unauthorised acceptance of gifts), one person for violation of Article 12 (prohibition of receiving another salary and compensation for performing another public duty), and one person for violating Article 16 (the obligation to transfer management rights on the basis of a share in the capital of a company owned by an public official). It is difficult to conclude whether the level of enforcement is sufficient but the Conflict of Interest Prevention Act has been applied to SOEs' top management in the recent years, which was a point of criticism in EC and other reports previously.

5.3.4. Anti-corruption focus of monitoring and audits and applicable ethical standards

Article 21 of the Accounting Act and Article 250a of the Companies Act require that public-interest entities, as well as those enterprises exceeding the criterion of the average number of 500 employees, including all qualifying SOEs, shall include in their management report a non-financial statement containing information, among other, relating to anti-corruption matters.

Under the Public Internal Financial Control System Act, a company should establish the internal audit function to evaluate the adequacy, efficiency and effectiveness of the internal controls and to provide, on the basis of objective evidence, a sufficient level of safety that the implementation of the existing risk management processes, controls and management, i.e. corporate governance, is functioning towards achieving the company's objectives. Independence of the internal auditors is prescribed by both Corporate Governance Codes (for listed and state-owned companies) and is to be safeguarded by the supervisory board and companies by-laws.

According to Croatian authorities, state auditors, in their activities abide by the Code of Ethics for Internal Auditors in the Public Sector, which outlines the principles and rules of conduct that internal auditors must apply when performing internal audit activities in the public sector, and the manner of resolving ethical issues. The principles and rules under the said Code are based on the principles and rules of the Code of Ethics as an integral part of the International Professional Practices Framework (IPPF) by the Institute of Internal Auditors Inc. (IIA).

Many of the above measures are as good as their implementation. Section 5, part II of this document attempts to look into the application of related requirements to determine how well equipped Croatian SOEs are against corruption in reality, and what can be done further to improve the public trust in this sector.

Chapter 6. Recent and ongoing reforms

The SOE reform in Croatia has accelerated since 2017 thanks to the implementation of several EU-funded projects within the Plan of Cooperation and Support for the Structural Reform Programme 2017-2020, which includes a five-year country strategy developed by the EBRD focusing on supporting corporate governance and privatisation of certain SOEs.

One of the major developments was achieved in 2018 with the amendment of the State Assets Management Act, which introduced for the first time, the obligation to draw up medium-term plans for SOEs. In addition, the Croatian Government adopted Guidelines for Tracking Business Plans and Reports of State Companies and Legal Entities as part of an EU-funded project on "improving SOE governance in Croatia" which aimed at setting up a unified reporting and monitoring framework for SOEs.

In 2019, the Government of Croatia rendered a Decision (Official Gazette no.99/2019) introducing the obligation for SOEs to establish a unit that would monitor the SOEs' compliance with applicable legislation and internal acts.

Subsequently, the MPPCSA and CERP (with the assistance of the EBRD and the EU) developed a framework for preparing and implementing so-called financial and operational improvement plans (FOPIP), as well as restructuring plans by state bodies and SOEs. This included the development of two Guidelines on preparing and implementing restructuring and FOPIP plans – one for the MPPCSA and CERP and the other for SOE management, reflecting their respective role and responsibilities in the restructuring process. These documents also outline a few good governance principles that stakeholders should take into account when developing and implementing FOPIPs and restructuring plans (both Guidelines should enter into effect in March 2021). The project (which is still ongoing) also helped establish an Early Warning System (EWS) for managing financially distressed SOEs, amongst other aspects.

Table 6.1. Recent developments on corporate governance of SOEs (2017-2020)

Date	
2017	Adoption of a new SOE Corporate Governance Code
2018	Amendment of the Law on State Asset Management to introduce mid-term budgeting for SOEs
2019	Introduction of the obligation to set up a compliance function in all majority-owned SOEs
2019	Adoption of the Strategy for State Property Management 2019-2025
2019	Adoption of a new framework for the selection and appointment of supervisory and management board members
2020	Establishment of an Early Warning System; Development of Guidelines for FOPIP and Restructuring Plans [not implemented yet]
2020	Introduction of the criteria for identifying SOEs of "special interest"

Source: Ministry of Physical Planning, Construction and State Assets, 2020.

In addition, the MPPCSA adopted the Law on Unvalued Construction Land which passed first reading in Parliament in January 2020. It aims at speeding up the activation of unused assets by providing clarity on land ownership. The adoption of the Law opens up potential for future investments (mostly in the tourism sector) and is expected to help increase revenues from state assets.

6.1. Ongoing and future projects

In addition, there are a certain number of projects financed by the EU and implemented through the EBRD, which are still ongoing and/or planned for the near future [Table 6/2].

Table 6.2. Overview of current EU-funded projects.

Project	Description	Status
Restructuring and increasing financial and operational effectiveness of SOEs	The project aims at improving the framework for restructuring SOEs (with a focus on financially distressed SOEs) by addressing the lack of adequate framework governing the restructuring process (e.g. lack of competences at both the line ministry and SOE levels). The project includes: - Strengthening monitoring system for tracking restructuring processes; - Implementation of an Early Warning System; - Guidelines for the ownership entities; - Guidelines for SOEs.	Started in 2019. Currently in process of implementation
Enhancing the competences of supervisory boards and audit committees in SOEs	- Improvements of SOE boards and audit committees with regards to their composition, responsibilities and functioning; - Review of relationship of supervisory board and audit committee with ownership entities	Started in January 2020
Activation of non-operating assets in SOEs	- Guidelines for asset valuation and commercialisation of non-operating assets. - Methodology for activation of non-operating assets	Started in June 2020

Source: Ministry of Physical Planning, Construction and State Assets, 2020.

In February 2020, the Government of Croatia adopted a Decision establishing the obligation for Government representatives on supervisory boards and audit committees to attend training sessions informing them about their duties and responsibilities. This took place under the project on “Enhancing the competences of supervisory boards and audit committees in SOEs” which is being implemented by the MPPCSA in cooperation with the EBRD. Training events took place in September and October 2020, gathering a total of 79 participants. More trainings are due to take place in 2021.

In addition, the project also aims at reviewing the legal framework and current practices relating to the composition, responsibilities and functioning of supervisory boards and audit committees and their relationship with the MPPCSA and their line ministries. Two new guidelines (on the work of audit committees and supervisory boards, respectively) should be issued soon. They aim at clarifying and strengthening the role and responsibilities of these two corporate bodies by identifying and recommending the application of best international practices.

More recently, a new project on “activating non-operating assets in SOEs was launched in June 2020 with the purpose of developing a framework for the activation and commercialisation of non-operating assets in SOEs and to provide support for the development of a strategic framework for enhancing the effectiveness of companies through the activation of inactive assets. The project foresees the creation of a register of assets as well as guidelines for asset valuation and strategy commercialisation of non-operating assets. A number of SOEs in Croatia have a significant portfolio of non-operating assets (e.g. construction sites which have been out of use for decades despite potential interest for commercial use by the private sector). The project aims therefore at enhancing the authorities’ capacity in registration and activation of non-operating assets in SOEs.

6.2. Ongoing legislative reforms within the ERM-II Accession Framework

In July 2020, Croatia’ request to access the Exchange Rate Mechanism II (ERM-II) was approved, bringing it closer towards its accession to the Eurozone. After fulfilling the conditions set out in its initial Action Plan, Croatia committed to implement a number of additional policy measures (so called post-entry commitments) to ensure sustainable economic convergence by the time it would adopt the Euro. These include:

(1) **Anti-money laundering:** Strengthening the anti-money laundering framework following the transposition of the 5th Anti-Money Laundering Directive (AML5 Directive):

(2) **Business environment:** Reducing the administrative and financial burden for the economy through further simplification of administrative procedures and reduction of parafiscal and non-tax charges;

(3) **Public sector governance:** Improve corporate governance of state-owned enterprises, through revising and aligning regulation and practices in accordance with the OECD Guidelines on Corporate Governance of SOEs;

(4) **Judiciary:** Strengthen the national insolvency framework in line with Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

Part II. Assessment of Croatia relative to the SOE Guidelines

Chapter 1. Rationales for state ownership

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

1.1. Articulating the rationales for state ownership

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

Some of the key values and strategies influencing the Government's decision to establish or maintain state ownership in certain companies or sectors are set out in the Strategy for the Management of State Assets 2019-2025 (Official Gazette no. 96/19) which was adopted in 2019 pursuant to the disposition of the State Assets Management Act. This document provides an overview of the Government's priorities and short to longer-term objectives in relation to state ownership and management (see section 4, Part I of this review for more information). Strategic objectives for state asset management are divided into seven specific objectives, each of which include its own measures, projects and activities. Related objectives can also be found in the Annual State Property Management Plan, the National Reform Programme, and the Convergence Programme of the Republic of Croatia 2019-2022.

Main priorities underpinning the Government's ownership policy for SOEs currently focus on: 1) the restructuring, recapitalisation or (partial or full) privatisation of SOEs that do not pursue infrastructure, energy or some other economic activity of special interest to the Croatian Government; and 2) the improvement of the governance of SOEs of special interest.

Rationales for establishing or owning individual SOEs may be found in certain laws and regulations, including specific acts establishing statutory corporations (e.g. the Act of the Croatian Bank for Reconstruction and Development, the Law on Games of Chance establishing the Croatian Lottery and the Financial Agency Act).

Furthermore, the Decision No. 22/2020 determining SOEs of special interest also provides some elements of the rationale for state ownership in all 39 individual SOEs currently on the list. In particular, the Decision establishes a procedure whereby the Ministry of Physical Planning, Construction and State Assets may, at the proposal of line ministries, include or remove SOEs from the list of "SOEs of special interest" based the analysis of an "ownership rationale" that line ministries need to develop for individual SOEs within their portfolio. These rationales are submitted each year to the MPPCSA with a proposal to include or remove SOEs from the list. The MPPCSA then assesses the request based on a set of general criteria elaborated in the Decision [Box 3.1, part I]. These include but are not restricted to:

1. Main activities of the SOE relate to the management of common good (e.g. water, forests, agricultural land, roads, railways) and/or infrastructure, which constitute a natural monopoly (e.g. communication, energy);
2. The SOE provides a universal service (e.g. postal services, electricity), and;
3. The SOE undertakes activities "of particular relevance to the Republic of Croatia" (e.g. defence industry, oil and gas, finance and banking, IT, games of chance, tourism).

In addition, if an SOE does not meet any of these criteria, it can also be listed as an SOE of special interest if it has a positive financial impact on the national budget and/or if its size and market share are important.[26] These criteria, however, can hardly amount to a "rationale for ownership" as they are very encompassing, ill-defined and could apply to any SOE depending on a discretionary political assessment of "impact" and "size".

1.2. The ownership policy

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

Croatia does not have a state ownership policy, although the MPPCSA has been tasked with developing such a document in the near future, as per the requirements of Act no. 85/2020 on the Internal Organisation and Scope of State Administration Bodies.

Some elements of an embryonic ownership policy can be found in several laws and regulations, including the aforementioned 2020 Act on the Internal Organisation and Scope of State Administration Bodies and the 2018 Act on State Property Management, among others. Both documents provide information on the state's role in the governance of SOEs and elaborate on the mandate provided to certain government bodies with regards to state ownership. However these documents do not allow for a full understanding of respective roles and responsibilities of these entities vis-à-vis SOEs and between each other.

Other aspects pertaining to an ownership policy (such as the overall rationale and objectives for state ownership) have not been elaborated, although some general objectives and priorities can be found in policy documents such as the Strategy for the Management of State Assets 2019-2025 or within the "ownership rationales" developed by line ministries for individual SOEs within their portfolio. There is, however, no document that would provide SOEs or the general public with a comprehensive and clear understanding of the state's expectations for all companies and main principles followed by the ownership entities regarding the exercise of the ownership rights.

[26] In the previous period the Government of the Republic of Croatia did not have formal processes, criteria or procedures to determine whether a certain SOE should be on the list and the decisions were taken *ad hoc* (e.g. due to the privatisation, bankruptcy, decrease of state ownership).

1.3. Ownership policy accountability, disclosure and review

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

The different laws and regulations but also policy documents (e.g. mid to long-term programmes, strategies) mentioned above are adopted by the Government of Croatia at its sessions and published on the Official Gazette and official websites of the Government of Croatia and competent ministries, as well as in the media.

Pursuant to the provisions of the Act on the Right of Access to Information (Official Gazette no. 25/13 and 85/15) and the Code of Consultations with the Interested Public in Law-making and Other Regulatory Procedures, all strategic documents are subject to prior public consultation with interested third parties. Under this framework, public authorities are also required to inform third parties about accepted and rejected comments and report on the conducted consultations.

Most of these documents (including sectorial policy programmes and the criteria for determining SOEs of special interest) are reviewed on a regular basis. For example, the State Assets Management Plan - which derives from the Strategy of Asset Management, is revised annually by the MPPCSA (upon consultation with other ministries and public bodies). The Ministry is also requested to report to the Croatian Parliament on the implementation of this plan by 30 September of each year (for the preceding year).

1.4. Defining SOE objectives

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

As mentioned, the Croatian Government has not yet developed a comprehensive overview of SOE's individual objectives. General objectives derive from the state's long-term and short-term policy documents such as the Annual State Asset Management Plan. Sectorial objectives are also laid down in strategic documents produced by line ministries, in which specific objectives in relation to individual (or groups of) SOEs may be elaborated in detail (e.g. the Public Debt Management Strategy 2019-2021; the Tourism Development Strategy 2020; the Transport Development Plan 2017-2030). Hence, SOEs would generally implement the policies of their line ministry in accordance with sectorial and national priorities as well as individual expectations which may be laid down in their respective statutory acts (when applicable).

Indeed, enterprises of special interest and other SOEs established as statutory corporations may have special public service obligations and/or other requirements placed on them (that deviate from the expectations one might have of a private enterprise in like circumstances) by their respective legislative act. For example, the founding act of the maritime transport company Jadrolinija or the Plovput Split Act (which establishes Plovput, the waterway company) stipulate that these companies have been established "in the interest of the Republic of Croatia" and must therefore undertake a certain number of public policy requirements such as "to perform maritime transport on lines where the

total transport cost cannot be covered from revenues" or to "ensure the maintenance of maritime waterways in the internal sea waters of Croatia" amongst other aspects. For SOEs not covered by specific legislation, public policy objectives are often harder to ascertain and, where they exist, tend to be implicit rather than publicly announced.

Chapter 2. The State's Role as an Owner

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

2.1. Simplification of operational practices and legal form

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

In Croatia, the majority of SOEs are established as either joint-stock companies or limited liability companies pursuant to the Companies Act. Out of the 59 fully or majority-owned SOEs, seven operate as statutory corporations [see section 3.2, part I for more information].

Table 2.1. Statutory corporations at the central level of government

Enterprise	Type of activities
Centre for Restructuring and Sale (CERP)	Management of SOE shares (except those of "enterprises of special interest" and companies whose management and disposal is regulated by a special law).
Jadrolinja	Shipping company for the maritime transport of passengers and vehicles
Financijska Agencija (Financial Agency)	Financial and electronic services
Croatian Deposit Insurance Agency (HAOD)	State Agency for Deposit Insurance and Bank Resolution
Croatian Bank for Reconstruction and Development - Hrvatska Banka Za Obnovu I Razvoj (HBOR)	Development and export bank established with the objective of financing the reconstruction and development of the Croatian economy.
Hrvatske Vode	Water management
Hrvatska Radiotelevizija	Television programming and broadcasting

According to the Croatian authorities, these companies have been established pursuant to specific legislation mostly to perform certain state administrative activities which ought to be performed only by a legal entity with public authority. These activities include "implementing laws and issuing regulations for their implementation, as well as carrying out administrative oversight and other administrative and professional activities" under the State Administration System Act. While the exercise of these tasks is apparent for most statutory enterprises, it is unclear how the activities of the maritime shipping company Jadrolinija (and arguably also the water management company Hrvatske Vode)

fits within this category.[27] These SOEs generally operate under specific rules established by their founding acts as well as other laws governing so-called extra-budgetary users amongst other aspects. They do not apply (or not fully) most of the laws and regulations governing (other) SOEs such as the Regulations on board appointments or the Government Decision on dividends.

Certain rules governing SOEs may differ from those applicable to private companies – either because of their specific legal form (i.e. statutory corporations) or on account of their "special interest" to the Government of Croatia, amongst other aspects, which makes for a very fragmented SOE legal framework. Hence, while the Companies Act sets a certain number of rules on corporate management (e.g. composition and structure of the board) applicable both to SOEs and private companies, a specific procedure has been elaborated for the selection and appointment of SOE board members in SOEs of special interest, which have to apply the requirements set forth by the 2019 Regulation on the selection and appointment of board members. The Regulation provides detailed information about the process and sets additional requirements for candidates, amongst other aspects.

With regards to disclosure requirements, public-interest entities (which includes large and/or SOEs of special interest) are subject to public disclosure requirements set forth by the Accounting Act. These include the obligation to submit their annual financial statements to the FINA, which keeps a register providing individual and consolidated financial information on all companies, including SOEs. In addition, SOEs that are budgetary and extra-budgetary beneficiaries (e.g. CERP, Hrvatske Vode, HAOD, Hrvatske Ceste) also have to comply with the Ordinance on Financial Reporting in Budgetary Accounting (Official Gazette no.3/15) which requires them to publish their annual financial statements on their websites no later than 8 days from the date of their submission to the FINA.

Certain SOEs (especially statutory companies) may be protected, wholly or in part, from insolvency or bankruptcy procedures due to their specific legal status. In particular, insolvency and bankruptcy procedures may not be executed against a legal entity that manufactures weapons or military equipment or that provides services to the Croatian Armed Forces for defence and security purposes, without prior approval of the relevant line minister (without which, the Republic of Croatia remains liable for the debt). Other examples include the following:

- The Croatian Motorways company (Hrvatske Autoceste d.o.o.) is independently accountable for its liabilities to the level of its invested equity (i.e. the state is not accountable for its debt except for the part for which it issued guarantees, such as loans). Public resources under the ownership of the Republic of Croatia (e.g. Motorways and road toll payment systems) may not be used to settle liabilities.
- The water management company (Hrvatske Vode) is accountable for its liabilities with all of its assets, while the Republic of Croatia assumes responsibility in solidarity for the liabilities of the company pursuant to Art. 208[2] of the Water Act.
- The State Agency for Deposit Insurance and Bank Resolution (now the Croatian Deposit Insurance Agency) is a non-for-profit organisation and the

[27] According to the Ministry of Sea, Transport and Infrastructure, Jadrolinija is maintained under state ownership (and a different legal form) mainly because it covers unprofitable maritime routes during and outside peak seasons.

state is accountable for its liabilities. Its founding Act stipulates that the Agency may cease its operations only if prescribed by law.

- No insolvency or bankruptcy proceedings may be enacted against the Croatian Bank for Reconstruction and Development, in accordance with Art. 4[2] of the Bank's founding Act. It may only cease its operations pursuant to a special law.[28]
- Articles 18[4] and 18[5] of the Financial Agency Act prescribe that FINA's deficit of revenues over expenditures shall be covered from the general reserves, or by the state budget. In addition, Art. 19 of the same Act prescribes that bankruptcy proceedings may be initiated only if the Government of the Republic of Croatia does not cover such losses within 90 days, or if it does not pass a decision establishing how such losses are to be covered.

Finally, Article 38[1] of the Act on the Execution of the State Budget for 2020 (Official Gazette no. 117/19, 32/20, 42/20 and 58/20) prescribes that, in order to protect the interests of the Republic of Croatia, the Government may take over the liabilities of credits or loans of legal entities of special interest for the Republic of Croatia.

2.2. Political intervention and operational autonomy

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

According to the Croatian authorities, SOEs are generally granted full operational autonomy to exercise their responsibilities and achieve their defined objectives. For corporatised SOEs, Art. 240 of the Companies Act recognizes that the "management board shall have direct responsibility for the management of the company" with the limitations laid down by the provisions of Articles 242[2] and 422[2], which stipulate *inter alia* that management board members, in executing the affairs of the company, must comply with the provisions set out in the Company' Statute or Articles of Association and mandatory instructions of the General Assembly and supervisory board (when applicable). Supervisory boards reportedly have the authority to monitor SOE management, however they may change the top management (in particular the CEO) only upon instructions from the line ministry. In addition, some operational decisions may require prior consent from the line ministries and/or the MPCSSA such as decisions relating to the acquisition of real estate worth more than HRK 1 million. In addition, it has been reported that ministerial approval may be required for recruitment within companies in their portfolio. This is however, performed mostly for monitoring purposes as consent on such matters is generally always granted according to the Croatian authorities.

The right for a government body or ministry to give direct instructions to SOE boards and/or management is not prescribed by law and therefore there are no safeguards in place to prevent the government from intervening in the day-to-day management of SOEs (with the exception of a few general rules and dispositions set out in the

[28] This disposition relates to Art.13[2] and 32[3] of the Deposit Insurance System Act according to which the deposit insurance system shall be exclusively financed by credit institutions and not by other taxpayers or the state budget of the Republic of Croatia.

Companies Act and related regulations). In practice, the Government as a shareholder generally exercises its right to speak and vote on important issues during the General Shareholders' Assembly and may therefore influence decisions at the company level.

The General Shareholders' Assembly is generally one of the main channels for line ministries to communicate commercial policies and strategies to SOE boards. In fact, it has been reported to the mission team that practical and direct communication often occurs between the General Assembly and the supervisory board (mainly through its state representative), and in some cases, even with the management board (without involving the supervisory board) for solving certain operational issues.

In some cases, however, government guidance can be provided in a more formal way. For example, the Ministry of Sea, Transport and Infrastructure informs SOEs in its portfolio of relevant sector policies through a letter published under the Ministry's Transport Development Strategy, that all companies are required to take into account in the development of their annual and mid-term plans. State-owned enterprises with specific policy assignments may also have their general objectives determined by special laws. However, line ministries are not responsible for defining specific objectives, such as financial and capital structure objectives or risk tolerance levels. Indirectly, some of these objectives can be extracted from the annual or mid-term plans prepared by SOEs and submitted to the Ministry of Finance and the MPPCSA in the case of SOEs of special interest (or CERP otherwise) in line with the requirements of the State Assets Management Act and the Instructions for SOE plans and reports. These documents are, however, not shared with line ministries nor made publicly available.

2.3. Independence of boards

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

In Croatia, applicable laws assign to the supervisory boards powers of strategy-setting and monitoring of management as in most OECD countries. However in practice, it appears that SOE boards do not always exercise such powers. The strategic and advisory role of SOE boards has been called into question by a 2016 State Audit Office Report on the effectiveness of the work of supervisory boards in public enterprises owned by local and regional self-government units which found board-related weaknesses in 58 out of 99 enterprises. In particular, the audit found that certain companies had not adopted strategic plans or had adopted them without the participation of the supervisory board. The State Audit Office has issued recommendations for the adoption of strategic plans and for supervisory boards to be included in the strategic planning process as well as in the monitoring of the implementation of development plans, amongst other aspects. Similar issues have been reported at the national level as well, however they have not been the focus of a comprehensive report from the State Audit Office.

The independence of the board has also been put into question as there is currently no mandatory requirement for SOE boards to include independent members (with the exception of listed companies). As a result, a large majority of SOE boards do not have independent board members and cannot be considered to operate fully independently from company shareholders and management. The law generally bans state officials, though not civil servants, from serving in boards or executive bodies of SOEs (with the exception of so-called extra-budgetary funds of special interest) as per Art. 14[1] of the

Act on the Prevention of Conflicts of Interest. In certain cases however the inclusion of state officials in the board is prescribed by law, such as for example the Croatian Bank for Reconstruction and Development, whose supervisory board includes six Ministers by virtue of their office, in addition to three members of Parliament and the President of the Croatian Chamber of Economy. Ministers also sit in the board of CERP and Hrvatske Vode. Until 1 January 2021, the Minister of Finance was sitting *ex officio* in the management board of the Croatian Deposit and Insurance Company (DAB).[29]

Board members are generally required to act "in the interest of the company" and to apply a duty of care in their activities as per Art. 272 of the Companies Act. The non-binding Code of Corporate Governance for SOEs also stipulates that "members of the supervisory board shall have a duty of loyalty and care for the interests of the company and its shareholders. This duty requires members of the supervisory board to act on a fully informed basis, in good faith and with due diligence [...]" and to "have no conflicts of interest [...] that would put in doubt their objective and independent decision-making for the benefit of the company".

Despite this, there is currently no clear definition of the respective personal and state liability when civil servants (not to mention, state officials) are on SOE boards. There is also generally no guidelines nor codes of ethics for members of the ownership entity and other state representatives serving as SOE board member in Croatia.

2.4. Centralisation of the ownership function

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

Currently there is no single centralised ownership entity or strong co-ordinating entity in Croatia. Line ministries, the MPPCSA and CERP (in the case of SOEs that are not of "special interest") are jointly involved in exercising the ownership function of SOEs. In practice, line ministries (and CERP) are responsible for: 1) state representation at the General Assembly; 2) the nomination process of both management and supervisory boards; and 3) participating in objective-setting for SOEs (to a certain extent).The MPPCSA, on the other hand, is mostly responsible for the regular monitoring and assessment of SOEs' financial performance and compliance with the applicable corporate governance standards. The Ministry also plays an important role in policy-making as it is in charge of drafting relevant policy documents such as the Strategy for the Management of State Assets (and related Annual State Assets Management Plans), as well as the Criteria for Identifying SOEs of Special Interest amongst other aspects [see Box 4.2, part I for the list of main competencies and responsibilities of the MPPCSA]. The Ministry employs approximately 11 people to carry out work related to SOEs.

For SOEs that are not of special interest to the Republic of Croatia, ownership rights are exercised by CERP together with line ministries. The CERP, which employs 79 people, is legally in charge of managing the stocks and shares held by the Croatian Republic, the

[29] The DAB has been replaced by the Croatian Deposit Insurance Agency (HAOD) in January 2021.

Croatian Pension Insurance Fund and the State Agency for Bank Deposits and Bank Resolution.[30] Activities performed by CERP include: 1) the sale of shares/stocks in SOEs; 2) participation in the restructuring process of SOEs; 3) participation in pre-bankruptcy proceedings pursuant to the regulation governing financial operations and pre-bankruptcy settlements; and 4) proposal of members to the Assembly, boards of directors and management boards in SOEs managed by the Centre.

The MPPCSA does not seem to currently have the necessary resources (human and financial) to effectively carry out its functions – especially when considering the growing number of SOE-related projects that are currently being implemented by the Ministry. A greater representation of competencies would be required within the SOE sector of the Ministry, especially in the field of accounting and auditing, which are two key areas relating to the Ministry's monitoring and assessment activities.

Furthermore, coordination of actions and policies between the different ministries and institutions responsible for SOE ownership and monitoring is currently very limited or non-existent. In terms of operational control for example, communication occurs exclusively between SOEs and the MPPCSA/CERP without including the line ministry (or directly between the SOEs and line ministries). Hence, while SOEs are legally required to inform the MPPCSA/CERP and the Ministry of Finance of their performance via quarterly and annual reports and plans, they do not need to submit these documents to their respective line ministries, which can create confusion and incoherence in terms of strategic guidance. On other issues such as board appointments, a certain degree of coordination exists only between line ministries and CERP, whereby CERP should notify the line ministry of upcoming board nomination appointments and requests candidate proposals, amongst other aspects.

In general, coordination between entities is not prescribed by the law and unfolds on an *ad hoc* basis. Working groups or commissions involving representatives from different entities may be established for specific purposes such as for example the identification of a strategic partner for an SOE of special interest (e.g. Croatia Airlines) or for issuing state guarantees for certain companies (e.g. SOEs in the road sector) which would typically require coordination between the Ministry of Finance and line ministries. A certain degree of improvement may be expected in the coming months as the ongoing EBRD project on "Restructuring State-Owned Enterprises" foresees the establishment of working groups involving the MPPCSA/CERP, line ministries and other members as relevant, to discuss and identify ways to resolve operational challenges in SOEs.

2.5. Accountability of the ownership entity

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

Line ministries, as well as the Ministry of Physical Planning, Construction and State Assets are accountable to the Parliament. The MPPCSA is notably required to report annually on the implementation of the Annual State Assets Management Plan (which

[30] If they were acquired during a bank resolution or privatisation procedure - with the exception of legal entities of special interest and assets entrusted to another body on the basis of a special law.

derives from the 7-year Strategy for State Asset Management) to the Croatian Parliament.

The activities of SOEs and ownership entities are externally audited by the State Audit Office (SAO) which also reports to the Parliament. As mentioned, the SAO is responsible for examining relevant documentation, internal control systems, accounting, financial and other procedures in SOEs as well as in other state sector units (including state administration bodies) and legal entities financed from the state budget, amongst other aspects. The SAO plans and conducts audits on the basis of Annual Programmes and Work Plans, and at the request of the Croatian Parliament, insofar as the Auditor General assesses that such a request is justified. Final audited reports are delivered to the audited entity and to the Croatian Parliament and published on SAO's official website.

2.6. The state's exercise of ownership rights

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

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

There are no comprehensive procedures or rules guiding state representation in General Assemblies. State representation at the General Assembly falls under the responsibility of line ministries, which may establish their own rules and procedures.

In general, state representatives are appointed at the proposal of the Ministry responsible for the area of activity performed by the SOE, unless otherwise required by a special law. The procedure for convening and voting at General Assemblies is prescribed by the Companies Act. Special laws and company acts (e.g. Statutes, Articles of Association) stipulate under which conditions the SOE management board may require the approval of the supervisory board and/or the General Assembly to adopt certain decisions. Upon completion of the General Assembly, a notary certifies the Record of the meeting and accompanying decisions (as per Art. 286 of the Companies Act).

As per Art. 275 of the Companies Act, state representatives in the General Assembly may decide *inter alia* on the use of profits, the dismissal of board members, the appointment of external auditors, amendments to the Statute of the company or changes in the company's equity. When they occur, decisions and instructions on how to vote on agenda items are generally taken by the Line Minister (upon discussion with advisors) or CERP's Director for companies under CERP's portfolio.

It is however unclear how actively represented the state is at the General Assemblies of minority state-owned companies (which are not considered SOEs and are thus not a focus of this review) and how frequently it exercises its voting rights.

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

Only the board nomination process of SOEs of special interest (including in those where the state is not the sole owner) is currently regulated which renders the board nomination process somewhat fragmented. The 2019 Regulation on the Selection and Appointment of Board Members prescribes two different procedures for appointing members of the supervisory board and members of the management board as only the latter is subject to public competition. However, in both cases, the nomination process is based on the appraisal of certain criteria including relevant skills, competencies and experience. It is however unclear whether SOEs may (or do) establish additional requirements based on an appraisal of the variety of skills, competencies and experiences required for the incumbent board.

The procedure is different for companies that are not of special interest and belong to CERP's portfolio. In these SOEs, board members are appointed by CERP's Executive Council, at the proposal of CERP's Director and of the SOE's line ministry. The number of appointed representatives generally corresponds to the proportionate participation of the state in the capital of the company. Where the state has a minority holding, CERP reserves the right to appoint board members where applicable[31]. Specifically in the case of management boards, this right is applied only in companies that are subject to restructuring procedures.

There is no independent nomination committee, nor are they any measures to encourage gender diversity on boards and senior management in Croatia.

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

Broad mandates and objectives for SOEs are not clearly defined in Croatia – except for statutory corporations whose founding acts (or sectorial legislation) generally define their predominant activities as well as the public policy goals they have been assigned. In some cases, similar objectives may feature in official strategic or policy documents (e.g. the objectives of the company HŽ Infrastruktura are defined in the National Programme and Strategy for Transport Development of Croatia). It is however unclear whether and how these (generally) long-term objectives are regularly monitored.

The Croatian State does not, as an owner, set nor monitor more specific financial, operational and non-financial objectives such as financial targets, capital structure objectives and risk tolerance levels. These objectives are generally set by the companies themselves in their annual and mid-term plans which are then shared with the MPPCSA/CERP and the Ministry of Finance but not with line ministries. In fact, even

[31] The appointment of board member is generally regulated by the company's Statute or Articles of Association which stipulate who may appoint board members. For example, the statute of Imunološki Zavod d.d. stipulates that CERP can appoint one member as long as it manages at least 20% of company shares. Similarly, the Agreement on Mutual Relations of Shareholders for INA d.d., concluded between the Republic of Croatia and MOL (Hungarian Oil and Gas Public Limited Company) stipulates that a shareholder that directly or indirectly holds a company share of over 25%, but less than 50% has the right to propose two board members for appointment.

supervisory boards do not have access to these documents. That being said, certain line ministries have established their own monitoring systems for SOEs in their portfolio.

Finally, and as mentioned, the MPPCSA/CERP do monitor the performance of individual SOEs on a quarterly (sometimes monthly) basis via certain key performance indicators (KPIs) such as ROA, ROE, liquidity ratios, net profit margins, EBITDA and leverage indicators. However, they do not disclose reports and plans received from individual SOEs in accordance with the restrictions set forth in Art.12[4] of the State Assets Management Act. The Annual Aggregate Report on SOEs which is published by the MPPCSA only provides an overview of individual and aggregate company performance in comparison to the previous reporting period but does not provide further information with regards to achieved results against operating plans.

F.4. [The state's prime responsibilities include:] Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;

As mentioned, SOEs are subject to a certain number of reporting requirements which are not fully standardised:

1. All companies in Croatia are required to submit their annual financial statements to the Financial Agency (FINA) for statistical purposes and for public disclosure pursuant to the Accounting Act and the Ordinance on the Structure and Content of Annual Financial Statement. The Register of Annual Financial Statements (kept by FINA which is itself an SOE of special interest) is the central source of information on the financial performance of companies (including SOEs). The information is provided electronically on an individual and consolidated form. It is publicly available to all users and free of charge.
2. Extra-budgetary beneficiaries (which include 7 SOEs) are specifically required to submit their financial statements to the State Audit Office and to publish them on their websites no later than 8 days after the date of submission to the Financial Agency.
3. SOEs are also required to submit (i) their quarterly and annual reports and (ii) annual and mid-term plans to the MPPCSA/CERP and to the Ministry of Finance, who are then responsible for monitoring and assessing SOE performance against a set of indicators such as liquidity, profitability and indebtedness. However they do not undertake any benchmarking against private or other public enterprises.
4. Large public-interest entities are required to include in their management report a non-financial statement containing information about "the company's operational performance and the impact of its activity, relating to, as a minimum, environmental, social and worker matters, respect for human rights, anti-corruption and bribery matters [....]" as per Art. 21[1] and 21[2] of the Accounting Act. Failure to publish such statements will result to a fine between HRK 10,000 and HRK 100,000. Disclosure of these statements is performed by inspectors and other authorised public officials from the Ministry of Finance.
5. Finally, some line ministries have also independently implemented their own reporting procedures for SOEs in their portfolios. The Ministry of Sea, Transport and Infrastructure for example, has developed a set of indicators

and basic balance sheet items that all SOEs are required to report on twice per year to the Ministry. The Ministry may also, for certain SOEs, benchmark performance against similar companies, including SOEs abroad.

No mechanism is in place to monitor SOE's compliance with applicable corporate governance standards. Requirements in this area are currently limited to the Code of Corporate Governance for SOEs which enumerates a certain number of principles that SOEs are recommended to apply in view of strengthening their corporate governance practices, including with regards to transparency and disclosure. Within the ongoing EU/EBRD project on "Restructuring SOEs" the Croatian authorities have recently developed a new questionnaire for SOEs that includes corporate governance related questions on the role and responsibilities of the supervisory board, its composition, internal and external audits as well as issues relating to transparency and anti-corruption amongst other aspects. The questionnaire has been introduced in December 2020 and thus the usefulness of such a questionnaire would depend on its effective implementation and the quality of information provided by SOEs.

Hence, currently the state does not seem to be properly empowered to make informed decisions on key corporate matters as only some entities such as the MPPCSA/CERP and the Ministry of Finance seem to have necessary and relevant information to accurately assess SOEs' performance or financial situation. However, without proper coordination and communication channels with line ministries (who are present in SOE boards and Assemblies) this would prove inefficient.

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

The state has not yet developed a clear and comprehensive policy outlining the financial and non-financial disclosure requirements for SOEs. However since 2018, SOEs are required to report on their financial performance and strategic plans using the "Guidelines for Tracking Business Plans and Reports of State Companies and Legal Entities" which have been developed with the assistance of the EBRD as part of an EU-funded project. This has reportedly helped improve and standardise business planning and reporting of companies and legal entities under state ownership.

The Code of Corporate Governance for SOEs recommends "companies in the state portfolio [...] to comply with all regulations related to business reporting and transparency that are prescribed for privately-owned companies" and, further, that "being subject to the Public Internal Financial Control System Act and the Fiscal Responsibility Act, companies in the state portfolio shall carry out their notification and reporting obligations in accordance with the listed Acts and relevant ordinances." The Code also sets out the "obligation" for line ministries (as the authorised owners) to inform the public at least once a year of the corporate governance of SOEs in their portfolio" [although it is unclear whether Ministries have applied this disposition in the past]. The MPPCSA for example, publishes an aggregate report on the performance of SOEs of special interest which is available on the Ministry's website in both Croatian and English.

Finally, under the Act on the Right of Access to Information which is also applicable to SOEs, companies are required, *inter alia*, to publish certain information on their websites including: annual plans, programmes and strategies; financial reports; relevant information on public services provided by companies; financing sources, allocated

grants and other aid, as well as conducted tenders. It is unclear whether this information is effectively published by the entities and/or if there is any sanction applicable when failing to disclose such information.

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

SOEs of special interest as well as SOEs that fall within the category of "medium and large" enterprises are subject to external audit as per Art. 20[1] of the Accounting Act. The annual shareholders' meeting (and therefore the ownership entity in fully- owned SOEs) is entitled to appoint external auditors in accordance with Companies Law, however, continuous dialogue between external auditors and the state remains uncommon in Croatia.

The 2018 Instructions for Drafting and Submitting Plans and Reports on the Performance of SOEs and Legal Entities Comprising State Asset do foresee the possibility for recipients of plans and reports (the MPPCSA/CERP and Ministry of Finance) to request the reporting SOEs – and where necessary at their own discretion - to enable communication with an external auditor via the audit committee of the company (or the board of directors in its absence).

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

Article 269 of the Companies Act stipulates that:

> "(1) Members of the supervisory board may receive remuneration for their services. Such remuneration may also be determined as a share of the company's profits. Such remuneration shall be determined in the articles of association and may also be approved by the shareholders' meeting. Such remuneration shall reasonably relate to the duties of the members of the supervisory board and to the condition of the company. If the remuneration is determined in the articles of association, the shareholders' meeting may, by simple majority, resolve on an amendment of the articles by which such remuneration is reduced.
>
> (2) Remuneration of the members of the first supervisory board for their services may be granted only pursuant to a resolution of the shareholders' meeting. Such resolution may be adopted only in the shareholders' meeting resolving on ratification of the acts of the members of the first supervisory board."

Similarly, the Code of Corporate Governance of the Zagreb Stock Exchange prescribes that the remuneration perceived by the Chairperson and other members of the board must reflect their time commitments and responsibilities and should not include variables or other elements associated with operational success.

Specifically for wholly or majority-owned SOEs, a 2009 Government Decision prescribes that the remuneration for board members may not exceed HRK 2000 net/per month. A similar recommendation is addressed to companies which are minority-owned by the state. Fees are fixed in accordance with the Government Decision of 2012 at a minimum of 3.2% of the average monthly salary for the companies, but this can vary up to 30% depending on salaries and if members fulfil certain criteria. This is different than the

variable part of remuneration which can be levied dependent on company success (e.g. annual bonus).

Finally, the Code of Corporate Governance for SOEs also prescribes that board members be rewarded for their services. Their remuneration should be determined by market practices and should not be set at a significantly different level than the remuneration paid in comparable private companies, except when the remuneration is stipulated under special law or regulations. In practice, however, remuneration levels for SOE board members remain reportedly below private sector levels and are not benchmarked on company performance which may be an impediment to attract and retain highly qualified board members.

Chapter 3. State-Owned Enterprises in the Marketplace

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

3.1. Separation of functions

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

Currently the responsibility for industrial/sectorial policies is not separated from the state's ownership function vis-à-vis SOEs that are affected by these policies or acting as an instrument for implementing them. Line ministries and the MPPCSA simultaneously perform ownership and regulatory functions in accordance with the dispositions of the Act on the Organisation and Scope of Ministries and Other Central State Administration Bodies.

Sectorial policies may be implemented through SOEs (for instance HŽ Infrastruktura d.o.o., Plovput d.o.o., Jadrolinija), however, those activities are generally prescribed by special laws. On the other hand, the Industrial Strategy of the Republic of Croatia – an umbrella document on the development of the industrial sector in Croatia – does not place any particular emphasis on SOEs as vehicles of industrial or regional policies but addresses all companies, private and public alike. The focus of the document is to provide an overview of the state of industrial operations and determine prospects for growth, set strategic goals and allocate resources accordingly in view of strengthening competitiveness.

In addition, there are a certain number of independent regulatory bodies operating in the sectors of energy, water, telecommunications, railways and postal services amongst others.

1. Croatian Competition Agency (AZTN)
2. Croatian Regulatory Authority for Network Industries (HAKOM)
3. Croatian Energy Regulatory Agency (HERA)
4. Croatian Financial Services Supervisory Agency (HANFA)
5. Agency for Electronic Media (AEM)
6. Croatian Railway Safety Agency (ASŽ)
7. Croatian Agency for Medicinal Products and Medical Devices (HALMED)

8. Agency for Quality and Accreditation in Health Care and Social Welfare (AAZ)
9. Croatian Agency for the Environment and Nature (HAOP)
10. Croatian Civil Aviation Agency (CCAA)
11. Agency for Inland Waterways
12. Air, Maritime and Railway Traffic Accidents Investigation Agency (AIN)
13. Coastal Liner Services Agency
14. Croatian Railway Safety Agency (ASŽ)
15. Croatian Personal Data Protection Agency (AZOP)

According to the Croatian authorities, in practice, regulators have a wide range of responsibilities, make independent decisions and treat private and state-owned enterprises equally (as they statutory powers extend beyond SOE operations). They also regularly monitor and publicise decisions concerning the SOEs.

3.2. Stakeholder rights

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

According to the Croatian authorities, stakeholders of SOEs (including enterprises held at the sub-national level) have access to the same legal and arbitrational mechanisms for redress as stakeholders in the private sector. Commercial disputes fall within the jurisdiction of commercial courts and may be resolved, if so agreed, through arbitration proceedings or out-of-court settlements. Furthermore, in accordance with Art. 186d of the Civil Procedure Act, when both parties are joint-stock companies or fully or majority-owned public enterprises (at the national and sub-national levels of the government), the Court generally instructs the parties to initiate conciliation proceedings within 8 days upon receipt of a statement of defence. If a party fails to attend the conciliation meeting, it may lose the right to claim compensation for any additional cost of the proceedings before the Court of first instance.

3.3. Identifying the costs of public policy objectives

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

It is currently unclear how many SOEs simultaneously undertake economic and public policy activities in Croatia. One reason is that public policy activities are opaque and not well defined. The identification and disclosure of public policy objectives is mostly prescribed by special laws and regulations which concern only a sub-set of SOEs. The structural separation between public policy and competitive activities is prescribed under the Act on the Transparent Flow of Public Funds (OG no.72/13 and 47/14) which regulates financial relations between Croatian public authorities and so-called public undertakings (which include fully and majority-owned SOEs). In accordance with Article

5 of the Act, undertakings that have been granted public funds by public authorities, either directly or through intermediaries, are required to keep separate accounts as part of their business ledgers, clearly demonstrating the amount of public funds received and their real usage. In particular, they are required to report on:

- Operating loss coverage;
- Capital insurance;
- Grants, i.e. funds refundable only under certain conditions;
- Any loan granted on more favourable terms than the market;
- Any financial advantage assigned by waiving profits or collecting overdue outstanding financial obligations;
- Fee-waivers for the use of public funds;
- Any compensation received for a financial burden imposed by public authorities.

This requirement also applies to public undertakings that perform different activities but have been granted public funds on account of only one or some of those undertakings.

As a result, public undertakings are required to submit the above-mentioned data to the Ministry of Finance by 31 May of the current year for the previous business year. The Ministry of Finance, in turn, must submit the information received to the European Commission within 15 working days from the publication of the public undertakings' annual reports, and no later than 9 months from the end of the business year. The financial statements resulting from separate accounting are generally not published but aim at keeping the state and regulator(s) well informed about SOE operations related to commercial and public policy objectives.

In practice, the Croatian authorities report that these requirements are duly applied by SOEs. For example, Hrvatske Autoceste d.o.o. (HAC) – which is the company responsible for the construction and management of motorways – operates under a legal monopoly in Croatia, which warrants a strict separation of accounts for certain ancillary market operations for which it receives state aid. Due to the specific role of the company, HAC applies a capital approach to book-keeping in accordance with the Roads Act. This means that parallel records are kept for commercial activities and other activities related to "public goods" (i.e. assets pertaining to the Republic of Croatia under the management of HAC such as motorways and other toll facilities). This would point towards good practices, however, the extent to which public policy objectives are identified and disclosed in a comprehensive and transparent way remains unclear. Furthermore, as pointed out in part A of this document, competition on the internal market seems to be limited by the large share of public enterprises in the economy and near-monopoly regimes in which some companies operate [see section 2.2, part I].

3.4. Funding of public policy objectives

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

As mentioned, SOEs that enter the category of "public undertakings" and with acknowledged public policy objectives are required to maintain separate accounts according to the Act on the Transparent Flow of Public Funds (see section 3.3. above).

In addition, SOEs may be compensated for their public policy activities. For example, the Croatian Post (Hrvatska Pošta d.d) is self-financed, except for activities performed as a universal service provider for which it receives a compensation to cover for the financial burden imposed on the enterprise in accordance with the Postal Services Act. The amount of said compensation is determined by the Croatian Regulatory Authority for Network Industries and accounted for in the state budget adopted by the Croatian Parliament.

According to the Croatian authorities, SOEs solely engaged in competitive activities are not supported by state measures that would confer them an advantage over private companies in like circumstances. The state may however adopt measures to co-finance public service obligations imposed on SOEs. These measures apply for example to companies providing maritime, road or air transport services for the financing of specific infrastructure projects such as the construction and development of public routes, amongst other aspects. These measures are reportedly adopted in a transparent way and in compliance with existing rules on state aid.

3.5. General application of laws and regulations

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

SOEs do not appear to benefit from any overarching exemptions from the laws and regulations applicable to private companies. Croatian SOEs and private companies are covered by the same provisions of the Competition Act (Official Gazette no. 79/09 and 80/13), enforced by the Croatian Competition Agency; the Public Procurement Act, enforced by the State Commission for Supervision of Public Procurement Procedures; as well as various sectorial regulations, enforced by sectorial regulators.

Furthermore, according to the Croatian authorities, SOEs and their board members do not have special legal privileges (such as sovereign immunity to lawsuits). However, certain SOEs may be exempt from taxation due to their activities. In particular, the Corporate Income Tax Act stipulates that only fully-corporatised SOEs – carrying out economic activities for the purpose of generating profit, income or revenue – are subject to standard income tax rules. In addition, according to this law, the Croatian National Bank is not subject to profit tax. SOEs may also benefit from tax exemptions if prescribed by laws or regulations (e.g. Investment Promotion Act), in which case they are also subject to individual state aid applications (i.e. state aid programmes).

Other examples include:

- The Act on the Croatian Bank for Reconstruction and Development exempts the Bank from the application of other regulations in the following circumstances:
  - "(1) Unless otherwise provided by this Act, the provisions of the Companies Act relating to limited liability companies and the provisions of the Banking Act shall apply to the organisation and operations of the Croatian Bank for Reconstruction and Development in an applicable manner, except for the provisions relating to the central bank's approval to provide banking and other financial services and

the establishment of branches and legal entities, central bank supervision, deposit insurance, special management, liquidation, bankruptcy and penal provisions.

- (2) The Croatian Bank for Reconstruction and Development shall not be subject to regulations on the allocation and maintenance of required reserves with the central bank and on limiting the scope and dynamics of placement growth, regulations on the organisation and operation of state administration bodies and regulations on civil servants and officials, regulations on the conclusion of credit and guarantee operations of extra-budgetary users, the Insurance Act, as well as any other regulations governing the relevant matter."

- The public telecommunications company Odašiljači i Veze d.o.o. (OIV) is exempt from "paying a fee for the acquisition of ownership rights, easements and construction rights to other public entities that manage the public land on which infrastructure building(s) are to be built", in accordance with the Act on the Regulation of Property Relations for the Purpose of Constructing Infrastructure Buildings.
- Universal postal services provided by the Croatian Post (Hrvatska Pošta d.d.) and the related deliveries of ancillary goods other than passenger transport and telecommunications services, are exempt from value added tax pursuant to the Value Added Tax Act (Official Gazette no. 73/13, 148/13, 143/14, 115/16, 106/18).

Finally, SOEs are also subject to the Competition Act, which defines the rules and methods for promoting and protecting competition, although certain SOE regulated activities and/or public policy activities may be exempted from its application. For listed SOEs, the provisions of EU Regulation No 596/2014 on market abuse also apply. The Regulation establishes a common regulatory framework on insider dealing, unlawful disclosure of inside information and market manipulation as well as measures to prevent market abuse, ensure the integrity of financial markets in the Union and enhance investor protection and confidence in those markets.

The Croatian Competition Agency (CCA) is the country's competition watchdog. It implements national and European competition legislation, in view of identifying anti-competitive practices and punishing infringements [Box 3.1]. It has in the past issued decisions on mergers and abuses of dominant position involving the Croatian Post [Box 3.2], Janaf, and certain railway companies. There is currently no major dispute involving SOEs.

Box 3.1. The Croatian Competition Agency

The Croatian Competition Agency was established in 1995 pursuant to the Decision of the Croatian Parliament of 20 September 1995 and became operative in early 1997. The CCA independently and autonomously performs the activities within its scope and powers regulated under the Competition Act (Official Gazette 79/09) and amendments, and reports annually on its activities to the Croatian Parliament.

Unlike other regulators in Croatia, the CCA carries *ex post* infringement proceedings covering anticompetitive behaviour of undertakings in all the sectors of the economy whether there is a specific regulator in the market concerned or not and in spite of the existence of sector specific regulation(s).

The powers of the CCA cover the following:

- Establishment of prohibited agreements between undertakings and definition of the commitments necessary for elimination of harmful effects of anti-competitive behaviour;

- Establishment of abuse of a dominant position of undertakings and prohibition of any behaviour leading to the abuse as well as definition of the commitments necessary for elimination of harmful effects of such anti-competitive behaviour and;
- Assessment of compatibility of concentrations between undertakings.

The work of the CCA is run and managed by the Competition Council consisting of five members (one of which is the President of the Council). The President and members of the Council are appointed for a five-year term of office and dismissed by the Croatian Parliament, at the proposal of the Government of the Republic of Croatia. The Competition Council collectively decides in all competition matters whereas the president of the Competition Council represents the CCA and is responsible for the legality of its decisions. The Competition Council adopts its decisions at its sessions, with the majority of votes, where no member of the Council can abstain from voting.

The CCA is financed from the state budget. It has no other operational or financial revenue of its own. Administrative fees and fines set and imposed by the CCA accrue to the budget of the Republic of Croatia as per Article 26[10] of the Competition Act.

After the accession of Croatia to the EU, the CCA has become responsible for the protection of market competition in the banking sector. Until 2014, the CCA was responsible for overseeing compliance of state aid proposals with applicable state aid rules (now under the competence of the Ministry of Finance). The CCA has determined in the past that some subsidies to state-owned firms constituted unlawful state aid.

Box 3.2. Case involving abuse of dominant position: CCA v. HRVATSKA POŠTA d.d.

One of the most important cases investigated by the CCA relates to the assessment of an alleged abuse of a market dominant position by the Croatian Post (Hrvatska Pošta - HP) in 2013. The allegations were brought forward by the company CityEx Ltd. which also provided postal services arguing that HP was engaged in predatory pricing. The complaint was initiated on the basis of several infringements relating to laws on public procurement, state aid, tax regulation and postal services.

In the course of the proceeding, the CCA did not find evidence that after 1 January 2013 (the date when full liberalisation of the mail market in Croatia became effective), HP had engaged in a predatory conduct with the objective of excluding the existing competitors from the relevant market and deterring entry of new operators. Hence, in December 2015, the CCA found that there was no ground for further action, according to Article 102 of the Treaty of the Functioning of the European Union and that HP had not abused its dominant position mainly because the universal postal service (and related prices) was and still is regulated *ex ante* in Croatia by the National Regulatory Authority for Postal Services.

Note that in this particular case, the CCA did not decide on the allegations made by City-Ex in its complaint as regards the application of other provisions regulating public procurement, state aid issues, taxes regulations and application of postal regulations, given that the application of these provisions fell under the scope of other authorities, such as the Ministry of the Economy, the Ministry of Finance and the European Commission, amongst others.

The CCA's decision was later confirmed by the High Administrative Court of the Republic of Croatia, in October 2017 and the International Centre for the Settlement of Investment Disputes in 2019, after the plaintiff (CityEX) issued an appeal.

Source: CCA, 2015 and 2020

3.6. Market consistent financing conditions

F. SOEs' economic activities should face market consistent conditions regarding access to debt and equity finance.

In particular:

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

According to Art. 3 of the Act on the Execution of the 2020 State Budget of the Republic of Croatia (Official Gazette 117/2019), the Government, through the Ministry of Finance is authorised to issue state guarantees for SOE loans at the proposal of the competent ministry – which could result in preferential interest rates from private lenders [see Annex C for more information on subsidies and financial guarantees provided to SOEs between 2016-2019]. For this purpose, a Guarantee Agreement is concluded between the Ministry of Finance and the borrower/SOE which defines the obligations of the SOE with regards to the use of credit funds (i.e. the SOE must provide the Ministry of Finance with collateral). In line with EU rules, state guarantees of legal monopolies such as the Croatian Motorways (Hrvatske Autoceste d.o.o), Croatian Roads (Hrvatske Ceste d.o.o) and HZ Infrastruktura are not treated as state aid.

Such guarantees are reportedly provided mainly to companies that need to implement large infrastructure or restructuring programmes (most often operating in the transport and shipbuilding sector). The approval procedure is fully documented allowing line ministries to assess the basis for the guarantee proposal, the creditworthiness of the applicant and the effects of a new debt on development prospects and liquidity, amongst other aspects. Laws and regulation governing state aid (including EU rules) also apply to this procedure, for which they may require prior/post notification to the European Commission. As a reminder, EU state aid rules generally prohibit any form of state support – such as subsidies, guarantees, or preferential access to services – that, among others, confers a selective competitive advantage or otherwise distorts competition, unless it is justified by "reasons of general economic development". Yet, as described in Part A of this review, general government debt sharply rose between 2008 and 2015, namely because of high government deficits and "off-budget transactions including the rising net borrowing of SOEs classified in the general government sector – most of which were running deficits – and the take-up of debt by the state upon repeated calls on guarantees to public corporations" according to the European Commission (European Commission, 2017[23]).

In addition, the budget deficit was aggravated by the accumulation of debt at the sub-national level where counties and municipalities own a significant number of public enterprises. Despite restrictive debt limits set by the Budget Act, local government units are generally able to circumvent restrictions by borrowing through local public enterprises and by providing guarantees for utility companies' loans (World Bank, 2016[30]). It is unclear whether such state support has accordingly been justified by reasons of general economic development.

SOEs are allowed to make use of any available creditors in the market, including from all 34 commercial banks which are the largest creditors in Croatia. SOEs may also borrow from state-owned institutions such as the HBOR and the Croatian Postal Bank (HPB). According to the Ministry of Finance, SOEs generally borrow from institutions that offer

the most favourable conditions at a given time. When granting loans to SOEs, state-owned banks are said to apply the same terms and conditions for SOEs as private companies.

State-owned banks like commercial banks are subject to a set of laws and regulations governing credit institutions and are subject to the supervision of the Croatian National Bank and the Croatian Competition Agency, which – under the European Competition Network System – are required to cooperate with the national competition authorities of EU member states and the European Commission. According to Croatian authorities, this is what ensures that the creditor/debtor relationship in these institutions is conducted at arms' length and on purely commercial terms.

F2. [SOE's economic activities should face market consistent conditions regarding access to debt and equity finance. In particular] SOEs' economic activities should not benefit from any indirect financial support that confers an advantage over private competitors, such as preferential financing, tax arrears or preferential trade credits from other SOEs. SOEs' economic activities should not receive inputs (such as energy, water or land) at prices or conditions more favourable than those available to private competitors.

According to the Croatian authorities, SOEs are subject to a similar tax treatment as private competitors in like circumstances (with the exceptions already mentioned in section 3.5, part II of this review and for which they are also subject to individual state aid rules). They are therefore liable to enforcement measures by the Tax Administration in accordance with the provisions of the General Tax Act. Should the taxpayer (public or private) fail to pay the due amount after receiving a warning, the Tax Administration is legally empowered to take any action necessary to settle the tax debt at the lowest cost (most commonly by seizing or blocking the taxpayer's bank account and/or other assets as appropriate). It is unclear whether SOEs accumulate tax arrears in practice (although this is currently not prescribed by the law and would, in principle, be allowed for private companies as well).

Concerning other potential sources of indirect financial support, the Croatian authorities report that trade credits between SOEs are allowed (through the conclusion of a loan agreement), but that they do not constitute a significant proportion of SOEs' financing overall. Transfer of capital from one SOE to another is possible if prescribed by law and/or government decisions. The transfer must be issued by line ministries and approved by the Ministry of Finance as well as the supervisory board and management board of the companies involved.

F3. [SOE's economic activities should face market consistent conditions regarding access to debt and equity finance. In particular] SOEs' economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

Croatian SOEs (including those engaged in competitive activities) do not have clearly defined financial goals and thus are not required to achieve a minimum rate-of-return on their activities. They are, however, expected to generate a profit, cover their expenses and/or reduce their losses.

One area where SOEs' financial conditions differ significantly from those of private companies concerns dividend pay-out ratios. The dividend policy is defined by the Government's Annual Decision defining the amount, procedure and deadline for the payment of dividends of fully corporatised SOEs into the state budget. The Decision applies only to SOEs of special interest with the exception of 9 legal entities that are subject to the provisions of special laws and/or international agreements.

The decision is elaborated at the proposal of the Prime Ministers' Office and the Ministry of Finance. The latest annual decision was adopted on 30 July 2020 (Official Gazette no. 88/20) and requires the General Assembly of the 15 fully corporatised SOEs listed in the Appendix of the Decision to pay 60% of their 2019 net profit to the State Budget of the Republic of Croatia. The Decision also applies to companies minority-owned by the state, although the amount is relative to the state's stake in the equity capital. The remaining SOEs of special interest have either reported losses (or distributed the profit to cover their losses) or have requested exemptions in order to finance large investment projects and/or to avoid jeopardising their current financial stability.

Certain companies may, however, be requested to pay a different amount: Agencija Alan d.o.o (active in the import/export of defence equipment) as well as the Croatian Lottery (Hrvatska Lutrija d.o.o) are both required to pay 100% of their net profits into the State Budget in accordance with specific legislations which may also prescribe the use of funds for specific purposes (e.g. the use of profits for the Croatian Motorways company is prescribed by the Roads Act).

SOEs may change their capital structure as prescribed by the Companies Act and founding documents. Rules on disclosure, auditing and accountability apply equally to SOEs and private sector companies in case of an increase/decrease of equity capital. In any case, the founding document of the company (such as the Articles of Association, or Act of Establishment) must be amended accordingly and the change in the equity capital must be recorded in the public register of the Commercial Court.

Furthermore, in accordance with Art. 305[3] of the Companies Act, capital increases by investments in kind and in right must be reviewed by at least one auditor (with a few exceptions set out in Article 305a of the CA). The audit report must be also submitted to the Commercial Court, along with the decision on equity capital amendment upon entry into the court register. In certain cases, the management board may be required to obtain a prior consent from the board of directors and/or the General Assembly.

3.7. Public procurement procedures

G. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

When SOEs engage in public procurement, whether as bidders or procurers, they are required to abide by the Public Procurement Act, which regulates the procedure for the award of public contracts and framework agreements for the procurement of goods, works and services. In applying this Act, contracting authorities/entities shall respect the principles of freedom of movement of goods, freedom of establishment; freedom to provide services as well as the general principles of competition, equal treatment, non-discrimination, mutual recognition, proportionality and transparency.

This Law applies to public authorities and SOEs, including their subsidiaries [Box 3.3]; and mandatorily applies to procurement contracts amounting to HRK 200'000 (approx. EUR 26'400) (VAT excluded) for goods and services, or HRK 500'000 (approx. EUR 66'000) (VAT excluded) for works.

Box 3.3. Application of the Public Procurement Act to subsidiaries of SOEs

A subsidiary of an SOE will be considered a public purchaser if it is a public law entity, i.e. cumulatively meets all of the following conditions:

- has a legal personality;
- is established specifically for the purpose of meeting needs in public interest, which are not of industrial or commercial importance; and
- is financed by the public purchaser in the amount of more than 50%; is subject to management supervision by the public purchaser or if more than half of the members of its administrative, management or supervisory bodies have been appointed by the public purchaser.

A subsidiary of an SOE will be considered a sectorial purchaser if it is:

- A public purchaser performing one of the sectorial activities (gas and thermal energy, electricity, water management, transport services, air, sea and river ports, postal services, oil and gas extraction and exploration or extraction of coal or other solid fuels).
- A company in which the public purchaser has or may have, directly or indirectly, a prevalent influence because of its ownership, financial shares or based on the rules by which the company is governed and performs one of the sectorial activities.
- Other subjects carrying out one of the sectorial activities on the basis of special or exclusive rights granted to them by the competent authority.

When procurers are SOEs, they must comply with the Public Procurement Act, regardless of their level of commercial orientation, except where exceptions are specified. Those include:

- Procurement of goods, services and assignment of works by the oil company Jadranski Naftovod d.d. (JANAF) is regulated by the Ordinance on the Procurement of Goods, Services and Assignment of Works No. 530/2018 of 01/01/2019. JANAF is subject to the Public Procurement Act, only when it appears as a bidder in public procurement.
- The exemption from the public procurement procedure also applies to the terrestrial television company OiV. In accordance with Article 32 of the PPA, the Act "shall not apply to public procurement contracts and contests whose main purpose is to enable the contracting authority to provide or use a public communications network or to provide the public with one or more electronic communications services, as defined in a separate law governing the field of electronic communications".
- The Croatian Post (Hrvatska Pošta d.d) is exempted from the application of the Public Procurement Act on contracts awarded by procurers for the following activities: a) domestic express and international express parcel delivery services and b) domestic unaddressed mail delivery services, in line with the EU Implementing Decision 2019/1204 of 12 July 2019.

In addition to the Public Procurement Act, the legislative framework of the public procurement system in Croatia includes the Concessions Act, the Act on Public-Private Partnership and the Act on the State Commission for Supervision of Public Procurement Procedures (Official Gazette no. 18/13, 127/13 and 74/14). Procurement plans and registers of public procurement contracts and framework agreements are published in the Electronic Public Procurement Classifieds of the Republic of Croatia since January 2018, pursuant to the Ordinance on the Procurement Plan, Contract Register, Prior Consultation and Market Analysis in Public Procurement (Official Gazette no. 101/2017).

The Act on the State Commission for Supervision of Public Procurement Procedures regulates the competences of the State Commission for Supervision of Public Procurement Procedures which operates mainly as a complaints handling mechanism. A complaint can be filed with the State Commission either directly, by registered mail or by electronic means. The right to lodge a complaint with the State Commission lies with any competing party, any bidder or any other economic entity having an interest in obtaining a particular public procurement contract or a framework agreement and who has been or could potentially be harmed by the alleged infringement of subjective rights. In accordance with the provisions of Article 434 of the Public Procurement Act, no appeal is allowed against the decision of the State Commission, but an administrative dispute may be initiated in front of the High Administrative Court of the Republic of Croatia.

Despite a seemingly well-developed public procurement framework, financial audits of SOEs have almost always revealed irregularities in the area of public procurement and as a result the State Audit Office considers this to be an area of high risk.

Chapter 4. Equitable Treatment of Shareholders and Other Investors

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

4.1. Ensuring equitable treatment of shareholders

A. The state should strive toward full implementation of the OECD Principles of Corporate Governance when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:

A.1. The state and SOEs should ensure that all shareholders are treated equitably.

General legal framework

The Companies Act affords shareholders of equivalent circumstances equal status in the company (Article 211). In theory, shareholders exercise their rights at the general meeting with votes they hold in accordance with statutory provisions. It is worth noting that the World Bank's Doing Business rankings (2020) assign Croatia a higher rating than the average of OECD "high income countries" on its shareholder rights index – that is, on the role of shareholders in key corporate decisions.

The equitable treatment granted in the Companies Act is reinforced by the ZSE Corporate Governance Code, which recalls that "it is important to ensure that all shareholders, irrespective of the size of their shareholding, have equal opportunities to engage in discussion with the company and to express their views through their votes at the general meeting." Each year, listed companies are required to submit a compliance questionnaire to the ZSE and publish it on their websites. There are currently 6 listed SOEs which are majority-owned by the central Government of Croatia (Croatia Airlines, Janaf, Postal Bank, Jadroplov, Vjesnik and ACI). The central government also has minority shareholdings (of 10-45%) in 8 companies that operate in various sectors of the economy and to which considerations of equitable treatment of shareholders apply. This includes the oil company INA, that brings in top revenue and that the state maintains on its list of "special interest" entities.

Shares may be ordinary and preferred. SOEs' Articles of Association should make clear whether the share structure confers special benefits to a particular individual shareholder or third party, while indicating who that person or party is (Article 167, 175, Companies Act).

Croatia has multiple legal provisions intended to protect minority shareholders in the events of insolvency, over-indebtedness, takeovers and related-party transactions. Members of the board of directors are subject to a standard of care and of being a diligent and conscientious member (Art. 252 of the Companies Act). They are prohibited from undertaking an action that, among other things, puts the company's creditors into an unequal position in the case of insolvency or over-indebtedness. Rights for minority shareholders in the event of takeovers also are protected by provisions of Articles 45 and 46 of the Act on the Takeover of Joint-Stock Companies (Official Gazette 109/07, 36/09, 108/12, 90/13, 99/13 and 148/13). In the case of related-party transactions, the supervisory board is responsible for agreeing on the activities to be carried out with the related party (when the value of the activity or activities is estimated to exceed 2.5% of the sum of fixed and current assets). Listed companies *need ex-ante* approval and must publish related-party transactions on their websites without undue delay.

Minority shareholders may exert influence on the company filing a complaint against founding members, members of the management board and supervisory board and against third parties (Companies Act, 2003 amendments). They may moreover exert influence on the appointment of individuals who will represent the company against the purported perpetrators. In cases where the general meeting does not adopt the decision to file a complaint for damages, minority shareholders may request the company to bring an action if their shares account for at least 10% of the share capital. Claims for compensation must be brought within six months from the general meeting, when the request was submitted (Art. 273a [1] of the Companies Act).

According to information obtained from the Croatian authorities, where shareholder agreements exist, aspects of ownership and structure of votes should be public while other aspects of the agreement may remain secret. Shareholder agreements may contain clauses intended to protect the state's interests as shareholder, as was the case during the privatisation of INA (Box 10.1). This said, shareholder agreements are not regulated and it is unclear whether involved parties are in the practice of disclosing the requisite information.

The state as owner is subject to the same regulatory framework as the one prescribed for private companies as regards shareholder rights and obligations. The Croatian administration reports that there are no special rules that would discriminate (against or for) the state in its role as owner. However, the state has not developed guidance regarding equitable treatment of non-state shareholders, nor is it explicitly addressed in the Corporate Governance Code for SOEs. The Code only recommends that all companies in the state portfolio have a supervisory board whose members are equally accountable to all shareholders (IV), lending indirect support to the principle of equitable treatment of shareholders.

Special ownership rights

The Republic of Croatia maintains post-privatisation "golden shares" in two companies, as provided by the respective acts on privatisation: the Act on Privatisation of INA – Industrija Nafte d.d. (Official Gazette no. 32/02) and the Act on Privatisation of Hrvatska

Elektroprivreda d.d. (Official Gazette no. 32/02).[32] Aside from these two acts, the state contends that CERP does not have or use golden shares or other mechanisms that would afford the state more rights than are written in law.

These two Acts allow the Republic to give its approval for the adoption of certain strategic decisions by the bodies of these fully-corporatised, privatised companies. The Republic of Croatia retains the right of pre-emption over part or the entirety of assets at an estimated market price in the event of winding-up procedures of the privatised companies (or their legal successors). Moreover, the privatisation schedule and dynamics are determined by the state, choosing strategic investors on the basis of public tenders and restricting direct investment. Court actions were taken against Croatia by the European Commission regarding the Act on Privatisation of INA, as elaborated upon in box 4.1.

Box 4.1. Privatisation Act of INA d.d.

In 2016, the European Commission formally requested that Croatia amend the Act on Privatisation of INA-Industrija Nafte, the largest energy supplier, on the grounds that it violated the right of free movement of capital and the freedom of establishment – which are obligations for Croatia since its EU accession.

The state retained partial ownership in INA, with the Act affording the state special powers. The state could veto INA's decisions relating to the sale of shares or assets above a certain value. This restricted other shareholders from influencing major company decisions that would otherwise be accorded with their share in the company. Such an arrangement could divert potential investment interest in INA. The European Commission claimed that the special rights granted to the state restricted the aforementioned free movement of capital and freedom of establishment that was unjustified under the Treaty on the Functioning of the European Union.

The matter was brought before the Court of Justice of the European Union in 2017 for Croatia's failure to amend the Act. It temporarily suspended the proceedings in 2018 after Croatia had published a draft amendment that aimed at eliminating the source of the claim. The amendment to the 2002 Act was adopted in 2019. The amendments grant the state the right to accept or deny a would-be investor of more than 25% or 50% of voting shares based on the state's assessment of a long-term business and management plan for the company as submitted by the potential investor. The reasons for denial are stipulated. The Act now grants the state the right to choose two representatives to attend meetings of the management board, without the right to vote and only in cases where the state is owner of one or more shares. Sanctions are laid down if the management board adopts a decision that the Government considers as threatening for the safe energy supply and safety of energy infrastructure.

A2. [Concerning shareholder protection this includes:] SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.

The right of access to information is one of the basic shareholder governance rights. This right belongs to the shareholder as the sole individual able to exercise the right and can be transferred only as part of a transfer of membership rights – that is, of shares. The Corporate Governance Code for joint-stock companies listed on the ZSE reiterates the

[32] This Act ceased to be effective on 23 February 2010. A new law may be adopted soon as privatisation of HEP is currently under discussion.

legal requirements for shareholders to have equal access to information about the company, and for the exercise and protection of their rights, irrespective of the number or class of shares.

The legal and regulatory framework does not explicitly require that the information is disclosed in a simultaneous fashion. Listed companies are to notify shareholders of the company's position at the annual general meeting, disclosing annual financial statements, reports on the company's position, reports of the supervisory board and audit reports. It is the responsibility of the management board to notify them about the company's business, and shareholders may choose to exercise their right of access or not. This right cannot be altered by Articles of Association and management board responsibilities in this regard do not change with changes to the board.

In practice, an asymmetry of information amongst shareholders may occur through the state's participation in boards.

A3. [Concerning shareholder protection this includes:] SOEs should develop an active policy of communication and consultation with all shareholders.

As far as could be established by the mission team there is no requirement for SOEs to develop an active policy for communication and consultation with all shareholders, nor are they encouraged to go beyond disclosure requirements of the law as follows. Listed companies are required to disclose information about the company, with the Capital Markets Act prescribing content requirements, deadlines and place of disclosure in order to help investors make informed decisions. The Capital Markets Act also establishes prohibitions for the use and disclosure of insider information, which should be drawn up in accordance with Instructions on the Form and Content of Disclosed Insider Information as stipulated in the Capital Markets Act.

At annual general meetings, listed companies must provide shareholders with information about the companies' position – making available annual financial statements, reports on the company's position, reports of the supervisory board and audit reports. Individual SOEs could go beyond minimum disclosure requirements and provide shareholders with additional information, or actively engage in dialogue with minority shareholders. However, there is no indication of whether this is actively or systematically done.

The Capital Markets Act imposes the responsibility for drawing up required information on the company and its management, governance and supervisory bodies. Supervisory boards can identify non-state shareholders by requesting the data from the Central Depository and Clearing Company, but it remains to be seen whether and how often boards request such information in an effort to verify that disclosure is current and issued appropriately.

A4. [Concerning shareholder protection this includes:] The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.

The Companies Act gives minority shareholders access to shareholder meetings, and provides for equal status of shareholders under equivalent circumstances (Article 211). The Croatian authorities report that, in practice, non-state shareholders do participate at general meetings, most often through their appointed representatives.

Non-state shareholders should be informed of the general meeting by invitation no later than 30 days prior to the meeting, as is the case for other shareholders. Invitations should be published in the company's journal or sent by registered letter. The information contained in the invitation is prescribed and should allow for shareholders to adequately prepare for their participation, the discussion and decision making whether personally or through proxies. They should also be informed of their right to put other items on the agenda and of the conditions they must satisfy in order to vote at the meeting.

The Companies Act (Article 274) allows Croatian companies to hold online general meetings if particular conditions have been met (Article 264[5] of the Companies Act). If a joint-stock company proceeds with an online general meeting, it must identify shareholders, and ensure the security of the electronic communication and the permanence of the declarations of intent when submitted by electronic means.

To facilitate minority representation, companies may include in their Articles of Association votes by proxy – in writing or by way of electronic means. However, cumulative voting is not used. A simple majority is required for adoption of shareholder decisions, except in certain cases when a majority of three quarters is required (e.g. cancelling or restricting a preference right, a resolution to increase the share capital against contributions). Shareholders may authorise a financial institution, a credit institution, a shareholder association or a custodian to vote at the general meeting in accordance with the Companies Act (Article 292, 1-7).

As for supervisory boards, specific shareholders may appoint a certain number of members to the supervisory board but it is unclear whether and where these rights afforded to specific shareholders are made known *ex-ante*. Notwithstanding this, when the state is the majority shareholder the competent ministries play a dominant role in the appointment of members of supervisory boards and management boards (see Section 7, Part II).

A5. [Concerning shareholder protection this includes:] Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.

There are no special rules or procedures to ensure that transactions in the SOE sector are executed on market consistent terms. Dutiful implementation of various regulations may bring Croatia in closer alignment with this particular recommendation. These regulations include the Competition Act, the Concessions Act, the Act on Public-Private Partnership and those related to public procurement (Public Procurement Act and the Act on the State Commission for Supervision of Public Procurement Procedures). Also applicable is the Regulation of the European Parliament and of the Council on Market Abuse.

A series of performance audits on the effectiveness of SOEs' public procurement processes conducted by the State Audit Office (SAO) in 2017, found that only eight out of the 43 audited SOEs that had conducted procurement processes were considered to be "effective". The SAO's cross-cutting audit summarised the irregularities detected that included, among other things, low publicity of tenders, the unjustified use of 'urgency' as a pretence for fast-tracking procedures, poor application of the rules regarding pricing and estimation of procurement value, conditions that do not accord with principles of "equal treatment" and failure to publish an awards notices. Such irregularities may cast doubts over the market consistency of other SOE transactions as well.

4.2. Adherence to corporate governance code

B. National corporate governance codes should be adhered to by all listed and, where appropriate, unlisted SOEs.

National corporate governance codes are not adhered to by both listed and unlisted SOEs. Listed SOEs are subject to the Corporate Governance Code of the Zagreb Stock Exchange. This Code is implemented on a "comply or explain" basis, with SOEs reporting annually on compliance with the Code. A basic tenant of the OECD Guidelines is that SOEs are subject to the best practice governance standards of listed enterprises. Croatia's listed SOEs are held to the same standards as their counterparts that are not state-owned, but the same cannot be said for unlisted SOEs. In 2017 the Republic of Croatia issued the Code of Corporate Governance of SOEs – intended for companies and other legal entities of special interest for the Republic of Croatia and those in which the state has stocks or shares (Official Gazette no. 132/2017). The Code aims to "establish, maintain and further improve high standards of corporate governance and operational transparency in companies". The Code does not apply to state agencies whose primary mission is the pursuit of public policy or service objectives. SOEs adhering to the Code must provide in their annual report, if not earlier, information on its application and justify any deviations. The competent ministry can request additional information regarding the application of the Code and its provisions.

The SOEs' Code, described in Part I, was adopted by the Government in 2017 at the initiative of the MPPCSA. It applies to all SOEs across line ministries. However, the mission team understands from various meetings with SOEs and ministries that the degree of implementation across line ministries is varied. Certain representatives reported that they do not have the capacity to conduct in-depth monitoring. The full implementation of the Code of Corporate Governance for SOEs would go a long way towards fulfilment of this recommendation.

4.3. Disclosure of public policy objectives

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

As explained in Part I, broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels are defined unilaterally by SOEs without prior approval or consultation with their line ministries. However, their strategies and plans generally take into account strategic plans issued by their respective line ministries. While SOEs' objectives are not explicit, their strategies and plans are published in national and sectorial strategies (for instance, the Strategy for the Management of State Assets 2019-2025). All non-state shareholders can theoretically access information about the strategic decisions of the Government regarding state assets from the Official Gazette and the Government's website.

The Law on Transparency of Public Funds requires any SOE receiving public funds to keep separate accounts within their accounting books, making clear: (i) the amount of public funds made available; and (ii) the actual use of these public funds. It is not within the scope of this review to assess whether the accounts clearly indicated which of those funds have been earmarked and used in practice for the pursuit of public policy objectives. Despite the fact that SOEs engaged in regulated activities are required to

keep separate accounts for operations related to public objectives, they are not legally required to publish the financial statements of the separate accounts. Exceptions are Hrvatske Ceste d.o.o. and Hrvatske Autoceste d.o.o., whose separate accounts' financial statements are published together with the auditor's report.

4.4. Joint ventures and public private partnerships

D. When SOEs engage in co-operative projects such as joint ventures and public-private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner.

Co-operative projects such as public-private partnerships (PPPs) involving SOEs are relatively rare. Two relevant examples relate to fully corporatised SOEs. First, Autocesta Zagreb – Macelj d.o.o., having been established by the Government in 2003, became concessionaire with exclusive rights for developing, planning, financing, constructing, managing and maintaining a highway and all ancillary facilities for 28 years (until 2032). One year later, in 2004, it entrusted another company – Egis Road Operation Croatia d.o.o. – with management of the highway. A second, Bina-Istra d.d., has been the concessionaire of the Istarski Ipsilon highway since 1995 under a public-private partnership agreement. This was the first of its kind to be concluded in Croatia wherein the concessionaire will return the infrastructure to the Republic of Croatia without any compensation after its contractual duration of 32 years has finished.

The contractual arrangements for PPPs include provisions regarding settlement of disputes within the domestic legal framework and possibly through international arbitration. Domestically, public-private partnerships are regulated by the Public-Private Partnership Act and the Regulation on the Implementation of Public-Private Partnership Projects (Official Gazette no. 88/12 and 15/15), as well as the Concessions Act (Official Gazette no. 69/17) and the Public Procurement Act (Official Gazette no. 120/16) relating to the award of public procurement and concessions contracts.

The Ministry of Economy and Sustainable Development and the Ministry of Finance both play key roles in the preparation and implementation of PPPs, including maintenance of a register of PPP projects in the case of the former. The Ministry of Finance, for its part, takes a decision on approving a partnership following an assessment of, among other things, fiscal risks to the state. At the time of writing it is unclear whether and which ministries systematically monitor fiscal risks throughout the PPP cycle.

Chapter 5. Stakeholder Relations and Responsible Business Conduct

The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

5.1. Recognising and respecting stakeholders' rights

A. Governments, the state ownership entities and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements.

There are no legal provisions, regulations or mutual agreements that establish rights specifically for the stakeholders of Croatian SOEs (e.g. employees, consumers and creditors). The Labour Act, however, establishes entitlements for employees of companies (including SOEs) vis-à-vis their employer. Article 164 allows employees to participate in the board, granting the same legal status as fellow board members. Employees are entitled to participate in decisions related to their economic and social rights and interests, and can elect representatives to the Employees Council that seeks to protect and promote employee rights and interests. SOEs are responsible for meeting obligations of the Labour Act and thus may expound on employee entitlements in their Articles of Association.

Employees of SOEs are offered legal protection when reporting irregularities through the Whistleblower Protection Act, introduced in 2019. The Act additionally covers volunteers, students, temporary workers, job applicants and other persons included in the SOEs' business activities. Before the Act was adopted, various acts and regulations offered a form of protection in a fragmented way. The Act brings a comprehensive legal framework and attention to the subject. An OECD Investment Review of 2019 recommended that the country take action to improve companies' awareness of Croatia's new legislation regarding whistleblower protection. This recommendation to improve awareness applies equally to SOEs. Moreover, the Anti-Corruption Programme for majority-owned SOEs (2019) reinforces the call for SOEs to protect individuals who report misconduct and irregularities. In practice, control entities in Croatia report mixed experiences with such channels. The State Audit Office conducted a cross-cutting audit of public procurement practices of 43 SOEs, finding that not one SOE reported to have received claims through their whistleblowing channels. The Office for the Suppression of Corruption and Organized Crime (USKOK) suggests that most claims brought to their attention are done

so as anonymous tips – that is, through whistleblowers going directly to the USKOK – for instance in a detailed anonymous letter. This could, among other things, suggest that SOEs' whistleblowing channels go unused for fear of incrimination. This raises concerns about whether SOE employees are offered legal protection in practice.

Though the specific rights of SOEs' stakeholders are not established in law, they can exercise their rights to transparency around public authorities thereby accessing information about an SOE and its activities according to the Act on the Right of Access to Information (OG 25,13, 85/15)]. Moreover, this Act regulates the reuse of information and specifies which information should be disclosed on an SOE's website (discussed in section 6, Part II of this review on Disclosure and Transparency).

While not specific to SOEs, EU regulations for the rail sector stipulate rail passengers' rights and obligations – aiming to safeguard those rights and improve the quality and effectiveness of the services (EC No 1371/2007). The railway transport company HŽ Putnički Prijevoz surveys customers on their satisfaction and existing and potential rail passengers on their needs, and conducts market research. In some cases, SOEs voluntarily gather customer feedback. Jadrolinija, a maritime transport entity, conducts customer satisfaction surveys aboard liners and a form available on its website. The surveys provide useful insight into passengers' preferences and needs, as well as on the quality of services they use. Hrvatske Autoceste d.o.o. systematically carries out user satisfaction surveys through its website and, in 2019, conducted a public opinion survey in cooperation with the agency IPSOS polls as part of the Modernisation and Restructuring of the Roads Sector project. Such consultation practices are not mandatory for SOEs. How the findings are used to inform decision-making remains to be seen and it is unclear whether SOEs follow-up on negative feedback and/or address any issues raised.

5.2. Reporting on stakeholder relations

B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labour, creditors and affected communities.

Public interest companies, including all special interest SOEs, as well as SOEs with more than 500 employees, are required to publish a non-financial statement in accordance with the Accounting Act (Art. 21) and the EU's Directive 2014/95/EU.

The non-financial statement should contain, *inter alia*, information related to environmental and employee matters, respect for human rights and anti-corruption efforts. Article 21 of the Accounting Act requires large public interest entities – which includes large, special interest SOEs – to prepare a management report with non-financial information including the impact of its activity relating to environmental, social and worker matters at a minimum.

The ZSE Corporate Governance Code requires listed companies to: assess impact of the company's activities on the environment and community, and manage associated risks; protect human and employees' rights; and prevent and sanction bribery and corruption. Supervisory boards and management boards are responsible for identifying key stakeholders for the purpose of interaction. The Code is administered on a "comply and explain" basis, thus requiring that SOEs report annually on their implementation of the guidance therein. Failure to include reporting against the Code would need to be satisfactorily justified. Accordingly, listed SOEs should submit questionnaire responses

to the ZSE on compliance by 30 June of each year at the latest, and publish it on their website. Thus, information about listed SOEs' fulfilment of Corporate Social Responsibility provisions should in theory be publicly available. The extent to which this practice is followed, including the quality of information reported and responses given, as well as timeliness remains to be seen.

5.3. Internal controls, ethics and compliance programmes

C. The boards of SOEs should develop, implement, monitor and communicate internal controls, ethics and compliance programmes or measures, including those which contribute to preventing fraud and corruption. They should be based on country norms, in conformity with international commitments and apply to the SOE and its subsidiaries.

SOEs have various internal controls, ethics and compliance measures, including those meant to prevent fraud and corruption, but the threat of exploitation of SOEs for illicit gain still looms large in Croatia's SOE sector. Specific anti-corruption rules and measures are detailed in section 5, Part I, of this review. Majority-owned SOEs must develop internal control systems in line with the Act on the Internal Control System of the Public Sector. The law cites compliance of business operations with laws and regulations as a means of improving those operations and achieving objectives, but it appears that internal control is not yet perceived to be an important part of corporate governance nor a means of realising company objectives. The Act does not apply to SOEs' subsidiaries, but some SOE groups have a common internal audit function for the parent and its subsidiaries (e.g. HEP d.d.).

In the case of majority-owned SOEs, internal control should be bolstered by a company's individual Anti-Corruption Plan, as required by the 2019-2020 Anti-Corruption Programme for majority-owned SOEs in turn foreseen under the umbrella of the national 2015-2020 Anti-Corruption Strategy (Official Gazette no. 26/15). According to the Croatian authorities, out of the 39 special interest entities within the competence of the MPPCSA, 27 SOEs adopted internal anti-corruption plans. These were reportedly submitted to the MPPCSA, the Ministry of Justice and published on the SOEs' websites. All 19 SOEs in majority state ownership within the competence of CERP have reportedly adopted internal anti-corruption plans.

As described in Part A, the Anti-Corruption Programme (2019-2020) requires SOEs to:

- elaborate specific controls for countering corruption and fraud. These include, for instance, SOEs creating clear rules on the appointment of management board members and members of the supervisory board. However such a suggestion may be futile given that this process is managed by the competent ministry for majority-owned SOEs and can be subject to political interest as shown in Box 5.1 of Part I. Controls could also include mechanisms for preventing conflicts of interest of the chairperson and members of the management board of majority-owned SOEs, as per the Conflict of Interest Prevention Act. As described in section 5, Part I, the percentage of declarations submitted in 2019 in Croatia was among the lowest in 10 countries assessed in a forthcoming OECD report. Sanctions have been given to supervisory and management board members of majority-owned SOEs for violation of the Conflict of Interest Prevention Act.

- introduce a compliance monitoring function; a measure that is supported by the Decision on the Requirement to Implement Monitoring of the Compliance of Operations in Legal Entities Under Majority State Ownership (Official Gazette no. 99/2019). The function itself should be defined in the entity's own regulation (e.g. company bylaws). There are no consequences for the SOEs that do not comply with the Decision. However, according to Croatian authorities, out of 39 special interest entities within the competence of the MPPCSA that are obliged to introduce the compliance monitoring function, 32 SOEs have already introduced compliance monitoring function into their business structure. Out of 19 SOEs in majority state ownership within the competence of CERP, the compliance monitoring function has been introduced by 14 SOEs. The Croatian authorities further reported that the MPPCSA does not have a formal procedure for checking the effectiveness of the compliance monitoring function, due to this requirement only recently being introduced. This however does not exclude the possibility for SOEs to check its effectiveness independently.
- adopt a Code of Ethics. SOEs' Code of Ethics should establish principles around morality and professional conduct for the corporate hierarchy and integrate these into the company's business processes and work environment, so that they become part of behaviour. Moreover, Croatia has a Code of Business Ethics adopted in 2005 by the Assembly of the Croatian Chamber of Economy and participating companies are listed on the Chamber's website. Meaningful implementation of Codes of Ethics might help address stakeholder concerns about a lack of understanding of a "culture of compliance" or, better yet, a "culture of integrity" in which SOE representatives understand the difference between what is legal and what is right.

Listed SOEs, in their statement on the application of the ZSE Corporate Governance Code for listed companies must provide a description of the main features of the undertaking's internal control and risk management systems in relation to the financial reporting process. This is the same for listed private companies. The Code aims to foster transparent business operations, avoidance of conflicts of interest amongst management board members, members of the supervisory board and senior executives, and support efficient internal controls and accountability mechanisms. The Code also obliges listed SOEs to report on the impact of their activities, including on issues relating to anti-corruption and bribery.

As regards verification, an internal audit function should be established to evaluate the adequacy, efficiency and effectiveness of the internal controls and to provide assurance that risk management, controls and management are conducted with a view to achieve objectives (Public Internal Financial Control Act, Official Gazette no. 78/15). Internal auditors in special interest and large SOEs work on behalf of and report to not only the Audit Committee as is good international practice - but also to the supervisory and management boards composed in part by the management representatives whose work and performance is the subject of audit. The mission team was informed that the audit committee can set audit activities, together with the management and supervisory boards, and thus can influence the degree to which controls are assessed and improved. For one SOE, 80% of its annual audit activities are established by the internal audit function and the remaining 20% by the audit committee and boards. On the other hand, the mission team was also informed that both internal and external audits (either by commercial or state auditors) can be too general and not enable the audit committee and boards to make informed decisions, to understand risks and to ensure effectiveness of controls.

The internal control system is also subject to external audit by the State Audit Office (SAO) in accordance with the Act on the State Audit Office Official Gazette no. 25/19). The SAO's audits place particular attention on the application of good governance principles and internal control when conducting (mostly performance) audits. Given questions about the seriousness with which the audit committee and boards treat internal audit recommendations or scrutinise audit findings, the role of the SAO in providing high-quality audits of SOEs' control activities becomes even more important. However, the SAO's work should be complementary to other checks and balances and not relied upon to fill the gap left by other internal and external audit processes.

These requirements, which have been introduced in recent years, may be a good faith effort to tackle the systemic corruption risks facing the SOE sector and close any gaps between the control, risk and compliance practices of private firms and SOEs. Private companies are not required to have an Anti-Corruption Plan, nor to introduce a compliance monitoring function (except credit institutions) and are not audited by the state auditor. Many Croatians at both the Ministerial and SOE levels seem to agree that the heightened requirements for SOEs around anti-corruption are a step in the right direction. Stakeholders seem aware of what is expected, of the need for transparency and of the (theoretical) repercussions in cases of non-compliance. A lack of controls has been said to be problematic in the past, and the new requirements under the Anti-Corruption Programme may go a long way in improving the scope and effectiveness of controls.

Recent public controversies involving SOEs, however, demonstrate how SOEs remain vulnerable to exploitation and undue influence despite the existence of controls. Part I provides a summary of recent public controversies (Box 5.1), where high-ranking officials and related-party members are alleged to have found guilty of abusing positions of power. The mission team was informed in interviews that SOEs are more commonly purported to be victims of exploitation with no SOE being found guilty of corruption to date. However, SOEs were both found and alleged to be linked to contract falsification, bid rigging and bribery, which can require the complicity of company insiders. The legal framework allows for a legal person to be punished for a crime if they benefited from, or should benefit from, illegal proceeds for itself or another person. The lack of enforcement action against SOEs, combined with other concerns discussed in this review including those about whistleblower protection and politicisation of management and supervisory boards, raises questions beyond the scope of this review about the involvement of corporate insiders and the effectiveness of enforcement more broadly. While important steps have been taken to improve the legal and regulatory framework for improving SOE control and risk management – there is much to be desired, starting with truly insulating SOEs' operations from politics.

5.4. Responsible business conduct

D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.

Public interest entities – thus all special interest SOEs – and large SOEs are required to produce a non-financial statement that includes information related to environmental, social and governance matters in pursuit of the Accounting Act (Art. 21) and EU Directive 2014/95/EU. The disclosed information should include but is not limited to a brief

overview of the company's environmental, social and governance (ESG) business model and policies, associated risks and the results of ESG measures taken.

The non-financial information can be presented: (i) within the management report; (ii) attached to the management report, or; (iii) as a separate report published on the company website no later than six months following the referenced year-end. The Ministry of Finance and FINA are responsible for overseeing the publication of the non-financial information and making available online a list of companies that are not compliant. This process is described further in section 6 on Transparency and Disclosure.

Croatian Airlines, for example, has published a separate non-financial statement on its website each year since 2017. Each report is prepared in line with the Global Reporting Initiative Standards and, in the case of the 2018 statement, is subject to review by the Croatian Institute for Corporate Social Responsibility (IDOP), which published their independent evaluation in line with international evaluation standards (AA10000AS(2008)).

Listed SOEs are moreover subject to the ZSE Corporate Governance Code which obliges listed companies to adopt policies related to assessing the impact of a company's activities on the environment and the community and managing related risks accordingly. However, mechanisms for the implementation of this requirement are not clearly established. The implementation of the Code is monitored by ZSE and HANFA, and statements of implementation are published online theoretically allowing for certification of companies' due diligence in this regard, yet companies' observance of responsible business conduct could not be established in practice.

The Code of Corporate Governance for SOEs does not include an equivalent provision, but its preamble suggests that its implementation can bring about benefits for both companies and the community, without requiring SOEs to undertake specific actions. In practice, certain line ministries may require SOEs to fill in questionnaires or provide information related to responsible conduct, but in practice these requests are easily ignored under the pretence that they are not connected with fiscal impact. While there are no state expectations nor mechanisms for assessment, SOEs reportedly lend support to the community through ad-hoc donations, for instance for recovery efforts following the recent earthquake.

SOE projects financed by the European Commission will be scrutinised by the basic standards of the European Commission, particularly as they relate to the environment and well-being of the community. There is room to extend such expectations beyond listed SOEs and those undertaking EC-funded projects to all SOEs considered "large".

5.5. Financing Political Activities

E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions

Croatia's Decision on promulgating the Act on the Financing of Political Activities, Election Campaigns and Referendums prohibits financing a range of representatives from the political sphere. Specifically, it is prohibited for SOEs to finance: political parties; independent members of Parliament; independent councillors; independent lists or groups of voters. It is prohibited to finance candidates by state bodies, public companies, legal entities with public authority, companies and other legal entities in which the

Republic of Croatia owns more than 5% of the shares and stocks according to the Register of State-Owned Assets, as well as public and other institutions founded by the Republic of Croatia or by a self-government unit. Pursuant to Article 10 of the Act on the Right of Access to Information, companies shall publish information regarding sponsorships and donations on their websites.

Despite these rules, recent controversies involving SOEs (Part I, Box 5.1) highlight how SOEs remain at risk of being used as vehicles for benefitting, if not financing directly, political activities and parties. Box 5.1 refers to the FIMI-Media case, involving an SOE and in which the implicated political party was also judged as responsible for the crime in addition to the former Prime Minister, and recent media reports about a video in which a member of parliament requested political support in exchange for a position heading a public entity (SOE). The mission team determines that more stringent regulations and their effective implementation are required to prohibit exploitation of SOEs for the financial or reputational benefit of any political parties.

Chapter 6. Disclosure and Transparency

State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

6.1. Disclosure standards and practices

The Accounting Act and the Companies Act, described in section 3, Part I, prescribe the preparation and public disclosure of companies' annual financial statements and, in certain cases, of annual reports. Large public interest SOEs are subject to the same standards of disclosure as listed companies. SOEs' obligations for disclosure are summarised in table 6.1 and elaborated upon below.

Table 6.1. Main laws and regulations related to SOE reporting and disclosure

Legislation or regulation	Applicability	Relevant requirements
Accounting Act	All sole traders and companies defined under the Companies Act, including SOEs, their branches and business units, as well as any natural and legal person if it is subject to profit tax with regard to its entire activity (undertakings)	Micro, small and medium enterprises shall draw up and publish statements in accordance with the Croatian Financial Reporting Standards, and large public-interest entities in accordance with International Financial Reporting Standards. The statements are made publicly available through FINA.
State Property Management Act and the Decision on tracking business plans and reports of companies and legal entities constituting state property and majority-owned SOEs	Majority-owned SOEs	Majority-owned SOEs are required to periodically submit to the MPPCSA and CERP quarterly financial statements, annual statements, annual plans, mid-term plans, plan amendments and, where necessary, other ad hoc reports. The list, content, form, bases and frequency of the above-mentioned statements and plans are defined in the Instruction for preparing and delivering business plans and reports of companies and legal entities constituting state property, adopted pursuant to Article 12 of the State Property Management Act. The information from those reports and plans are not made publicly available.
Credit Institutions Act	Credit institutions (two state-owned banks under the Credit Institutions Act in 2019*)	Prescribes that the information on the composition of management boards and supervisory boards is public information (e.g. on the court register, webpages and in annual statements).
Capital Market Act (Official Gazette no.65/18 and 17/20) and Code of Corporate Governance (issued by HANFA and ZSE)	Companies whose shares are listed for trading on a regulated market	Listed companies must publish on their websites, *inter alia*, annual, semi-annual and quarterly statements. The Capital Market Act specifies the scope of information, disclosure procedures, timelines and formats.
Code of Corporate Governance for SOEs	Companies in which the Republic of Croatia has stocks or shares	Companies in the state portfolio shall comply with all regulations related to business reporting and transparency that are prescribed for private-owned companies and, further, that "being subject to the Public Internal Financial Control System Act and the Fiscal

		Responsibility Act, they shall carry out their notification and reporting obligations in accordance with the listed Acts and relevant ordinances."
Ordinance on Financial Reporting in Budgetary Accounting (Official Gazette no. 3/15, 93/15, 135/15, 2/17, 28/17, 112/18 and 126/19)	Public legal entities that are not companies, but statutory entities classified as extra-budgetary users (e.g. Hrvatske Vode, CERP, HAOD),	Prescribes the preparation and publishing of financial statements, detailing their form and content, periods for which such statements are drafted, as well as the obligations and deadlines for their submission. Such "extra budgetary users" are required to publish annual financial statements on their website or, if they do not have their own website, on the website of the competent body according to the organisational classification of the state budget.
Right of Access to Information Act (OG 25,13,85/55)	Public authorities, including majority-owned SOEs as made explicit in Article 5[2].	Requires from SOEs to, *inter alia*, publish on their website the following information in an easily searchable and machine readable format: annual plans, programmes, strategies, financial reports, independent auditor's reports on the audit of financial operations, annual reports on the company's status, information on their internal organisation and the names of the members of the management board and supervisory board with their contact details, management board decisions and measures adopted with the agreement of the Croatian Government, information on provided public services, information on financing sources, information on allocated grants, sponsorships, donations or other aid, including a list of beneficiaries and amounts, information on announced tenders, list of documents necessary for tender participation, and information on the outcome of tender procedures [...] (Art. 10).

Note: *These are Hrvatska Poštanska Banka d.d. (market share around 5%) and Croatia Banka d.d. (market share around 0,5%).

A. SOEs should report material financial and non-financial information on the enterprise in line with high quality internationally recognised standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. With due regard to company capacity and size, examples of such information include those below:

The form and content of the aforementioned disclosures vary with the size of the SOE and its status as a special interest SOE. Unlike large companies, micro and small undertakings (as defined by Article 5 of the Accounting Act) are not required to prepare an annual report, but shall draw up annual financial statements in line with the Croatian Financial Reporting Standards as established in Article 19 of the Accounting Act. Medium-sized companies that are not of special interest also must prepare financial statements and annual management reports without non-financial indicators.

As regards accounting standards, large special interest SOEs must prepare annual financial statements and annual reports in compliance with the International Financial Reporting Standards (IFRS). Out of the 39 SOEs of special interest, 30 SOEs are categorised as large, 6 are categorised as medium (Zračna luka Zadar d.d., Zračna luka Pula d.d., Zračna luka Rijeka d.d., Zračna luka Osijek d.d. and Agencija Alan d.o.o.) and 3 are categorised as small (Zračna luka Zagreb d.d., Hrvatski operater tržišta energije d.o.o. and Pomorski centar za elektroniku d.o.o.). Two of the large, special interest SOEs are considered "extra-budgetary" corporations (such as Hrvatske Vode and CERP) and

must therefore keep budgetary accounts in accordance with the Budget Act that calls for application of the International Public Sector Accounting Standards (IPSAS).

In regard to CERP's portfolio, out of 19 majority-owned SOEs, only two apply IFRS (Borovo d.d. and Plinacro d.o.o.) with the rest 17 SOEs applying Croatian Financial Reporting Standards as they are not of special interest nor categorised as either micro, small or medium enterprises.

The SOE Guidelines encourage the state to give due consideration to the enterprise size and commercial orientation when deciding on the reporting and disclosure requirements of SOEs. Most commonly, small SOEs that are not engaged in public policy objectives should not be subject to requirements as high as those not falling into this category. It follows that SOEs that are large or where state ownership is motivated primarily by policy objectives (even if of a smaller size) be subject to particularly high standards of transparency and disclosure. This is the case in Croatia.

The Tax Administration, the Ministry of Finance and FINA are all competent to supervise companies for their accounting operations and whether said operations are conducted in accordance with the Accounting Act.

Companies must submit to FINA the annual report accompanied by annual financial statements, for companies obliged under Article 21 (that is, for medium and large entities), or annual financial statements and consolidated statements for those not subject to annual reports submissions (that is, micro and small enterprises not considered special interest) for the purposes of public disclosure as per Article 30. FINA (i) establishes and maintains the register and (ii) collects and processes information from annual financial statements and annual reports.

The Ministry of Finance (MoF) has ultimate supervisory authority over the preparation and disclosure of non-financial statements and the consolidated non-financial statement where applicable, directly or indirectly. FINA should notify the MoF of the fulfilment of the financial reporting obligations by 31 July and non-financial reporting obligations by 31 October, for the previous year. Companies whose financial year do not correspond to the calendar year must report to the MoF on the fulfilment of their obligations.

FINA must inform the MoF of which companies have and have not fulfilled their duties in accordance with the law. The Ministry of Finance then publishes on its website the list of entities which have not submitted in accordance with the law. Those endowed with supervisory authority have two methods of supervision: a warning and commencement of misdemeanour or criminal proceedings (Article 41b). Misdemeanour or criminal proceedings of a fine of HRK 10,000.00 to HRK 100,000.00 (Article 41a) can be initiated in the event of non-compliance with the Accounting Act including the failure to submit financial and non-financial statements and annual reports, where applicable, or if it fails to disclose such documents.

In practice, it appears that the dedicated civil servant or inspector will first request delayed or missing submissions by phone before moving to the formality of issuing a warning from the Ministry of Finance. While the Accounting Act provides for fines of non-compliant companies, according to the MPPCSA, there is no fine foreseen in the Instructions for Drafting and Submitting Plans and Reports on the Performance of SOEs and Legal Entities Comprising State Assets. The mission team is not aware of any instances where fines have been issued.

In addition, and following the decentralisation of state ownership in 2018, the MPPCSA was tasked with monitoring financial aspects of SOEs, while competent ministries would

cover operations. As regards general disclosure, the MPPCSA asserts that the special interest SOEs that it oversees are largely compliant with their disclosure obligations, with the vast majority submitting plans and reports in a timely manner or with minimal delay. In cases where information is not submitted or delayed, the Ministry's dedicated inspector or civil servant requests that the SOE submit the information by phone or subsequently through a formal reminder by the Ministry. The World Bank's Doing Business rankings assign Croatia a higher score than Europe and Central Asia on corporate transparency – that is, on the level of information that companies must share regarding their board members, senior executives, annual meetings and audits.

It should be noted that the fragmentation of Croatia's ownership structure and varying capacities between ministries results in an asymmetry of information between ministries as regards the performance of SOEs owned by the state. Line ministries establish their own practices to acquire information to fulfil their responsibility to monitor SOEs in their portfolios. They expressed in interviews that they are lacking capacity to do more in monitoring their SOEs, including with regards to broader corporate governance goals such as those contained in the Code of Corporate Governance for SOEs. More systematic assessment of SOEs and improved communication between entities responsible for exercising ownership on behalf of the state would serve to provide the state shareholder with a better understanding of the risks presented by its ownership. The new early-warning system should facilitate improved coordination and this is generally seen in-country as a step in the right direction.

A.1. [Examples of such information include:] A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity);

SOEs are not required to establish nor publish a clear statement to the public on enterprise objectives and their fulfilment. SOE objectives are considered to be contained in SOEs' multi-annual strategies. Majority-owned SOEs are required to publish information about, *inter alia*, plans, strategies, programmes and annual reports on the company's status in accordance with the duties prescribed in the Right of Access to Information Act (table 6.1).

As mentioned earlier SOEs must derive their strategic plans taking into account state-level strategies – for instance, the Strategy for the Management of State Assets 2019-2025. SOE strategies are reportedly then integrated and published in state strategies. They can also be found in sectorial strategies such as the Energy Development Strategy of the Republic of Croatia until 2030 with an outlook to 2050, the Transport Development Strategy of the Republic of Croatia (2017–2030) and the Water Management Strategy. Theoretically, all such strategic documents are subject to public consultations, and later made available online.

A.2. [Examples of such information include:] Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives;

The Accounting Act requires special interest and large SOEs to disclose financial statements, non-financial statements and annual reports. The financial statements should be drafted with a truthful and fair presentation of the development and operating results of the enterprise. These are made public through FINA. Statutory corporations must publish annual financial statements on their website.

The Act on the Right of Access to Information requires SOEs to publish on their website, *inter alia*, financial reports, independent auditor's reports on the audit of financial operations, annual reports on the company's status, management board decisions and measures adopted with the agreement of the Croatian Government, information on provided public services, information on financing sources, information on allocated grants, sponsorships, donations or other aid, including a list of beneficiaries and amounts, information on announced tenders, list of documents necessary for tender participation, and information on the outcome of tender procedures (Art. 10).

The Act on the Transparent Flow of Public Funds, which regulates the transparency of financial relations between public authorities and public enterprises, requires public undertakings including majority-owned SOEs, that have been granted public funds by public authorities, either directly or through intermediaries, to keep separate accounts as part of their business ledgers, clearly showing the amount of public funds granted and the real usage of these public funds (Art. 5) and to report this information to the Ministry of Finance on an annual basis (Art. 6).

SOEs engaged in regulated activities are required to keep separate accounts for operations related to fulfilment of policy objectives. They are not, however, legally required to publish the financial statements resulting from separate accounts. The statements are intended to keep the state regulator informed about SOE operations related to non-commercial activities that have societal impact. Postal service providers have to keep separate accounts if they are, providing postal services. For instance, the universal postal service provider (namely HP – Hrvatska pošta d.d.) has to keep separate accounts of revenues and expenses related to providing the universal service (Postal Service Act, OG 144/12, 153/13, 78/15, and 110/19). All of the above is prescribed by the Croatian Regulatory Authority for Network Industries (HAKOM). Separate accounts are also required for companies that are in charge of the operations of roads as public goods such as Hrvatske ceste d.o.o. and Hrvatske Autoceste d.o.o., as well as for energy companies such as HEP (Energy Ac, Art. 21 and 23).

A.3. [Examples of such information include:] The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes;

SOEs that are listed on the stock exchange are required to disclose information about their governance, ownership and voting structure. Listed companies' annual management report should include "information on significant direct and indirect holders of shares in the company, including indirect holding of shares in pyramid structures and mutual shares, holders of securities with special control rights and description of those rights, restrictions on voting rights, time limits for exercising voting rights or cases in which, in cooperation with the company, financial rights from securities are separated from holding such securities, rules on appointment and revocation of such appointments of members of the management board, supervisory board, on amendments to the articles of association, on powers of members of the management board, supervisory board and other governing bodies, in particular on the powers to issue shares of the company or to acquire own shares" (Article 272p(d)).

Companies on the stock exchange are also required to include a Statement on the application of the corporate governance code and whether there are deviations. Large public interest entities whose securities are listed in a regulated securities market must prepare a special report on the application of the corporate governance code (Accounting

Act, Art. 22). This must include a description of the method of functioning of the general assembly, its powers, shareholders' rights and how these rights are exercised, followed by the composition and functioning of executive and supervisory bodies and their boards, a description of the diversity policies applied in relation to the executive, supervisory and management bodies of the company (e.g. age, gender, education).

HANFA and ZSE's Corporate Governance Code reaffirms that companies whose shares are listed should treat all shareholders equally and provide details on the functioning of mechanisms that protect minority shareholder rights. Special benefits granted to an individual shareholder must be in the Articles of Association. Shareholder agreements should be public and demonstrate the ownership and structure of the votes, while a certain part of the agreement can remain secret and confidential.

As mentioned, the 2017 Code of Corporate Governance of SOEs is intended for companies and other legal entities of special interest for the Republic of Croatia and recommended for any companies in which the state has stocks or shares (Official Gazette no. 132/2017). While the Government introduced the Code for all SOEs regardless of the ministry under which they fall, the mission team understands that its implementation across SOE portfolios is inconsistent, meaning that not all SOEs are challenged to adhere to the standards of privately listed firms. The full implementation of the Code of Corporate Governance for SOEs would go a long way towards fulfilment of this recommendation.

A.4. [Examples of such information include:] The remuneration of board members and key executives;

Remuneration of board members and key executives should be available for SOEs listed on the stock exchange. This information should appear as a report on remuneration contained in the company's annual report. For each individual company this includes, *inter alia*, all fixed and variable parts of remuneration, the shares and options granted, whether any variable remuneration was requested for return and whether the company deviated from its remuneration policy. Information must also be provided about remuneration paid in the case of early termination or regular termination or to pay former management board members or executive directors whose position was terminated in the previous financial year. The remuneration report should be reviewed by the auditor when reviewing the annual financial statement and then published on its website (along with the auditor's report) for a period of 10 years.

As regards unlisted SOEs, though the requirements are less encompassing, Chairpersons and management board members of majority-owned SOEs will also have information about their salaries made public when their declarations of assets are published in accordance with the Act on the Prevention of conflict of Interest (Official Gazette no. 26/11, 12/12, 126/12, 48/13, 57/15 and 98/19).

A.5. [Examples of such information include:] Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board;

SOEs are required to publish tenders for positions on the management board in the Official Gazette and in daily press. The names of candidates of supervisory boards should be published on the website of the competent ministry, pursuant to the Code of Consultations with the Concerned Public in Law-making and Other Regulatory Procedures (Official Gazette no. 140/09). It is expected that the candidates fulfil the

criteria for procedure of the selection as detailed in the 2019 Regulation on the selection and appointment of board members.

For Credit Institutions, general criteria and characteristics of candidates for supervisory boards or management boards are also established. The composition of the boards should be made public via court registers, webpages and annual statements (Credit Institutions Act, Article 35 and 45).

Only listed companies indicate which members of the supervisory boards and committees are independent – as determined by the Code of Corporate Governance issued by the ZSE and HANFA). The Code provides a definition of independent members that should serve as a reference in pursuit of potential candidates.

A.6. [Examples of such information include:] Any material foreseeable risk factors and measures taken to manage such risks;

The Accounting Act requires that at least large companies, including SOEs, accompany their financial statements with a description of main risks and uncertainties to which they are exposed, and a comprehensive business analysis with financial and non-financial indicators relevant for business operations, including information related to environmental protection and employees. In addition, SOEs must prepare a non-financial statement including among other things a description of principal risks related to business operations, their exposure to price risk, credit risk, liquidity risk and cash flow risk, and the way in which they manage those risks.

A.7. [Examples of such information include:] Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships;

SOEs are not, as a general rule, required to report on financial assistance received from the state or on contingent liabilities related to public-private partnerships. Government guarantees are published by the Ministry of Finance on an annual basis, with details on the approval date, registration number, the bank on whose behalf the guarantee was given, the debtor, amount and due date. An overview of issued state guarantees is also published on the Croatian Government's website. Finally, decisions on guarantees issuance are made during sessions – the records for which are public.

A.8. [Examples of such information include:] Any material transactions with the state and other related entities;

Related parties are defined separately in the Corporate Income Tax Act, the Companies Act (Art. 263a) and the General Tax Act (art. 46-49). Transactions should be undertaken only upon prior consent of the supervisory board pursuant to the Companies Act. Related party transactions (RPTs) must be immediately disclosed by companies, including SOEs, listed on the stock exchange, on their websites for a minimum of five years.

The Accounting Act (Art. 17) refers to implementation of international accounting standards, referencing therein related-party transactions, calling on mechanisms for preventing abusive RPTs in the International Accounting Standard IAS 24 "Related Party Disclosures". Implementation of this standard, and thus issuance of completed and accurate financial statements should theoretically provide the information necessary to determine whether a company's related parties' existence, transactions to or outstanding

balances with such parties have influenced the profit or loss of the company. Those required to implement IFRS (only large public-interest entities) should also provide information on the relationship between the parent and subsidiary, regardless of whether transactions have been executed between them, whereas the Companies Act does not consider transactions between parent and subsidiary as a related-party transaction or if the company is the sole member directly or indirectly. Additionally, transactions that must be approved or consented to by the general assembly are not considered RPTs. The micro, small and medium enterprises, including SOEs, find reference to RPT responsibilities in the Croatian Financial Reporting Standard.

Article 29 of the Accounting Act obliges companies to report on payments to the public sector and publish it in accordance with the disclosure of financial statements or financial reports. This shall be drawn up in the form of a consolidated report. Micro, small and medium-sized privately-owned companies are exempt from this, but public-interest entities regardless of size are not. Members of the management and supervisory board, or executive directors and members of the administrative board, are held jointly and severally liable for the legality, veracity, accuracy and completeness of the reports on payments to the public sector.

A.9. [Examples of such information include:] Any relevant issues relating to employees and other stakeholders.

SOEs' financial statements are published in accordance with the Accounting Act, encompassing information about employees and their costs. Large SOEs are also required to include non-financial information in the management report that can foster an understanding of the company's development, performance, position and impact of activities on employee, environmental and social matters, as well as relative to human rights and anti-corruption issues among other aspects (Accounting Act, Art. 21). This is the case also for listed companies subject to HANFA and ZSE's Code of Corporate Governance. The Code further requires that supervisory boards provide for regular dialogue between the company and major stakeholders, organising meetings with external stakeholder where necessary to improve understanding of the company and its operations.

6.2. External audit of financial statements

B. SOEs' annual financial statements should be subject to an annual independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit.

The annual financial statements of special interest (including statutory corporations) and large SOEs[33] are subject to external audit. SOEs with more than 5000 employees should have two external auditors conducting the audit of annual financial statements. SOEs are additionally subject to state audits that are, as far as could be determined by the mission team, conducted on an *ad-hoc* basis for all SOEs and on a 4-yearly basis for statutory corporations.

Some guarantees for auditor independence are prescribed in law (Articles 48-51, Audit Act). Auditors should, as a basic tenet, be independent from the entity and its decision-

[33] Having more than 500 employees or whose assets exceeded HRK 5 million in the previous year.

making process. Croatia's safeguards for auditor professionalism and independence include, *inter alia*, that: external auditors execute their duties in accordance with international auditing standards; auditors be selected at least three months before the end of the reporting period for which the statutory audit is conducted; and the auditee is prohibited from hiring the certified auditor(s) for at least one year or two in the case of public interest entities. The legislation prohibits appointment of auditors to leadership positions in particular, though this specification seems redundant given the ban on appointment should apply to all positions. Nevertheless, auditors may not accept the positions of: a member of the management board, supervisory board or governing board of the audited entity, accept the position of the chief accounting and/or financial officer in the audited entity, become a member of the audit committee of the audited entity or, where such committee does not exist, of the body performing equivalent functions to an audit committee. Aside from the certified auditor, fellow employees or partners of the audit firm may not assume the aforementioned positions for at least one year.

As regards auditor rotation, the only applicable legislation is the EU's Statutory Audit Directive (2006/43/EC) for audit of public interest entities. This regulation foresees rotation of individual audit partners after seven years and of audit firms after 10 years. While member states are allowed to define shorter maximum terms at the domestic level, Croatia has not done so. Member states are also allowed to extend the duration of audit engagement. The Audit Act requires the auditor to record the fees it charges an auditee for statutory audit services, "other audit services" or "other services" in a given year as part of its records on clients. More rigorous standards could be applied.

In accordance with the rules, the annual financial statements of the 39 SOEs of special interest are subject to external audit of annual financial statements, except for the CERP. The external auditors of the 2019 accounts are provided below (table 6.2), highlighting that five such audits were conducted by a "big four" firm: Croatia Airlines d.d., the Financial Agency, INA - Industrija Nafte d.d., HBOR and the Croatian Postal Bank (HPB).Three others' were conducted by Grant Thorton, another well-known international firm.

Table 6.2. External auditors of annual financial statements: Special interest SOEs of the Republic of Croatia, 2019.

External Auditor	Audited SOE
BDO Croatia d.o.o.	ACI d.d., Opatija
	Državne nekretnine d.o.o., Zagreb
	HŽ Infrastruktura d.o.o., Zagreb
	Narodne novine d.d., Zagreb
	Odašiljaci i veze d.o.o., Zagreb
	Zracna luka Dubrovnik d.o.o., Cilipi
	Zracna luka Pula d.o.o., Pula
	Zracna luka Zagreb d.o.o., Zagreb
Audit d.o.o.	Autocesta Rijeka – Zagreb d.d., Zagreb
	Hrvatska kontrola zracne plovidbe d.o.o., Zagreb
	Hrvatske šume d.o.o., Zagreb
	HŽ Cargo d.o.o., Zagreb
	HŽ Putnicki prijevoz d.o.o., Zagreb
	Hrvatske vode, Zagreb
GRANT THORTON Revizija d.o.o.	Agencija za komercijalnu djelatnost d.o.o., Zagreb
	APIS IT d.o.o., Zagreb
	Hrvatska lutrija d.o.o., Zagreb
BDO Croatia d.o.o., FACT Revizija d.o.o.	Hrvatska elektroprivreda d.d., Zagreb

	Hrvatske autoceste d.o.o., Zagreb
	Hrvatske ceste d.o.o., Zagreb
Ernst & Young d.o.o.	INA – Industrija nafte d.d., Zagreb
	Hrvatska poštanska banka d.d., Zagreb
KPMG Croatia d.o.o.	Croatia Airlines d.d., Zagreb
	Hrvatska banka za obnovu i razvitak (HBOR), Zagreb
	Financijska agencija (FINA), Zagreb
Bašrevizor d.o.o.	Plovput d.o.o., Split
	Zracna luka Split d.o.o., Kaštel Štafilic
Iris nova d.o.o.	Jadrolinija, Rijeka
	Zracna luka Rijeka d.o.o., Omišalj
Audit d.o.o., BDO Croatia d.o.o., KPMG Croatia d.o.o., TPA Audit d.o.o.	HP – Hrvatska pošta d.d., Zagreb
Vedanta Audit d.o.o.	Hrvatski operator tržišta energije d.o.o., Zagreb
RSM Croatia d.o.o.	Agencija Alan d.o.o., Zagreb
UHY Rudan d.o.o.	Janaf d.d., Zagreb
Miran d.o.o., Praevenire d.o.o.	Pomorski centar za elektroniku d.o.o., Split
Alpha Audit d.o.o.	Zracna luka Zadar d.o.o., Zadar
Auditus d.o.o.	Zracna luka Osijek d.o.o., Klisa
Antares revizija d.o.o.	Državna agencija za osiguranje štednih uloga i sanaciju banaka (DAB), Zagreb
REVIZIJA ReMar d.o.o.	Imunološki zavod d.d., Zagreb
Fin. statements not subject to external audit	Centar za restrukturiranje i prodaju (CERP), Zagreb

Auditors should be safeguarded against interference in the execution of their duties. The law prohibits the audit firm's members and shareholders, including members of the management board, governing board and supervisory board, from intervening in the execution of the audit and the release of the audit report in a way that interferes with the independence and objectivity of the audit process and report.

By law, special interest and large SOEs should have an independent audit committee which selects the auditor, and monitors the external audit of financial statements and the independence and objectivity of the external auditor (Article 65, Audit Act). As expressed in earlier sections, the OECD would not consider the audit committee to be independent. Independence in Croatia is defined only as independent from the company. One of the three audit committee members is an employee representative, one is external and the third is a 'civil servant' – or what the mission team would refer to as a state representative. The state representative can be the Chair of the audit committee. The lack of true independence of audit committees is of grave concern given their primary role in supervising a company's main oversight and assurance processes.

The State Audit Office – or Croatia's Supreme Audit Institution (SAI) – also has the mandate to audit SOEs and their state owners. Specifically: "entities subject to a state audit shall be, *inter alia*, legal entities founded by the Republic of Croatia or by the local community and legal entities in which the Republic of Croatia or the local community has shares or stakes (Article 9, Act on the State Audit Office).The Act on the State Audit Office regulates the establishment, organisation, jurisdiction, operating methods and other matters pertinent to the work of the State Audit Office [More information on the State Audit Office can be found in section 4.3, part I of this document].

Like most other SAIs, the State Audit Office reports to Parliament and is granted autonomy and independence (from the executive branch) in its work. The State Audit Office subscribes to the standards espoused by the International Organisation of Supreme Audit Institutions (INTOSAI). Further safeguards for professionalism and performance of the state external audit body are found in law, which prohibits, among other things, their participation in a supervisory board or management body of the

auditee. State audit reports are submitted to the auditee and the Parliament for deliberation and are posted on the State Audit Office's website. The SAI reportedly acts in an *ad-hoc* manner with commercial auditors, expressing respect for one another's work and keeping one another informed about certain auditees as needed. Whether it is the SAI or commercial auditor who instigates contact, however, varies by audit.

The requirement of SOEs to undergo external audit by a third party of annual financial statements as well as state audit places more requirements on them than private entities. In addition, SOEs with over 5000 employees are required to have two external audits by commercial auditors, as is seen in table 6.2. SOEs did not consider this as a disadvantage, and this may be owing to the fact that there is reportedly little or no overlap between audit scopes.

SOEs confirm that internal and external auditors interact in an ad-hoc manner. The Ordinance on Internal Audits in the Public Sector (Official Gazette No. 42/16), requires SOEs' internal audit units to cooperate with external auditors when they are undergoing the audit of the annual financial statements. The degree of co-operation specifically in the context of the annual financial statement could be questioned. The SAI, for its part, reported that it experienced reticence on the part of SOEs to furnish certain documents (notably, meeting minutes), once they realised they were previously used by the SAI to detect irregularities.

Croatia appears to align with the recommendation by subjecting special interest, listed and large SOEs, as well as statutory entities where of special interest, to annual external audit. Specific state control procedures do not substitute for an independent external audit. External auditors of SOEs are subject to the same standards for independence as private sector companies. However, as per the OECD Guidelines, such high standards of independence "generally involve limiting the provision of non-audit services to the audited SOE as well as periodic rotation of audit partner […]". The mission team has reservations about the stringency of the safeguards contained in the Audit Act (and thus as applied to SOEs) and suggests that SOEs might voluntarily adopt more rigorous safeguards than are required in the Audit Act to limit the risk of conflict of interest.

6.3. Aggregate annual reporting on SOEs

C. The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

Since 2018, the Ministry of Construction, Physical Planning and State Assets publishes an annual aggregate report on SOEs of special interest. The latest version was published on December 2020 for 2019. This is prepared based on publicly available information – the same which is contained in the information that SOEs are periodically required to send to the Ministry and to CERP. This includes quarterly financial statements, annual statements, annual plans, mid-term plans, plan amendments and, where necessary, other ad hoc reports.

The Ministry's report provides basic information on 33 legal entities,[34] including aggregate information on the financial performance of SOEs and a description of each SOE's business operations, composition of management boards, audit committees and supervisory boards, ownership share, financial and non-financial information and basic financial indicators. In contrast, information received periodically from SOEs in the MPPCSA's portfolio that is not otherwise made publicly available does not appear in the annual aggregated report. For example, the annual report does not provide an overview of the achieved operating results in relation to plans, but only the achievements in comparison to the previous calculation period. The report is published on the Ministry's website in both Croatian and English.

CERP, for its part, publishes information about the status of companies in its portfolio on a monthly basis. In addition, it publishes the decisions of competent authorities regarding the sale of shares or stakes in those companies and the proposals for appointing supervisory boards and management. In short, therefore, while a significant body of evidence is disclosed by SOEs, the ministries and CERP, full aggregate annual reporting in the sense of the OECD Guidelines has not yet been established.

[34] Six SOEs have not been included in the two aggregate reports issued so far, due to the MPPCSA "inability to consolidate data" from SOEs that apply different accounting standards and, in certain cases, due to the unavailability of data.

Chapter 7. The Responsibilities of the Boards of State-Owned Enterprises

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

7.1. Board mandate and responsibility for enterprise performance

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably.

SOE boards in Croatia are predominantly two-tiered, with the exception of SOEs established under a special law (i.e. statutory corporations) which may adopt a different company structure. In practice, the board generally consists of a management team (Director-General/Director/Managing Director) or a supervisory board according to the Croatian authorities.

The Supervisory Board

Where it exists, the supervisory board must have at least three members. It may have more members, provided that their number is always odd (Article 254[1]). In most cases, SOEs have five members in their boards. According to Article 263 of the Companies Act, the competences of the supervisory board (SB) are the following:

1. Supervise the management of the company;
2. Inspect and examine the books and records of the company as well as cash and securities of the company amongst other aspects. The SB may also commission individual members or special experts to carry out such tasks. The SB shall instruct the auditor to audit the annual financial statements of the company and the group;
3. Submit to the shareholders' meeting a written report on the performed audit referred to in paragraph 1 of this Article. The said report shall in particular state whether the company complies with the law, the company's bylaws and the resolutions of the shareholders' meeting [...];

4. May call a shareholders' meeting. It shall do so whenever the interests of the company so require. Any resolution to such effect shall require a simple majority;
5. Management responsibilities may not be conferred on the supervisory board. However, the Articles of Association or the supervisory board may determine that specific types of transactions may be entered only with the prior consent of the supervisory board. If the SB refuses to grant consent, the management board may request that the shareholders' meeting grant the necessary consent [...].

Under the Credit Institutions Act, the supervisory board has additional competences and duties such as to approve the institution's business policy, strategic objectives, financial plans, among other documents, submitted by management boards in accordance with Articles 48 and 49 of the Credit Institutions Act.

The Management Board

According to the Companies Act, the management board shall consist of one or more persons as provided for in the Articles of Association of the company. If the management board is comprised of more than one person, one of them must be appointed chairperson (Art. 239[1]). The management board reports to the supervisory board (i.e. the board of directors) on the company's business policy, profitability and transactions amongst other aspects. Companies that are subject to the Credit Institutions Act must have at least two members in the management board as per Art. 36[1] of the aforementioned Act.

In addition, the management board is empowered to perform legal acts of representation in transactions in and out of the court (Art. 241) and prepare and execute any resolution, general act or agreement adopted by the general shareholders' meeting (Art. 243) amongst other aspects.

In terms of accountability, there is no legal obligation nor is it common practice to issue a Director's Report along with the annual statements to external auditors. External auditors generally do not provide observations on the work of the supervisory board. However, the supervisory board is accountable for the accuracy of the annual financial statements of the company and must report on the performed audit to the shareholders' meeting providing information about the financial and economic situation of the company (Art. 263).

Finally, there is no legal notion of a "shadow director" in Croatia. In accordance with the Companies Act, the supervisory board may appoint certain of its members as deputies to replace absent or incapacitated members of the management board for a predetermined period of time, which may not exceed one year (Art. 261). In addition, under the Credit Institutions Act, financial institutions may appoint two supervisory board members as deputy members of the institutions' management board until the decision regarding the selection or appointment of new members is approved and for a period not exceeding three months. Such appointments are to be notified to the Croatian National Bank as stipulated in Art. 245[1] of the CIA.

7.2. Setting strategy and supervising management

B. SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government. They should have the power to appoint and remove the CEO. They should set executive remuneration levels that are in the long term interest of the enterprise.

According to the Croatian authorities, SOE boards have the authority to effectively monitor and review corporate strategy in line with Art. 250 of the Companies Act, which stipulates that management boards are required to inform the supervisory board about company operations and the state of business, amongst other aspects.[35] It has been reported, however, that boards usually do not receive quarterly and annual financial statements as well as business plans that ought to be submitted to the Ministry of Finance and the MPCCSA/CERP.

In principle, boards of directors are empowered to appoint and dismiss members of the management board in accordance with Art. 244[1] of the Companies Act. In SOEs, however, boards are generally not allowed to change the top management or recruit CEOs without consultation with the government – which may impede them to fully exercise their monitoring function and may as well open the door to political interferences. As a reminder, the 2019 Regulation on the selection and appointment of board members prescribes that while the selection of management board members, including the chairperson, ought to be based on a competitive procedure, its appointment needs to be proposed by the Government of Croatia to the competent body (i.e line ministry) unless prescribed otherwise by a special regulation. Furthermore, the appointment of management board members in institutions subject to the Credit Institutions Act requires the mandatory approval of the Croatian National Bank as per Art. 39[1] of the aforementioned Act. SOE boards are also not empowered to decide on CEO remuneration as they usually apply the requirements of the Decision on Determining Salaries and other Remuneration of the President and Members of the Management Board in SOEs (OG 83/09, 03/11, 03/12, 43/12, 22/12, 25/14 and 77/14) – a decision which is no longer in force, but still widely used in practice.

There is no clear indication whether it is acceptable or legitimate for public authorities to directly influence board decisions in Croatia. The law does not define “undue influence” or “political interference” in an SOE board’s operation. In practice, SOE boards frequently include state representatives from line ministries, which are also responsible for implementing specific state strategy or public policy issued by the Government. State representatives usually consider such information when making decisions, however, there have been no reported cases of outright “undue influence” in SOEs of special interest according the MPPCSA. Despite this, the politicisation of SOE boards remains an area of concern, with many studies and reports (including the Global Competitiveness Report) recognising that “there is a need to depoliticise board appointments (including in SOEs) as “the lack of clear separation between political and career posts creates significant instability among senior civil servants, reduces corporate institutional memory and learning, as well as incentives for qualified staff to stay” (World Bank, 2016[30]).

[35] The supervisory board may also require that the management board be informed on other “material” information on the company.

The methods of communication between line ministries and SOEs appear to be somewhat informal - with the line ministry oftentimes speaking directly to the CEO, particularly for operational matters, without involving the supervisory board. Good international practice holds that the state as a shareholder should not be involved in the operations of the company and should communicate through the board. In contrast, when it comes to companies and their interaction with the MPPCSA, communications are reportedly more formalised and come via letters addressed to the company. The variance in approaches to communication of ministries and enterprises owned by the state could, at best, be considered confusing and, at worst, could allow for a line ministry to exercise undue influence in the operations of a company without records of communication.

Members of the supervisory and management boards have a duty of care as per Art. 272 and 252 of the CA. They are obliged to "act in the interest of the company" when conducting their functions and are, in particular, "bound to maintain business secrecy over confidential information". The Code of Corporate Governance for SOEs also recommends board members "to make objective and independent decisions primarily based on the benefit of the company; and to not be in a conflict of interest or make decisions based on personal interest [....]."

Members of the supervisory and management boards are "jointly and severally liable if they act in violation of their duties" as per Art. 273[2] of the CA; and "bear the burden of proof in the event of a dispute as to whether or not they have employed the care of a diligent and conscientious manager". The Companies Act further states that they "are not liable for damage if they have acted pursuant to a lawful resolution of the shareholders' meeting. However, liability for damages shall not be precluded by the fact that the supervisory board has consented to the act". The law does not discriminate between the liabilities of different board members, whether they are nominated by the state or any other shareholder or stakeholder.

Possible sanctions include the dismissal of a board member and compensation of the company or shareholders if a board member violates his/her duty by using his/her influence, or is found to have been unduly influenced by outside persons or institutions to the detriment of the company or its shareholders as per Articles 273[1] and 273[2] of the CA. Furthermore, under the Criminal Code, any person who misuses his/her office and/or authority shall be punished by imprisonment from six months to five years (Article 295[1] of the Criminal Code). Sanctions can be higher in case of bribery.

SOE boards do not currently receive any training on their collective and individual responsibilities and liabilities. However, on 27 February 2020, the Government of Croatia adopted a Decision establishing mandatory trainings for government representatives in SOE boards and audit committees to be provided by the EBRD, under an EU-funded project. The first series of such trainings took place in September and October 2020. More trainings should take place in 2021.

7.3. Board composition and exercise of objective and independent judgment

C. SOE board composition should allow the exercise of objective and independent judgment. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.

According to the 2019 Regulation on the selection and appointment of board members, board members of SOEs shall be appointed by the competent ministry (i.e. line ministry),

at the proposal of the Government of Croatia. Concretely, the line ministry receives and reviews the necessary documentation from candidates in line with the requirements laid out in Article 3 of the Regulation [Box 7.1] and interviews candidates (as per Article 6). There is no specific requirement in terms of board diversity such as gender, age, or geographical, professional and/or educational background.

Box 7.1. General conditions for candidates to Supervisory and Management Board of SOEs

Article 3 of Regulation on the Conditions for the Selection and Appointment of Members of Supervisory boards and the Management of SOEs of Special Interest to the Republic of Croatia.

A candidate referred to in Article 1, paragraph 1 of this Regulation, in addition to the conditions laid down in Article 255 of the Companies Act and in the specific regulations governing the selection and/or appointment procedure for particular activities, shall fulfil the following conditions:

– The candidate has completed a graduate university study programme, or an integrated undergraduate and graduate university study programme, or a professional specialist graduate study programme, or an equivalent study programme in a relevant discipline;

– The candidate has at least five years' professional experience gained in management positions for legal entities of special interests for the Republic of Croatia in which the Republic of Croatia holds a majority share and whose consolidated revenue in the preceding financial year is below HRK 750,000,000.00, or ten years' professional experience gained in management positions for legal entities of special interests for the Republic of Croatia in which the Republic of Croatia holds a majority share and whose consolidated revenue in the preceding financial year exceeds HRK 750,000,000.00;

– The candidate has knowledge of corporate governance and knowledge of finance and accounting;

– The candidate has no conflicts of interest in accordance with the specific regulations governing the prevention of conflicts between public and private interests in public office and in accordance with the rules of the Corporate Governance Code for Companies in which the Republic of Croatia Holds Shares or Interests.

The names of candidates are publicly disclosed and subject to public consultation during approximately 15 days. After this, the line ministry issues its opinion on candidates to the Government of Croatia, which, in turn, submits its proposal to the competent body of the SOE. According to Article 10 of the Regulation, the Government may also "in the absence of a supervisory board or the minimum number of members of the supervisory board required to take valid decisions" propose board members to the supervisory board of an SOE, for an appointment period of no longer than six months. Such board members must also fulfil the conditions laid down in Article 3 of this Regulation [see Box 7.1].

The Regulation also applies to other SOEs unless prescribed otherwise by a special law or regulation. For SOEs under CERP's portfolio, the State Property Management Act stipulates that "board members shall be appointed by CERP's Governing Council, at the proposal of the Director-General". Financial institutions require prior approval from the Croatian National Bank for appointing board members (Art. 46 of the Credit Institutions Act).

In practice, most SOE boards seem to include a mix of state and employee representatives as well employees (including executives) from related companies. Information provided by Croatian authorities on the 11 largest commercial SOEs in Croatia shows that about 26% of board members are "independent" although the lack of

clear definition and criteria of independence makes it difficult to assess whether level of independence – especially considering that they are directly appointed by the state [cf. figure 4.3, part I]. Hence, the current legal and regulatory framework governing SOE board members appointments does not appear to sufficiently protect boards from political interference, which could prevent them from effectively exercising independent judgment and taking strategic decisions. This is particularly evidenced by the frequent change of SOE boards in line with political cycles.

In certain cases, even civil servants are (informally) considered "independent" in Croatia, as they may not be appointed among the same department/unit supervising the SOE into question, in accordance with the dispositions laid out in Art.35[1] of the Civil Servants and Officials Act. This Article does not however, specifically prescribe that such members are considered "independent".

A challenge seems to be related to the fact that line ministries generally appoint members of both supervisory and management boards mainly from the government and non-commercial sector. It is however worth mentioning that SOEs interviewed in the course of this review have explained the difficulties they face in hiring members with sectorial experience in view of the limitations placed on board hires, low remuneration levels, the presence of many competitors and the small size of the economy. This fact is further compounded by the poor remuneration of SOE boards as compared to competitors in the private sector which have, according to one SOE interviewed in the course of this review, remuneration of 200-300% higher than their SOE.

According to the Act on the Prevention of Conflict of Interest, state officials (which includes politicians such as deputy ministers, parliamentarians or state secretaries) are not allowed to serve on SOE boards unless required by special law. This is usually the case in most statutory corporations such as HBOR, HAOD, Hrvatske Vode and CERP where ministers sit in the board by virtue of their position. Exceptionally, state officials may sit on the board of "two extra-budgetary funds of special interest to the state or a local/regional self-government unit". State officials are however, in virtue of Article 14[2] of this Act, not entitled to remuneration for performing board functions, except for the reimbursement of travel and other justifiable expenses.

Importantly, it should be noted that the issue of board competencies would be examined and potentially revised on the basis of an ongoing project on "enhancing competences of supervisory boards and audit committees in SOEs", which is currently being implemented in cooperation with the EBRD, and funded through the European Commission's Structural Reform Support Programme. The project recognises that "there are only general requirements" for SOE board members in the current framework, which regulates the composition and effectiveness of the supervisory board [see Box 7.1] and that "there is no evidence that these general requirements are then tailored further to the needs of a particular SOE in order to achieve the optimal mix of skills at the supervisory board". For these reasons, the project (which started in 2019) aims at developing guidelines addressed at both supervisory boards/audit committees and at the Government, for enhanced effectiveness of these bodies, addressing *inter alia* issues relating to the supervisory board's composition, responsibilities and functions. In addition to adopting a new Decision (OG 22/20) establishing mandatory trainings for state representatives in SOE boards and audit committees, a new Methodology for determining the conditions and manner of selecting candidates to supervisory boards in legal entities of special interest to the Republic of Croatia is currently being prepared under the same project. It will serve as a basis for a new Decree to be adopted in 2021.

7.4. Independent board members

D. Independent board members, where applicable, should be free of any interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardise their exercise of objective judgment.

As mentioned, there is currently no requirement or widespread practice to nominate a certain number of independent or non-executive directors in SOEs – except for listed SOEs and credit institutions. According to Chapter IV of the Code of Corporate Governance of the Zagreb Stock Exchange, listed companies are required to have a "majority of independent board members (including the Chairperson)". The following definition of "independence" is provided in Annex A of the Code:

A member of the supervisory board or one of its committees cannot be classified as independent if he/she is a person who:

- is or represents a significant shareholder or a group of significant shareholders; or is a spouse, close relative or in-law to a significant shareholder;
- has been a member of the management board of the company or any related companies within the previous three years; or is a spouse, close relative or in-law of any of the members of the management board;
- has been an employee of the company or of any of its dependent or related companies, within the previous three years;
- has been appointed as an employee representative; receives other payments from the company in addition to the remuneration received for carrying out its supervisory board activities;
- is or has been, within the previous three years, in any significant business relation with the company or its associated companies, directly or indirectly as a partner, shareholder, member of the supervisory or management boards or a senior manager of an organisation which has significant business relations with the company;
- is or has been within the previous three years, a partner or an employee of an audit company which provides or provided any audit or non-audit services to the company or its associated companies;
- has significant relations with members of the company's management board through their involvement in other companies, bodies or organisations; or
- has been a member of the supervisory board for more than 12 years.

Even for listed SOEs, however, the code remains flexible as it prescribes that "supervisory boards seeking independent members should treat this definition as an initial assessment of independence only. A candidate's ability to make an independent and effective contribution to the supervisory board will also be influenced by factors such as their past experience, their character and their personal values. Nomination committees should assess these factors when considering candidates".

In addition, "large" financial institutions are also required to have "a sufficient number of independent members" in their boards according to Art. 45[2] of the Credit Institutions Act. For these institutions, the definition of independence is set forth in a Decision adopted by the Croatian National Bank under Art.9 of the Credit Institutions Act.

According to this Decision, a board member is independent if he/she:

- is not the majority shareholder of that credit institution nor any of its associated companies nor represents the majority shareholder;
- is not nor has been, within the previous five years, a member of the management board of that credit institution or another institution or company that falls within the scope of prudential or accounting consolidation;
- is not an employee of, nor is otherwise associated with, the majority shareholder of the credit institution;
- is not an employee of the institution or company that falls within the scope of prudential or accounting consolidation;
- is not nor has been, within the previous three years, a member of senior management of the credit institution or another company that falls within the scope of prudential or accounting consolidation, whereas he/she is responsible directly to the management board;
- is not nor has been, other than the remuneration received for performing the function of a member of the supervisory board of the credit institution or company that falls within the scope of prudential or accounting consolidation, receiving significant remuneration nor is or has been generating significant income;
- is not nor has been, within the previous three years, a member or a partner of an audit firm which provides or has provided audit services or a company which provides consulting services to the credit institution or company that falls within the scope of prudential or accounting consolidation, nor an employee of such companies who is or has been significantly associated with the services provided;
- is not a member of the management board of another company in which a member of the management board of the credit institution is a member of the supervisory board;
- is not a related party to a member of the management board of the credit institution or another company that falls within the scope of prudential or accounting consolidation, nor is a related party to any of the persons listed in items 1 to 11 of this Article;
- has not been a member of the management board or supervisory board of that credit institution for more than 12 consecutive years, and
- is not a majority shareholder in or member of the company or entity that was a significant supplier or significant customer of the credit institution or another company within the scope of prudential or accounting consolidation, nor has had another significant business relationship with the credit institution.

While keeping in mind that the OECD SOE Guidelines do not specifically recommend any given number of independent board members, the limited applicability of the above recommendations to the state-owned sector may in practice hamper the autonomy and objectivity of SOE boards.

7.5. Mechanisms to prevent conflicts of interest

E. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.

Rules governing conflicts of interest are established in the Conflict of Interest Prevention Act and – to a certain extent – the Companies Act. However, in both cases they mostly relate to members of the management board. The Companies Act for example contains dispositions (Art. 248a) according to which members of the management board cannot take decisions or conclude transactions without the approval of the supervisory board when:

- Such person is a legal representative, a statutory representative, an authorised signatory or a proxy of the other contracting party;
- The other contracting party or either his/her legal representative, statutory representative, authorised signatory or proxy is a blood relative in the direct line of descent in any degree, or in the indirect line of descent up to the second degree, or is their spouse, common-law spouse, a relative by affinity up to the second degree, regardless if the marriage is effective or has been terminated, or is either the adoptive parent or the adoptee of the other contracting party or such party's legal representative, statutory representative, authorised signatory or proxy;
- There is a conflict of interest between a member of the management board and a company in relation to the decision-making or the conclusion of the transaction;
- Regardless of the fact that a member of the board is part-taking in the decision-making process or the conclusion of the transaction, he/she shall immediately inform both the rest of the management board's members and the supervisory board of the circumstances described under paragraph 1, by furnishing the notice with all relevant details pertaining to the nature of such relationship with the other contracting party, along with his/her evaluation on whether the conflict of interest subsists;
- When a member of the management board acts in violation of the duties described under paragraphs 1 and 2 of this Article, provisions under paragraphs 2 and 3 of Article 248 of this Act shall apply accordingly.

The Conflicts of Interest Prevention Act stipulates that conflict of interest exists when the private interests of the official conflict with the public interest, and in particular when:

- The private interest of the official affects his/her impartiality in the performance of public office;
- The private interest of the official may reasonably be regarded as affecting his/her impartiality in the performance of public office, or
- The private interest of an official may affect his/her impartiality in the performance of public office.

In addition, pursuant to the same Act, members of the management board (including the Chairperson) of majority-owned SOEs have a status of officials for which they are required to submit their declarations of assets, which also includes information on their

salaries [more information on declaration of assets is provided under section 5.3.4, Part I].

Other laws and regulations such as the 2019 Regulation on the selection and appointment of board members requires candidates to board positions to have "no conflicts of interest in accordance with the specific regulations governing the prevention of conflicts between public and private interests in public office and in accordance with the rules of the Corporate Governance Code for SOEs." The latter recommends supervisory board members not to:

- Adopt decisions on the basis of personal interests or the interests of persons with whom they are affiliated;
- Be a member of the supervisory or management board of other companies engaged in similar activities and shall not, either personally or through other persons, compete in any way with the company;
- Have a decisive ownership interest in a competing company.

These dispositions provide therefore only a narrow definition of potential conflicts of interest. Certain of these dispositions (e.g. "not adopt decisions on the basis of personal interests") may even establish a high burden of proof. In many countries, directors should not at all be involved in decisions where personal interests are concerned. In addition, this definition does not address the issue of "non-personal interests" which may for example arise when a board member also sits in the board of another SOE and may therefore have to deal with competing interests.

7.6. Role and responsibilities of the Chair

F. The Chair should assume responsibilities for boardroom efficiency, and when necessary in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.

According to the Companies Act, where there is a supervisory board, the Chair acts as the primary point of contact between the ownership entity and the board. The Chair (or any member) of the supervisory board may not be a member of the management board, which is a good practice that could potentially indicate that boards are effectively able to make objective and independent decisions without undue influence from management. In practice however, it appears that the CEO may also act as the main point of contact with the ownership entity, especially when it comes to operational issues.

7.7. Employee representation

G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

Employee representation in SOE boards is mandated by Art. 164[1] of the Labour Act, which stipulates that supervisory bodies of companies, cooperatives and public institutions shall include one employee representative. Such representatives have

reportedly the same duties and responsibilities as other board members, which may positively contribute to SOE boards' independence, competence and information. Employee representatives are appointed and dismissed by the Employee's Council or, in its absence, directly by employees through free and direct elections by secret ballot, in accordance with Art. 164[3] of the Labour Act. This requirement does not, however, apply to financial institutions for which the Credit Institutions Act explicitly prohibits employee representatives to sit in their boards.

Similar to other board members, there is no obligation to provide specific trainings to employee representatives. In view of ensuring the confidentiality of board deliberations, board members are reportedly informed about their duties, including professional secrecy, at the beginning of their term.

7.8. Board committees

H. SOE boards should consider setting up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

State-owned enterprises of special interest as well as those defined as "large public-interest undertakings" by the Accounting Act, are required to have an audit committee, which may be a stand-alone committee, or a committee of the supervisory board according to Art. 65[1] of the Audit Act. The audit committee shall have at least three members - to be selected among members of the supervisory board and/or employees of the company (or outsiders) and appointed by the General Assembly of the company or an equivalent body. Together they shall have competences relevant to the sector in which the company is operating, with at least one of them having competences in accounting and/or auditing, in accordance with Art. 65[3] of the Audit Act. The tasks of the Audit Committee include, *inter alia*, to inform the supervisory board about the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process.

The independence (as defined by international standards/OECD SOE Guidelines) of members of the audit committee (including the chair) is not prescribed by law. This is not consistent with international good practice which calls for the president or chair of the audit committee to be independent (that is, from the company and the shareholder). For instance, in Croatia Airlines, the one state representative on the supervisory board is also the Chair of the audit committee, fulfilling this role in addition to its role as advisor to the Minister of Sea, Transport and Infrastructure.

Furthermore, as described by the EBRD-led project on "Enhancing competences of supervisory boards and audit committees in state–owned enterprises" the role and responsibilities of audit committees, as well as their selection process and remuneration policies "still remain largely undefined and non-standardised". This ongoing project aims at developing guidelines for enhancing the composition and effectiveness of audit committees in SOEs.

The use of other specialised board committees is not mandated nor very common in Croatia – except for listed SOEs and financial institutions of "a significant size". The latter

are required to establish a remuneration committee, nomination committee and risk committee in line with the requirements of the Credit Institution Act. Members of such committees are to be appointed among members of the credit institution's supervisory board. Each committee shall have at least three members, one of which shall be appointed chairperson (Art.50[3] of the CIA). The duties of each of these committees are detailed in Art.51-53 of the CIA.

7.9. Annual performance evaluation

I. SOE boards should, under the Chair's oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

There is no legal requirement, nor is it a widespread practice for SOE boards to carry out self-evaluations appraising their performance and efficiency. In accordance with Art. 263[3] of the Companies Act, supervisory boards are only required to report on the supervision of the company's business operations to the General Assembly. A requirement to carry out self-evaluations is foreseen under the ongoing project "Enhancing competencies of supervisory boards and audit committees in SOEs".

7.10. Internal audit

J. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

According to the Public Internal Financial Control System Act (Official Gazette no. 78/15), all SOEs with a few exceptions[36] should develop internal audit procedures that provide for "an independent and objective assessment of the internal control system and expert opinion and advice for improving the effectiveness of risk management processes, controls and management of business, i.e. corporate management". According to Art.24 of the Act, internal audit shall be established in one of the following manners:

a) by establishing an independent internal audit;

b) by appointing an internal auditor;

c) by establishing a joint internal audit; or

d) through an agreement with an institution which will establish internal audit in one of the manners referred in item a),b), or c) of this paragraph.

The Act further specifies that the internal audit activities shall be performed by certified internal auditor(s) and shall be established as an independent internal organisational unit, directly reporting to the audit committee and supervisory boards (where they exist).The Act also details the scope of internal activities (Art.22) and the manner of performing internal audit activities (Art.31-35) amongst other aspects.

[36] The Ordinance on Internal Audits in the Public Sector (OG 42/16) specifies that companies with up to 50 employees and income of up to HRK 400 million are not required to have an internal audit unit. Instead, internal audit activities will be performed for them by the internal audit of the public authority that has the largest share in its ownership (e.g. ministry, county, city).

Financial institutions are also required to establish an internal audit function in addition to a risk control and compliance function with requirements established by the Credit Institutions Act. In particular, the law specifies that “a credit institution shall organise an internal audit function as a separate organisational unit, functionally and organisationally independent from both the activities it audits and from other organisational units of the credit institutions (Art. 106[4]). Internal auditors shall report directly to the management and supervisory board as well as the audit committee and/or another relevant committee established by the supervisory board. Any irregularity in the operations shall be immediately notified to the credit institution’s management and supervisory board and to the Croatian National Bank (Art. 108).

While SOEs are aligned with the letter of this recommendation, the involvement of management in internal audit reporting and, apparently, in planning means that Croatia diverges from the spirit of the recommendation in practice. As far as can be established, there is greater involvement of management in internal audit activities than would be afforded by international standards. For instance, in one statutory company, the annual audit plan is “set” by both the internal audit unit (80%) and the supervisory/management boards and audit committee (20%). Moreover, as mentioned previously, internal audit reports to supervisory boards and management boards which are composed of company representatives and audit committees, which have one company representative. Taken together, there is an opportunity for management, whose work is the subject of audit, to exercise influence over the scope of audit plans and activities, and the findings or follow-up of recommendations on the part of the management board, the supervisory board or the audit committee.

Part III. Conclusion and recommendations

Conclusion

The Government of Croatia has taken steps in recent years to improve the management and corporate governance of SOEs. In particular, the five-year country strategy developed in 2017 with the support of the European Commission and the EBRD should continue to help establish, *inter alia,* a clearer reporting and monitoring system for SOEs as well as a comprehensive framework for the preparation and implementation of restructuring plans and Financial and Operational Performance Improvement Programmes (FOPIPs). Other measures include the adoption of an SOE Corporate Governance Code, the issuance of an aggregate report on SOEs of special interest and the introduction of an obligation for SOEs to set up a compliance monitoring function.

Despite this, important concerns remain. First, the current legal and regulatory framework applicable to SOEs in Croatia makes SOEs subject to multiple – and sometimes unclear – provisions and requirements. In particular, the distinction made between SOEs of special interest and the rest of SOEs, but also the existence of different requirements depending on the legal form of the SOE and its size and/or dependence on the state budget, renders it very difficult to navigate the intricacies of the law and get a clear and comprehensive view of SOE practices in Croatia.

Second, Croatia's current ownership arrangements make it difficult to exercise state ownership rights on a whole-of-government basis. Line ministries, in concert with the MPPCSA, oversee a portfolio of 39 SOEs of special interest, while CERP exercises more direct ownership rights over the rest of the state's portfolio (including 19 fully or majority-owned companies). The situation is further complicated by a lack of clarity on roles and responsibilities between ownership entities vis-à-vis SOEs and an apparent lack of communication and coordination between competent ministries.

Third, the absence of a formal state ownership policy and ambiguities regarding the extent of SOEs' commercial and non-commercial objectives, contribute to a situation in which the performance of SOEs is likely to be sub-optimal and difficult to meaningfully monitor.

At the level of individual SOEs, a fundamental shortcoming is the limited role of the supervisory boards, who generally have neither the independence nor the responsibilities to fulfil essential strategy-setting and corporate oversight roles. Nomination procedures are not uniform across SOEs and do not sufficiently protect boards from political interference. Moreover, the remuneration framework for SOE boards does not incentivise professional business people to apply for such vacancies. In practice therefore, many SOEs operate either as extensions of their ownership ministries or at the discretion of their executive management (whose representatives are appointed by the state rather than the supervisory boards).

Integrity in the state-owned sector is also an issue. Most SOEs generally have various internal controls, ethics and compliance measures in place, but the risk of exploiting SOEs for illicit gain has not been eliminated, as demonstrated by recent scandals and indictments involving SOE managers and high-ranking politicians. The problem in many cases appears directly linked with the excessive politicisation of SOEs and their governing bodies.

Finally, as SOEs are often sizeable operators in commercial sectors of the economy, due attention should be paid to maintaining fair competition. Several elements may distort the level-playing field between SOEs and (actual or potential) private competitors, including the partial corporatisation of several commercially-oriented enterprises as well as uneven application of public procurement rules by SOEs as raised by multiple control bodies of the Croatian administration.

Recommendations

Strengthening the state ownership function

- *Establishment of an ownership coordination unit*. In the context of Croatia's mostly decentralised ownership arrangements, considerable progress could be made by establishing a central state ownership coordination body. This ownership coordination entity would report to the Government of Croatia and ideally be housed within an independent public agency reporting directly to the Government of Croatia or within a ministry provided it is not simultaneously tasked with sectorial regulation. The entity should be afforded in law the adequate mandate and resources required to effectively fulfil its coordination role, including but not limited to the following tasks: developing and monitoring compliance with the state's governance and disclosure standards for SOEs; monitoring the performance of SOEs; and engaging in regular public reporting. It should also play a role in SOE board nominations by proposing candidates to the ownership ministries, thus helping establish professional boards. The ownership coordination unit could additionally be granted direct ownership rights, in a first stage, for a defined portfolio of SOEs, with a view to eventually broadening the portfolio to include all SOEs.
- *Elaboration of an ownership policy and strong corporate governance and disclosure standards for SOEs*. Priority should be given to develop an ownership policy clearly outlining the rationales and objectives for state ownership in Croatia. The scope of the ownership policy should cover all SOEs fully or majority-owned at the national level. It should define the respective responsibilities of the state bodies involved in its implementation, including the foreseen mandate of the proposed ownership coordination unit. The state ownership policy, or other complementary policy document(s), should clearly outline all corporate governance and disclosure requirements applicable to SOEs, including any differences in requirements according to size, market-orientation or legal form. The ownership coordination unit should be tasked with leading the development of the ownership policy, in consultation with, and, the full support of, all relevant government departments and the associated ministers. A requirement to update regularly the ownership policy should also be established.
- *Clarify SOEs' financial and non-financial performance objectives*. Guided by the state's overarching expectations as an owner set forth in the ownership policy, the Croatian authorities, with the participation of the ownership coordination unit, should define clear financial and non-financial performance objectives for all SOEs. The definition of objectives could usefully start with a classification of SOEs according to whether they undertake (i) a primarily public-policy function; (ii) a predominantly commercial function; or (iii) a mixture of both. A structured mechanism should be established which can then be utilised to set and monitor these enterprise-specific performance objectives. The development of such objectives could initially be the responsibility of ownership ministries, but it should be subject to review by the ownership coordination unit in a mandatory advisory capacity.

Harmonising the SOE legal and regulatory framework

- *Harmonisation of the legal and regulatory framework.* The challenges highlighted in the previous section may be best addressed by promulgating a new law and/or amend existing legislation. However, given the current fragmented state of the legal and regulatory framework governing SOEs, the Government of Croatia would gain from consolidating existent and relevant rules into one comprehensive law on SOEs. In addition to harmonising the legal and regulatory framework, this would help align applicable corporate governance standards and requirements with the SOE Guidelines and the present recommendations. The law could, *inter alia*, address issues such as the rationale for state ownership, the roles and responsibilities of all stakeholders exercising SOE ownership rights in Croatia, the selection and appointment of board members and other relevant corporate governance issues such as transparency and reporting requirements.

Maintaining a level-playing field with private companies

- *Streamline SOEs' legal and corporate forms.* Statutory SOEs (known as "legal entities" in Croatia) that operate commercially (i.e. those that are not primarily undertaking public-policy or administrative functions) should be incorporated as joint-stock companies. The Croatian authorities could also consider converting large and economically important SOEs operating as limited liability companies to joint-stock companies. Any transformation of SOEs' legal forms should be preceded by an in-depth review of individual SOEs' objectives, in order to make an informed assessment of their commercial orientation.

Improving transparency and disclosure practices

- *Extend the scope of the aggregate report.* In order to enhance transparency, the Croatian authorities should develop annual aggregate reports on SOEs that cover not only enterprises of special interest but all SOEs fully or majority-owned at the central level of government. In addition to the current information on SOEs' financial and non-financial objectives and related performance, the aggregate report could also include an assessment of SOEs' compliance with the state's applicable governance and disclosure rules, including the Corporate Governance Code for SOEs. The reports could also serve to inform the public of the state's ownership policy and any associated standards, as well as any recent or prospective changes to the state's ownership portfolio or practices.
- *Improve financial and non-financial disclosure by SOEs.* Disclosure standards could be further strengthened and harmonised across the SOE sector to ensure high quality and credibility of all SOEs' corporate reporting and not just of listed SOEs. In this regard, it would be useful to establish in a single policy document (or include as part of an existing policy document) what accounting, audit (internal, external and state) and disclosure standards are applicable to SOEs, including any differences according to enterprise characteristics.

Strengthening internal control systems

- *Strengthen the effectiveness of SOEs' internal control systems*. The Croatian authorities should strive to improve the effectiveness of SOEs' internal control systems, notably by: continuing the rollout and ensuring the effectiveness of mandatory compliance functions in majority-owned SOEs; ensuring proper implementation of safeguards to protect the autonomy of internal auditors and the

independence of external auditors, including transparency around provision of non-audit services to the SOE subject to external audit; and ensuring the existence and effectiveness of specific control measures – notably, whistleblower channels and for the management of procurement and other material risks.

Strengthening board autonomy and independence

- *Establish professional and independent supervisory boards.* The boards of at least Croatia's largest SOEs[37] (as defined in the Accountancy Act) should be required to comprise a majority of independent directors, with clear criteria for their independence including from the shareholder and from the company and its management. No state representatives – civil servants or otherwise – should be considered as independent. Nomination procedures should ensure that supervisory board members of all majority- and fully-owned SOEs are selected based on their professional qualifications and subject to a transparent and competitive procedure. The state's board member remuneration policy and practices should ensure that it is able to attract and retain qualified industry professionals.
- *Establish independent audit committees in SOEs*. The audit committees of at least large SOEs should have financially qualified members and an independent chair – that is, independent from the company and the state shareholder. No state representatives – civil servants or otherwise – should serve as audit committee chair.
- *Empower supervisory boards to carry out the functions of setting strategy and supervising management.* The current role and responsibility of SOE supervisory boards in Croatia should be strengthened to empower them, whether by law, corporate bylaws or board charters, to consistently oversee strategy, appoint the CEO (or the management board, in two-tier boards) and supervise management, free from political pressure and interference.

[37] Entities with more than 500 employees.

Annex A. Overview of enterprises fully or majority-owned by the central government

Enterprises of special interest owned by line ministries and the Ministry of Physical Planning, Construction and State Assets

	Enterprise	Ministry	Sector
1	HRVATSKA ELEKTROPRIVREDA d.d	Ministry of Economy and Sustainable Development	Energy
2	HROTE d.o.o		
3	JADRANSKI NAFTOVOD d.d.		
4	AGENCIJA ALAN d.o.o.	Ministry of Defence	Production, services and trade
5	AKD d.o.o.	Ministry of the Interior	
6	DRŽAVNE NEKRETNINE d.o.o	Ministry of Physical Planning, Construction and State Asset	
7	FINANCIJSKA AGENCIJA	Ministry of Finance	
8	HP - HRVATSKA POŠTA d.d.	Ministry of Sea, Transport and Infrastructure	
9	HRVATSKA LUTRIJA d.o.o.	Ministry of Finance	
10	HRVATSKE ŠUME d.o.o.	Ministry of Agriculture	
11	NARODNE NOVINE d.d.	Ministry of Economy and Sustainable Development	
12	HRVATSKE VODE		
13	INA – INDUSTRIJA NAFTE d.d.*		
14	APIS IT d.o.o.	Ministry of Finance	Transport and communications
15	AUTOCESTA RIJEKA - ZAGREB d.d.	Ministry of Sea, Transport and Infrastructure	
16	CROATIA AIRLINES d.d.		
17	HKZP d.o.o		
18	HRVATSKE AUTOCESTE d.o.o.		
19	HRVATSKE CESTE d.o.o.		
20	HŽ CARGO d.o.o.		
21	HŽ INFRASTRUKTURA d.o.o.		
22	HŽ PUTNICKI PRIJEVOZ d.o.o		
23	JADROLINIJA		
24	ODAŠILJACI I VEZE d.o.o.		
25	PLOVPUT d.o.o.		
26	PCE d.o.o.	Ministry of Defence	
27	ZRACNA LUKA DUBROVNIK d.o.o.	Ministry of Sea, Transport and Infrastructure	
28	ZRACNA LUKA OSIJEK d.o.o.		
29	ZRACNA LUKA PULA d.o.o.		
30	ZRACNA LUKA RIJEKA d.o.o.		
31	ZRACNA LUKA SPLIT d.o.o		
32	ZRACNA LUKA ZADAR d.o.o.		
33	ZRACNA LUKA ZAGREB d.o.o.		
34	ACI d.d.		Tourism

35	DRŽAVNA AGENCIJA ZA OSIGURANJE ŠTEDNIH ULOGA I SANACIJU BANAKA	Ministry of Finance	Finance
36	HRVATSKA BANKA ZA OBNOVU I RAZVITAK		
37	HRVATSKA POSTANKSA BANKA d.d		
38	IMUNOLOŠKI ZAVOD d.d.	Ministry of Economy and Sustainable Development	Other
30	CENTAR ZA RESTRUKTURIRANJE I PRODAJU	Ministry of Physical Planning, Construction and State Asset	

Note: *While minority-owned by the state, INA has a significant importance in the state portfolio and is part of the Government's list of enterprises of special interest.

SOEs owned and managed by the Centre for Restructuring and Sale (CERP)

	Enterprise	Sector of activity	State ownership (in percentage)
1	3.MAJ STM d.o.o	Shipbuilding	100
2	HRVATSKA BRODOGRADNJA – JADRANBROD d.d.		100
3	AGRODUHAN d.o.o	Agribusiness	89.6
4	NACIONALNA VELETRŽNICA d.d.		100
5	BOROVO d.d.	Manufacturing	99.99
6	KONOPLJA d.d.		53.13
7	LIPOVICA d.o.o		100
8	ORLJAVA d.o.o		100
9	ZRAKOPLOVNO-TEHNICKI CENTAR d.d.		100
10	BRIJUNI RIVIJERA d.o.o	Tourism	66.67
11	PLETER USLUGE d.o.o		100
12	DE – FOS d.o.o		100
13	INSTITUT ZA SIGURNOST d.d.	Research & Development	95.6
14	BRODARSKI INSTITUT d.o.o		100
15	JADROPLOV d.d.	Transport	70.44
16	LUKA VUKOVAR d.o.o		100
17	PLINACRO d.o.o	Electricity and gas	100
18	VELETRŽNICA OPUZEN d.o.o	Trade	99.52
19	VJESNIK d.d.	Telecommunications	52.96

Other majority-owned SOEs

	Enterprise	Sector of activity	State ownership (in percentage)
1	CROATIA BANKA d.d.	Finance	100
2	HRVATSKA RADIOTELEVIZIJA	Information and telecommunication	100

Annex B. Financial performance indicators for some of the largest SOEs in Croatia, in HRK

Hrvatska Elektroprivreda D.D.	2015	2016	2017	2018	2019
Turnover	9,516,865,329	8,856,568,510	8,823,844,235	9,413,863,610	10,519,884,837
EBITDA	1,376,768,117	928,421,473	185,218,478	177,569,463	595,198,609
Net Profit	1,624,338,909	1,323,818,373	364,022,458	353,976,075	1,107,307,661
Dividends		607,000,000	794,291,024	218,413,475	212,385,645
Assets	35,081,636,950	35,510,796,121	34,367,807,336	34,371,920,107	35,106,700,189
Equity	24,825,486,122	25,581,761,092	25,149,872,953	25,217,255,323	26,158,879,035
Provisions	211,589,550	212,605,551	217,014,030	221,244,278	223,593,493
Long-term debt	6,105,874,986	5,196,179,343	5,154,937,223	4,881,746,244	4,617,932,686
ROA	4.63%	3.73%	1.06%	1.03%	3.15%
ROE	6.54%	5.17%	1.45%	1.40%	4.23%

Hrvatske Autoceste d.o.o.	2015	2016	2017	2018	2019
Turnover	1,582,008,076	1,689,260,471	1,924,214,811	2,422,050,219	2,296,106,052
EBITDA	918,616,470	1,028,412,541	1,218,322,307	1,557,391,847	1,386,664,284
Net Profit	0	0	139,666,964	492,585,779	398,543,792
Dividends	0	0	0	0	0
Assets	43,914,276,457	42,798,007,938	41,668,485,196	39,766,529,779	38,858,208,344
Equity	19,773,127,350	18,785,356,485	18,667,155,086	17,889,936,861	17,766,352,610
Provisions	155,468,851	157,067,387	194,198,132	50,718,678	71,584,221
Long-term debt	19,857,838,893	18,488,954,342	19,533,693,297	17,217,433,625	19,485,250,688
ROA			0.34%	1.24%	1.03%
ROE			0.75%	2.75%	2.24%

HZ Infrastruktura d.o.o.	2015	2016	2017	2018	2019
Turnover	1,341,641,261	1,200,430,641	1,237,346,470	1,223,069,487	1,322,322,216
EBITDA	81,949,494	60,425,957	55,458,032	-58,062,345	48,711,315
Net Profit	10,923,630	1,012,336	1,805,693	-99,636,522	466,574
Dividends	0	0	0	0	0
Assets	13,396,495,056	13,583,206,786	12,797,566,793	12,978,128,624	13,372,016,631
Equity	9,303,239,908	10,480,123,618	9,620,273,070	8,482,420,431	8,128,527,040
Provisions	99,416,220	92,562,245	139,343,744	192,919,831	155,664,139
Long-term debt	1,846,223,856	832,384,592	722,799,191	794,497,042	866,997,476
ROA	0.08%	0.01%	0.01%	-0.77%	0.00%
ROE	0.12%	0.01%	0.02%	-1.17%	0.01%

Hrvatski Operator Prijenosnog Sustava d.o.o.	2015	2016	2017	2018	2019
Turnover	1,639,312,855	1,674,964,187	1,861,727,475	1,764,589,987	1,727,167,274
EBITDA	539,306,314	594,973,187	695,780,202	566,488,788	532,615,879
Net Profit	189,689,605	271,672,952	289,017,059	176,207,762	132,152,122
Dividends	0	9,605	952	0	30,000,000
Assets	5,785,361,399	6,213,632,313	6,600,034,268	6,698,393,086	6,949,371,340
Equity	4,176,013,822	4,641,588,984	5,223,735,961	5,101,938,159	5,190,677,327
Provisions	61,470,791	66,948,134	75,260,326	72,310,260	106,169,015
Long-term debt	845,379,939	620,503,571	502,953,394	420,924,698	426,019,316
ROA	3.28%	4.37%	4.38%	2.63%	1.90%
ROE	4.54%	5.85%	5.53%	3.45%	2.55%

Jadranski Naftovod d.d.	2015	2016	2017	2018	2019
Turnover	744,958,304	752,733,581	780,779,826	781,857,011	714,324,672
EBITDA	479,675,026	533,456,331	533,073,039	480,935,003	452,505,709
Net Profit	233,586,684	290,492,210	290,739,622	303,742,793	261,909,631
Dividends	57,436,506	133,162,005	166,263,570	0	86,567,899
Assets	3,878,369,696	4,050,128,431	4,107,164,215	4,422,312,789	4,624,282,550
Equity	3,592,472,309	3,749,802,514	3,874,278,567	4,178,021,360	4,353,363,092
Provisions	50,687,422	31,181,141	27,806,754	14,783,693	14,654,794
Long-term debt	134,167,845	144,523,161	80,098,150	82,646,312	88,203,201
ROA	6.02%	7.17%	7.08%	6.87%	5.66%
ROE	6.50%	7.75%	7.50%	7.27%	6.02%

Plinacro d.o.o.	2015	2016	2017	2018	2019
Turnover	525,054,105	601,556,739	655,899,860	477,496,741	399,375,898
EBITDA	276,605,826	346,329,063	375,246,159	257,468,077	198,450,395
Net Profit	108,737,649	189.131,527	234,985,468	77,846,853	15,089,453
Dividends	0	0	0	0	0
Assets	4,364,184,451	4,453,925,286	4,572,772,226	4,553,782,805	4,521,734,008
Equity	2,557,256,805	2,742,763,582	2,977,749,050	3,055,595,903	3,070,685,356
Provisions	4,269,195	3,882,645	8,894,989	10,023,602	8,909,697
Long-term debt	1,591,127,375	1,436,678,208	1,290,699,372	1,138,367,153	1,011,544,506
ROA	2.49%	4.25%	5.14%	1.71%	0.33%
ROE	4.25%	6.90%	7.89%	2.55%	0.49%

HEP- Operator Distribucijskog Sustava d.o.o.	2015	2016	2017	2018	2019
Turnover	7,018,390,205	6,619,001,081	4,325,341,958	3,994,608,960	3,748,390,248
EBITDA	1,827,530,024	1,816,526,977	1,884,364,135	1,668,717,248	1,232,337,763
Net Profit	725,198,647	667,086,760	679,612,587	534,811,578	151,978,582
Dividends	0	0	0	0	0
Assets	16,197,979,207	16,737,329,423	16,832,316,906	17,444,388,071	17,382,776,499
Equity	1,886,300,808	2,664,777,090	2,937,422,537	2,114,531,022	1,974,941,060
Provisions	359,753,738	286,748,640	359,567,754	386,746,398	425,518,938
Long-term debt	6,337,611,876	7,505,195,323	7,556,632,325	7,461,178,648	7,434,970,425
ROA	4.48%	3.99%	4.04%	3.07%	0.87%
ROE	38.45%	25.03%	23.14%	25.29%	7.70%

HPB d.d./Bank	2015	2016	2017	2018	2019
Turnover	1,353,981,695	1,338,330,117	1,276,405,482	1,183,079,536	1,233,105,712
EBITDA					
Net Profit	123,216,697	181,261,017	8,333,460	151,857,564	143,772,515
Dividends	0	30,762,215	0	0	
Assets	17,713,166,474	19,305,827,779	19,798,832,598	21,254,806,746	23,773,157.202
Equity	1,779,264,127	1,887,450,861	1,905,291,773	2,002,500,812	2,370,211,645
Provisions	41,555,550	67,558,661	77,063,845	84,909,385	196,063,323
Long-term debt	1,004,380,000	709,421,000	672,258,000	485,792,000	824,095,000
ROA	0.70%	0.94%	0.04%	0.71%	0.60%
ROE	6.93%	9.60%	0.44%	7.58%	6.07%

Hrvatske Šume d.o.o.	2015	2016	2017	2018	2019
Turnover	2,084,732,341	2,076,480,032	2,074,232,449	2,229,676,776	2,283,502,060
EBITDA	312,103,529	300,791,862	231,945,895	162,077,913	199,099,704
Net Profit	186,389,971	174,801,636	113,751,584	51,882,299	47,097,278
Dividends	0	178,938,104	104,880,981	68,250,950	31,129,380
Assets	2,323,637,181	2,352,452,625	2,430,255,080	2,476,772,374	2,545,073,529
Equity	1,532,907,586	1,597,955,065	1,603,191,034	1,582,020,594	1,597,926,912
Provisions	298,974,535	336,540,259	331,684,584	279,642,216	263,392,760
Long-term debt	92,539,670	93,069,674	112,985,853	154,322,709	171,785,194
ROA	8.02%	7.43%	4.68%	2.09%	1.85%
ROE	12.16%	10.94%	7.10%	3.28%	2.95%

HP - Hrvatska Posta d.d.	2015	2016	2017	2018	2019
Turnover	1,703,112,481	1,697,950,800	1,662,992,849	1,715,070,757	1,903,205,121
EBITDA	248,129,733	207,642,028	233,718,900	198,491,741	190,720,473
Net Profit	163,918,001	107,899,295	70,352,186	39,350,589	130,675,028
Dividends	0	0	0	0	0
Assets	1,417,126,579	1,470,442,784	1,541,753,237	1,678,369,289	1,908,530,538
Equity	719,076,013	838,384,060	923,409,492	967,582,786	1,098,257,814
Provisions	55,666,356	84,826,685	40,572,993	44,674,210	107,595,372
Long-term debt	405,734,053	305,553,463	305,015,959	84,484,047	265,709,140
ROA	11.56%	7.34%	4.56%	2.34%	6.85%
ROE	22.80%	12.87%	7.62%	4.07%	11.90%

Hrvatske Ceste d.o.o.	2015	2016	2017	2018	2019
Turnover	194,888,900	181,343,600	173,239,500	183,856,700	202,699,332
EBITDA	22,660,600	21,344,300	20,398,400	24,024,400	29,801.300
Net Profit	-514,200	-287,900	-473,700	-308,700	-355,858
Dividends	0	0	0	0	0
Assets	71,720,124,300	73,543,679,600	73,663,706,900	75,686,343,200	76,745,369,851
Equity	61,096,216,600	62,951,338,300	63,437,465,600	65,096,968,600	65,791,184,194
Provisions	158,808,200	159,285,100	169,348,200	160,901,900	159,463,425
Long-term debt	8,428,124,700	7,915,494,200	8,834,097,600	9,006,025,000	9,005,245,300
ROA	0.00%	0.00%	0.00%	0.00%	0.00%
ROE	0.00%	0.00%	0.00%	0.00%	0.00%

Annex C. Subsidies and financial guarantees provided to SOEs between 2017 and 2020

Total subsidies, in HRK

Company	2017	2018	2019	2020	Total
AKD d.o.o.	49,140		0	0	**49,140**
CROATIA AIRLINES d.d.	78,881,000	81,050,000	82,873,199	170,206,537	**413,010,737**
FINANCIJSKA AGENCIJA (FINA)	0	0	15,254	0	**15,254**
HP-HRVATSKA POŠTA d.d.	78,766.289	79.81..271	94.092,547	92,846,019	**345,522,127**
HEP-HRVATSKA ELEKTROPRIVREDA d.d.	0	11,157,724	0	0	**11,157,724**
HŽ CARGO d.o.o.	0	40,779	0	0	**40,779**
HŽ PUTNICKI PRIJEVOZ d.o.o.	453,749,216	467,804,293	448,682,699	460,794,523	**1,831,030,732**
JADROLINIJA	206,809,217	242,726.697	249,922,252	247,578,789	**947,036,954**
ODAŠILJACI I VEZE d.o.o.	0	66,576	0	770,640,000	**770,706,576**
ZRACNA LUKA DUBROVNIK d.o.o.	858,563,979	0	0	0	**858,563,979**
ZRACNA LUKA OSIJEK d.o.o.	3,150,000	3,100,000	6,500,000	6,450,000	**19,200,000**
3. MAJ BRODOGRADILIŠTE d.d.	133,589,515	0	0	0	**133,589,515**
HRVATSKE CESTE d.o.o.	0	0	0	27,076	**27,076**
JADROPLOV d.d.	0	8,000,000	5,000,000	0	**13,000,000**
ULJANIK d.o.o	3,150,000	3,100,000	6,500,000	6,450,000	**19,200,000**
Total	**1,813,632,779**	**893,807,893**	**887,085,951**	**1,748,542,946**	**5,343,069,569**

Note: According to the Ministry of Finance, data on subsidies for 2020 are still being collected and therefore cannot be considered as final. The data for 2020 is submitted to the Register of State Aid up to and including 17.02.2021. This table doesn't contain payments for activated guarantees or loans to entrepreneurs in difficulties.

Total guarantees, in HRK

Company	2016	2017	2018	2019	Total
3. MAJ BRODOGRADILIŠTE d.d.				343.698.466	343.698.466
AUTOCESTA RIJEKA - ZAGREB d.d.	525.534.940		1.500.802.512		2.026.337.452
CENTAR ZA RESTRUKTURIRANJE I PRODAJU		325.462.368			325.462.368
ERO ËKOVIC GRUPA d.d.			76.000.000		76.000.000
HRVATSKE AUTOCESTE d.o.o.	3.376.138.900	1.484.727.200	8.476.256.236	2.958.574.000	16.295.696.336
HRVATSKE CESTE d.o.o.	1.268.475.411	445.004.820	3.768.309.731	200.000.000	5.681.789.962
HŽ CARGO d.o.o.	250.000.000				250.000.000
HŽ INFRASTRUKTURA d.o.o.		362.447.856		350.000.000	712.447.856
JADROPLOV d.d.	32.812.918				32.812.918
PETROKEMIJA d.d.	200.286.036				200.286.036
ULJANIK BRODOGRADILIŠTE D.D.			714.175.536		714.175.536
ULJANIK d.d.	1.348.948.316	457.666.089	101.619.812		1.908.234.217
ULJANIK PLOVIDBA D.D.			261.638.103		261.638.103
ZRACNA LUKA OSIJEK d.o.o.				17.600.000	17.600.000

Annex D. Total amount of dividends provided by SOEs to the state budget between 2016 and 2020

CERP's portfolio

Company	2016	2017	2018	2019	2020
ACI d.d. Opatija	12.240.164			16.558	19.095
EKRAN d.o.o. Split			368.307		
GORICA d.o.o. Velika Gorica	27.895		45.666		
GORICA HUP d.d. Velika Gorica		17.288			
GRADAC d.d. Gradac		180.027			
IMPERIAL d.d. Rab	994.434				
METALMINERAL d.d. Kerestinec			97.830	48.915	
PODRAVKA d.d. Koprivnica	9.816.912	9.812.733	9.812.733	12.676.806	12.676.806
VELEPROMET d.d. Vukovar	415.480	519.350	519.350	519.350	
VETERINARSKA STANICA REMETINEC d.o.o. Brezovica					89.820
VETERINARSKA STANICA d.o.o. Velika Gorica		70.915	126.245	53.186	120.554
VETERINARSKA STANICA d.o.o. Vrbovec	38.850	38.850	38.850	38.850	38.850
VETERINARSKA STANICA KUTINA d.o.o. Kutina	19.853			19.853	
VETERINARSKA STANICA REMETINEC d.o.o. Brezovica		25.398	42.652	27.044	

Portfolio of the Ministry of Physical Planning, Construction and State Assets

Company	2015	2016	2017	2018	2019
ACI d.d.	649.782			9.087.923	15.390.072
Agencija Alan d.o.o.	79.681.773	20.809.501	81.163.156	18.410.969	28.136.831
Agencija za komercijalnu djelatnost d.o.o.	11.514.355	13.141.454	15.894.071	37.302.133	37.448.936
APIS IT d.o.o.	3.929.128	2.806.666		1.693.085	2.265.433
Brijuni Rivijera d.o.o.		93.060	151.852		
Državne nekretnine d.o.o.	9.914.306	12.242.448	12.981.962		13.399.599
Hrvatska elektroprivreda d.d.		607.000.000	794.291.024	218.413.475	212.385.645
Hrvatska lutrija d.o.o.	13.501.061	29.297.274	38.400.265	45.399.817	52.141.232
Hrvatska poštanska banka d.d.		13.817.332			
Hrvatske šume d.o.o.		178.938.104	104.880.981	68.250.950	31.129.380
Hrvatski operator tržišta energije d.o.o.	178.078	287.849		1.929.543	1.158.155
HŽ Putnicki prijevoz d.o.o.	1.797.330				
INA - Industrija nafte d.d.	67.253.280		68.149.990	364.064.422	560.444.000
Jadrolinija		5.833.047			
Janaf d.d., Zagreb	27.525.585	63.815.896	86.836.860		45.213.058
Koncar elektroindustrija d.d.	7.738.896				
Narodne novine d.d.	453.029	618.595			4.479.643
Plovput d.o.o.	768.509	727.464	2.304.060	335.014	340.062
SKDD d.d.		1.509.143			
Zracna luka Pula d.o.o.		146.818			2.372.688
Zracna luka Split d.o.o.		22.327.677			41.360.744
Zracna luka Zadar d.o.o.		325.187			4.213.783
Zracna luka Zagreb d.o.o.	4.755.960	414.171		1.509.284	380.646

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OECD Review of the Corporate Governance of State-Owned Enterprises

CROATIA

This report evaluates the corporate governance framework for the Croatian state-owned enterprise sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The report was prepared at the request of Croatia. It is based on discussions involving all OECD countries.

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