

THE CONCEPT

FOR THE IMPLEMENTATION

**of the OECD Guidelines on Corporate
Governance in the Ukrainian
Legislation on the Management of
Municipally-Owned Legal Entities**

The Concept for the Implementation of the OECD Guidelines on Corporate Governance in the Ukrainian Legislation on the Management of Municipally-Owned Legal Entities

In 2024, Ukraine actively embarked on the implementation of the OECD Guidelines on Corporate Governance of State-Owned Enterprises. These efforts resulted in the enactment of the Law of Ukraine On Amendments to Certain Legislative Acts of Ukraine to Improve Corporate Governance dated 22.02.2024 №3587-IX.

In addition, following the passage of the Law of Ukraine On the Specifics of Regulating the Operation of Legal Entities of Certain Forms of Incorporation and Associations of Legal Entities During the Transition Period, which effectively repeals the Commercial Code of Ukraine, local communities have been mandated to corporatise municipally-owned enterprises and set up non-business companies (municipal non-commercial enterprises) and business companies. At the same time, the right of communities to establish new municipal unitary enterprises (both commercial and non-commercial) has

been restricted. However, they have retained the right to continue managing the existing enterprises or to reorganize them into joint-stock companies, limited liability companies, or non-business companies with a community holding a 100% stake in the share capital.

However, an analysis of the legislation has revealed the need to extend the OECD corporate governance guidelines to municipally-owned legal entities (municipally-owned enterprises and non-business companies) mindful of the state ownership policy provisions and their adaptation to the governance of municipally-owned legal entities. Moreover, the OECD's underlying principle is that those entities responsible for the ownership functions of enterprises held at sub-national levels of government should seek to implement as many of the recommendations in the Guidelines as applicable, including with regards to fair competition in the marketplace.

The table below outlines the key OECD requirements, their application in the governance of municipally-owned enterprises and non-business companies, the status of compliance with the provisions, and proposals for their improvement through the development of a dedicated draft law to implement corporate governance elements in the municipal sector.

This document was prepared by experts of the European Union Anti-Corruption Initiative (EUACI) in Ukraine and EU-LEAP. The opinions, conclusions or recommendations are those of the authors or compilers of the publication and don't represent official views of the EUACI, European Union, or the Ministry of Foreign Affairs of Denmark.

February 2025

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
I. Rationales for state ownership The ultimate purpose of state ownership of enterprises should be to maximise long-term value for society, in an efficient and sustainable manner. The government should develop an ownership policy. The policy should, inter alia, define the overall rationales and goals for state ownership, the state's and other shareholders' role in the governance of SOEs. The ownership policy should be subject to appropriate procedures of accountability. The government should review at regular intervals its ownership policy and evaluate its implementation. The state should define the rationales for owning individual SOEs and subject these to recurrent review. The rationales for ownership, and any public policy objectives that individual SOEs, or groups of SOEs, are required to achieve should be clearly linked to their main line of business, mandated by the relevant authorities and publicly disclosed.	The legislation does not set forth the requirements or obligations for local governments to develop a municipal ownership policy. At the same time, the Civil Code of Ukraine sets out that a non-business company having a territorial community as its sole member is subject to corporate governance requirements applicable to business companies in which the state holds more than 50 percent of shares (stakes). One such requirement for state-owned enterprises is the development of a State Ownership Policy by the Cabinet of Ministers of Ukraine. However, the legislation does not clearly stipulate which corporate governance instruments should be applied by companies, thereby vesting local governments with discretionary powers.	Not implemented due to the absence of a municipal ownership policy, which is manifested in the following points: 1) the existence of approximately 14,000.00 municipally-owned enterprises (13,901.00 as at 01.01.2025), whose number is continually increasing (a 21.53% increase since 2016); 2) most municipally-owned enterprises (MOEs) demonstrate a negative return on equity and assets; 3) a half of all MOEs (around 7,000.00) operate at a loss; 4) the majority of MOEs opt for voluntary liquidation by resolution of their owners rather than bankruptcy proceedings and settlement with creditors; 5) the state continues to subsidize MOEs from local budgets or via other financial instruments; 6) the activities of some MOEs contribute to market distortions and hinder fair competition.

Proposals

Enshrine in legislation the requirement for local governments to develop a Municipal Ownership Policy – a document that sets out a strategy for the development, use and management of municipal property assets. This policy should set forth the principles, mechanisms, and criteria for the governance of municipally-owned legal entities, provide for their segmentation based on their functions and public significance, justify the expediency of their creation, reorganization or liquidation, and stipulate the transparency and disclosure requirements for their operation. It should also outline the methods for improving resource efficiency, attracting investment, and maintaining a balance of community interests.

This requirement should be implemented through a legal provision obligating local governments to develop a Municipal Ownership Policy for their respective territorial communities in line with the specific criteria. This policy should be based on the State Ownership Policy approved by the Cabinet of Ministers of Ukraine on 29 November 2024, No. 1369, and factor in the unique aspects of governing municipally-owned legal entities in each community. The policy should be approved by a local council resolution.

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
II. The state's role as an owner Governments should simplify and standardise the legal forms under which SOEs operate. Their operational practices should follow commonly accepted corporate norms. The state should clearly define owners' expectations, allow SOEs full operational autonomy to achieve them and refrain from intervening in the management of SOEs. The state should let SOE boards exercise their responsibilities and should respect their independence. The exercise of ownership rights should be clearly identified within the state administration and be centralised in a single ownership entity. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Prime responsibilities of the ownership entity include being represented at the general shareholders meetings, establishing transparent board nomination processes, monitoring the implementation of goals and financial targets, and setting up reporting systems, information disclosure policy, continuous dialogue with external auditors, and a clear and transparent overarching remuneration policy for SOE boards.	The community's role as an owner is recognized in the legislation but does not fully align with the OECD Guidelines. Under the Constitution, a community may set up, liquidate and reorganize municipally-owned enterprises. The legislation specifies that communities may set up business companies (without clearly defining their types) and non-business companies, and manage the existing municipal unitary enterprises, though the creation of new municipally-owned enterprises is prohibited. Municipally-owned enterprises and non-commercial companies are accountable to the community, which approves their annual plans, reviews management reports, and provides financial support. According to the law, local governments appoint the executives of municipally-owned legal entities, and set forth the criteria for the establishment of supervisory boards and audit of financial statements. However, there are no legal provisions governing remuneration policies for executives and supervisory board members.	The community exercises its ownership function to fully control MOEs, as these are unitary entities in which the community holds a 100% stake. The MOEs corporatisation reform has changed the approach to the forms of incorporation that communities should apply to municipally-owned legal entities. However, since MOEs continue to operate, there is a risk that local governments may choose not to transform the existing MOEs or create new legal entities. Instead, they may expand the powers or scope of operation of the existing MOEs, as they retain full control without the interference of other members (shareholders). It is also important to note that the law does not specify which forms of incorporation (e.g., general partnership, limited partnership, joint-stock company or limited liability company) communities may use to set up a business entity, which leaves room for discretion in their decision-making. MOEs' executives are often appointed based on political motivation or personal interests rather than competitive selection. While some communities have put in place the competitive selection procedures, they are rather formal due to lack of the clearly defined job criteria. As the establishment of supervisory boards for MOEs is not mandatory, local governments enjoy discretionary powers.

Proposals

Standardise the incorporation forms for business companies in accordance with the new law (Draft Law No. 6013), and endorse that MOEs may only take the form of joint-stock companies (JSCs) or limited liability companies (LLCs). Alternatively, specific criteria should be defined for selecting the appropriate form of incorporation based on an enterprise's objectives and territorial community needs.

Set out the requirements for the management and functioning of MOEs based on the OECD Guidelines to ensure transparency of their operations and to encourage local governments to reorganize such enterprises in order to improve their efficiency. Establish mandatory procedures for the appointment of executives, including public competitions, transparent selection criteria, and professional qualification requirements. Set out the legislative criteria for the mandatory establishment of the supervisory boards for large critical infrastructure enterprises along with clear guidelines for determining which enterprises are required to undergo financial audits.

Introduce supervisory boards with a majority of independent members having the authority to carry out strategic oversight over enterprises' activities. Set forth clear qualification requirements for nominees to supervisory boards.

Ensure that employee remuneration policies are included in the community's Municipal Ownership Policy, which for its part should contain the standards for assessing the performance of both executives and supervisory boards.

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
III. State-owned enterprises in the marketplace Consistent with the rationale for state ownership, the legal, regulatory and policy framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs engage in economic activities. Where SOEs carry out public service obligations, they should be transparently and specifically identified, allowing for an accurate attribution of costs and revenue. If SOEs are used to allocate support measures in line with their public policy objectives, care should be taken to ensure that: (i) support measures are consistent with applicable competition and trade rules; (ii) support measures and their funding are clearly defined and publicly disclosed; and (iii) support measures do not cause unfair disadvantages to other commercial undertakings. The state should not exempt SOEs, when engaging in economic activities, from the application and enforcement of laws, regulations and market-based mechanisms, and should ensure tax, debt and regulatory neutrality to prevent undue discrimination between SOEs and their competitors.	The legislation requires local governments to obtain the Antimonopoly Committee's approval for establishing municipally-owned legal entities if their activities could affect the market competition. The regulation of municipally-owned enterprises is somewhat different from that of state-owned enterprises and business companies. MOEs are subject to less stringent requirements, have a simplified organizational structure, and face less oversight of their operation and reporting. Certain regulations stipulate that the specifics of MOEs' operation align with the requirements for state-owned commercial or public enterprises, but do not specify exactly what kind of requirements apply, thus creating discretionary gaps in governance. At the same time, MOEs may receive financial support from both local and state budgets in the form of various subsidies.	Due to the exclusive oversight of MOEs by local communities and the lack of clearly defined operational requirements, MOEs may overlook the provisions of the law, which leads to: ▶ inadequate operational control; ▶ absence of a unified public register with an up-to-date list of MOEs and their official financial statements; ▶ poor operational efficiency: MOEs' operational and financial performance is significantly lower compared to private sector companies; ▶ chronic financial losses and ongoing dependence on funding; ▶ misallocation of resources: a number of enterprises operate as quasi-municipal entities and de facto perform commercial functions under non-market conditions. According to data from the Antimonopoly Committee of Ukraine (AMCU), local governments submit an average of 30 requests per annum for approval of new business entities. At the same time, AMCU annually identifies an average of 100 MOEs involved in violation and/or actions with signs of violation of the laws on the protection of economic competition. It should be noted that legislation sets out the regulatory framework for MOEs by referring to requirements stipulated for state-owned public enterprises. However, the analysis has shown that this legal reference is not relevant in practice. An interesting fact is that according to the State Statistics Service there were only 21 state-owned public enterprises in Ukraine as at 1 January 2025, which means that this form of incorporation is rather unpopular.

Proposals

Establish clearer requirements for the operation of municipally-owned enterprises and municipal non-commercial enterprises, as well as their management and oversight by local governments, specifically legal provisions regulating the activities of municipally-owned enterprises by aligning them with best practices established for state-owned commercial or public enterprises. These provisions should set out the specific measures to increase accountability and liability for failure to submit accurate information.

Regulate the operation of municipal non-commercial enterprises by introducing mandatory corporate governance mechanisms to improve the efficiency of their operation and reduce the discretionary powers of local councils.

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
IV. 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, including minority and foreign shareholders, and ensure shareholders' equitable treatment and equal access to corporate information. The state should strive toward full implementation of the G20/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.	The majority of municipally-owned enterprises are set up as unitary enterprises with a community holding a 100% stake in the share capital. The implementation of corporate governance mechanisms in these enterprises is not mandatory; they are applied selectively at the discretion of local councils. The legislation requires non-commercial companies to apply the corporate governance requirements, but does not provide the specifics of their application. Enterprises structured as business entities with a stake held by a community are governed by legislation regulating the operation of joint-stock companies and limited liability companies.	The establishment of supervisory boards in municipally-owned enterprises is one of the most effective tools for overseeing their activities and ensuring the equitable treatment of shareholders and other investors. In practice, only a few municipally-owned enterprises have had supervisory boards established by local governments, primarily in cities such as Kyiv, Lviv, and Mykolaiv. Regarding the overall implementation of the OECD Guideline on Corporate Governance, the corporatisation reform of municipal enterprises is in its early stages. Additionally, there are few business entities with municipal ownership. Therefore, it is crucial to monitor the establishment of new entities and track the operation of the existing ones.

Proposals

The legislation should clearly define the corporate governance framework for municipally-owned enterprises and non-commercial companies, as well as introduce the mechanisms for their oversight and assessment of their implementation.

The protection of shareholder and investor rights should be explicitly outlined in municipal policy documents, particularly in the Municipal Ownership Policy. This policy should establish mechanisms for shareholder rights protection, procedures for access to information, transparent decision-making processes, detailed reporting obligations for municipally-owned enterprises, and accountability measures for officials in case of violations.

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
V. Disclosure, transparency and accountability SOEs should report on their activities by providing both financial and non-financial information in line with internationally recognised standards. Such information should include the enterprise's objectives, financial and operating results, governance and ownership structure, remuneration of board members and key executives, composition of the board and board member selection process, risks, state financial assistance, material transactions with the state, and other aspects. SOEs should have risk management systems to identify, manage, control and report on risks, which embody a set of internal controls, ethics and compliance programmes or measures. SOEs should establish an internal audit function that has the necessary capacity, autonomy and professionalism, and reports directly to the board and to the audit committee. An annual external audit should be conducted by an independent auditor in order to assure that financial statements are prepared in accordance with the international standards. The ownership entity should publish an annual report on SOEs. The report should be transparent, reliable and publicly accessible.	The legislation requires MOEs to publicly disclose information about their activities by publishing it on their official websites or those of the designated authorities unless otherwise provided by law. Mandatory disclosures include MOEs' business objectives, financial statements and audits, charters, details of executive officers and their remuneration procedures, contracts, transactions, and commitments. However, international reporting standards apply only to MOEs classified as public interest entities, such as large enterprises and natural monopolies. An audit of MOEs' financial statements is not mandatory, and the criteria for selecting the enterprises subject to audit are determined by local council. At the same time, the legislation requires MOEs to establish internal control and audit mechanisms in line with the principles set forth by the Cabinet of Ministers of Ukraine. The Cabinet's Resolution No. 1062 of 12 December 2018 outlines the fundamental principles of internal control for budget spending units. However, the special legislation does not explicitly stipulate the powers of local councils regarding internal control and audit of municipally-owned enterprises. The Law of Ukraine On the Specifics of Regulating the Operation of Legal Entities of Certain Forms of Incorporation and Associations of Legal Entities During the Transition Period stipulates that the State Property Fund of Ukraine must, within one year of the date of enactment of this Law, approve the requirements for the list of necessary registration data on assets owned by territorial communities.	According to the legislation, reporting on the MOEs' activities is mandatory. However, research data shows that: ▶ only 35% of MOEs report on their activities on the E-Data platform; ▶ approximately 60% of MOEs do not publicly report on their activities (either on their own websites or those of the designated authorities). Currently, gathering information about MOEs activities remains challenging. For instance, if information about a MOE is requested from a local council, the council often redirects the request to the enterprise itself, as it does not have the necessary information. Some communities refuse to provide full information arguing that MOEs are the administrators of information according to the law, and as their local councils do not have such information, it should be requested from each MOE individually. There are instances when local councils either do not respond to requests or waive a request for information altogether. This means that MOEs violate information disclosure regulations, making access to information difficult or impossible. The requirements for internal control and audit of MOEs are outlined in the Budget Code and resolutions of the Cabinet of Ministers. However, the responsibility for their implementation rests with local governments, while some provisions are of advisory nature only.

Proposals

Create a Register of Municipal Property, which will store up-to-date information on the operation of MOEs, including their segmentation by size, functions, purpose, etc. This register will also contain all other legally required information about the activities of municipally-owned legal entities.

Responsibility for the reliability of information and its disclosure should rest with community authorities. Alternatively, a central executive authority should be designated responsible for collecting information about MOEs' activities for each reporting period and should serve as the custodian of such information.

To ensure transparency in the cooperation between municipally-owned legal entities and local governments, the legislation should obligate communities to establish internal audit and control mechanisms, adhere to these mechanisms, and report on their implementation. These obligations and accountability measures could be formalized in the Law of Ukraine On Local Governments in Ukraine or incorporated into the Municipal Ownership Policy.

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
VI. The composition and responsibilities of the boards of state-owned enterprises The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. The role and duties of SOE boards should be clearly defined in legislation. SOE boards should effectively carry out their functions of reviewing and guiding corporate strategy, appointing and removing the CEO, and setting executive remuneration levels. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated or appointed based on qualifications relevant to the enterprise's sector of activity and business profile, have equal legal responsibilities, and be free from conflicts of interests and political interference. SOE boards should consider setting up specialised committees to support the full board in performing its functions and to carry out a well-structured evaluation to appraise their performance and efficiency.	Local governments have the power to make decisions regarding the criteria that determine whether the establishment of supervisory boards is mandatory for municipal unitary enterprises and business companies in which a territorial community holds more than 50 percent of shares (stakes). They also have the authority to approve the procedure for setting up supervisory boards, appoint board members and set the requirements for them, define the scope of their authority, and set out the selection criteria for independent auditors and enterprises whose financial statements are subject to audit.	The optionality of having independent supervisory boards set up in municipally-owned legal entities limits the transparency of MOEs' operations and poses corruption and political risks. In addition, the broad discretion enjoyed by local councils regarding the formation of supervisory boards and qualifications of their members leads to inconsistent approaches, especially when compared to business companies in which a majority stake is held by a community.

Proposals

To enhance the efficiency of municipally-owned legal entities, the legislation should set out the mandatory criteria for the formation of supervisory boards in enterprises that have a significant impact on territorial communities' livelihood. These should include a clear mechanism for their creation, qualification requirements for board members, safeguards against conflicts of interest, and a defined scope of powers and responsibilities.

OECD Guidelines	Compliance of Ukrainian Legislation with the OECD Guidelines on the Governance of Municipally-Owned Enterprises	Implementation status
VII. State-owned enterprises and sustainability The corporate governance framework should provide incentives for state ownership entities and SOEs to make decisions and manage their risks in a way that contributes to SOEs' sustainability and resilience and ensures long-term value creation. Where the state has sustainability goals, the state as owner should set concrete and ambitious sustainability-related expectations for SOEs, including on the role of the board, disclosure and transparency, and responsible business conduct. The ownership policy should fully recognise SOEs' responsibilities towards stakeholders. State ownership entities and SOEs should take action to ensure high standards of integrity in the state-owned sector and to avoid the use of SOEs as conduits for political finance, patronage or personal or related-party enrichment.	The legislation does not explicitly provide for the application of a corporate governance model to municipal unitary enterprises. However, local councils have the authority to make such decisions (though it is not a widespread practice). It should also be noted that the Commercial Code of Ukraine required business entities in the municipal economic sector to implement anti-corruption programmes. However, the updated legislation does not stipulate this requirement.	The optionality of implementing corporate governance principles in municipally-owned enterprises significantly hinders the formation of effective incentives for both these enterprises and their governing bodies to make decisions that ensure their stability, sustainability and long-term value creation. This approach leads to reduced accountability, lack of risk management responsibilities, and misalignment of enterprises' activities with community interests and sustainable development goals. In addition, the absence of legislative provisions requiring business entities in the municipal economic sector to set up anti-corruption programmes provides local governments with a broad discretion in appointing deputies and other related parties as MOEs' executives or in leveraging MOEs' resources for political gains.

Proposals

To mitigate corruption risks in the management of municipally-owned legal entities, it is essential to legislate for the mandatory implementation of anti-corruption programmes as well as internal audit and controls for such entities. The requirements for reporting on their implementation, compliance, and public disclosure should also be established at the legislative level.