



# Technical Assistance Consultant's Report

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## State Owned Enterprise Reforms and Private Sector Participation (Financed by the Asian Development Fund)

Prepared by VINSTAR Consulting International

For Ministry of Finance (Executing Agency) for Solomon Islands

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**Asian Development Bank**

***VINSTAR Consulting International***

**Final Report**

**TA No. 4482-SOL: State Owned  
Enterprise Reforms and Private  
Sector Participation**

**Submitted to**

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**and**

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**March 2007**

***VINSTAR***

# **Final Report**

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## Abbreviations

ADB	Asian Development Bank
DFE	Domestic Financial Expert
DFR	Draft Final Report
DLE	Domestic Legal Expert
EA	Executing Agency
ERU	Economic Reform Unit
HFL	Solomon Islands Home Finance Limited
ICGFS	International Corporate Governance and Financial Specialist
ICSI	Investment Corporation of the Solomon Islands
ILRE	International Legal and Regulatory Expert
IPSTL	International Privatisation Specialist/Team Leader
ISO	International Standards Organisation
LDA	Livestock Development Authority
MOFNRP	Ministry of Finance National Reform and Planning
NPF	National Provident Fund
OAG	Office of the Auditor General
PS	Permanent Secretary
PSP	Private Sector Participation
SIG	Solomon Islands Government
SOE	State-Owned Enterprise
TA	Technical Assistance
TOR	Terms of Reference

## Executive Summary

The goal of this TA was to support the SIG in its efforts to improve the environment for the private sector, in line with the strategic focus of ADB's country strategy and program for the Solomon Islands. The purpose of the TA was to assist the Government to improve SOE ownership arrangements, accountability, and performance.

The TA had five approved outputs:

- (i) a sound government policy on SOE ownership, performance, and divestment;
- (ii) private sector participation in prioritised SOEs;
- (iii) adequate legal and regulatory frameworks for those sectors in which privatised SOEs will operate;
- (iv) reporting and performance monitoring regime for SOEs that will remain under State ownership; and
- (v) on-the-job training for key stakeholders in government and SOEs.

21 person months of international consulting time and 18 months of domestic consulting time were allocated to five international and domestic consultants working with counterparts in the Executing Agency, the Ministry of Finance, National Reform and Planning and its Economic Reform Unit. The consultants included an International Privatisation Specialist and Team Leader, an International Corporate Governance and Financial Specialist, an International Legal and Regulatory Expert and Domestic Financial and Legal Experts. An initial output of the TA was an analysis of major issues in SOE reforms in the Solomons (refer Annex 1 SOE Reforms Issues Analysis).

There were difficulties in making early progress with the first TA output: a sound government policy on SOE ownership, performance, and divestment. First, more work was needed to get majority Cabinet commitment to the reform process. Secondly, long-term reforms became a low priority in the political instability before and after national elections (April 2006). Thirdly, more work was needed to build up local stakeholder awareness and capability relative to the scope and complexity of work required.

Fortunately, tri-partite agreement was reached on the problems and their solutions. Government counterparts, consultants, and ADB agreed that a temporary refocus on capacity development and awareness building – especially for SOE management and boards, their professional advisers, and official policy advisers – was needed prior to any serious reform action. These stakeholders were engaged in a process of problem analysis and solution design through a reference group of key stakeholders, a programme of workshops on governance and the need for legislative change (refer Annex 2 SOE Governance Discussion Paper), the presentation of an indicative new SOE Act; and by August 2006 a summary set of papers was prepared for ERU in the form of a “package” of Cabinet papers proposing a comprehensive program of SOE reforms. This process was successful in building skills and capacity, instilling confidence in the need for change, and creating a “peer support network” among SOE managers. In this way, wider and stronger external stakeholder understanding and support was created for an SOE reform programme, with an emphasis on better performance in sustainable service delivery, and the required policy actions were agreed with ERU. The “Cabinet package” took time for ERU to digest but, in September 2006, a SOE GMs’ Forum meeting helped reinforce the messages that these reforms were needed to achieve the new government’s objectives, and SOE GMs were keen supporters of these reforms.

Over this time, stakeholder understanding and support was also built for the ideas in TA Output 3, namely that, if government wants to protect consumers, effective regulation is an alternative to ownership of a monopoly service provider.

A draft summary paper on SOE reform action was prepared in late November 2006 and expected to be presented to Cabinet for approval in early December 2006. This included recommendations on introduction of a consistent legislative framework for SOEs (an SOE Act – refer Annex 3 Draft SOE Act); a Government Policy Statement on SOE ownership and regulation; provision for CSOs; requesting donor support to update SOE financial accounting and reporting; and clarifying SOE goals and performance targets. In the event this was not presented to Cabinet in December.

On returning to Honiara in late January 2007, the TA simplified the paper to focus mainly on securing Cabinet approval for drafting a new SOE Act, reflecting feedback from PS Macro-Policy. Work on the 2007 Budget (presented on 8 February) and key ensuing Budget debate meant that key officials were unable to focus on the revised draft Cabinet paper until after Parliament had recessed on 23 February, but the Budget speech, as approved by Cabinet, included specific policy commitments to all the major elements of the recommended reform program: a new SOE Act this year; updating all SOE accounts; developing and publishing service delivery targets for all SOEs; reviewing consumer protection laws; and replacing annual subvention payments with targeted subsidies for mandated services – conditional on proof of good governance and a financial justification.

To help focus on action now needed to implement these SOE reforms, the TA prepared a draft Action Plan (refer Annex 4 for SOE reforms Implementation Action Plan) to enable officials and the Minister of Finance to see more clearly the various aspects of the envisaged reforms, their linkages and extent to which they can proceed separately, and likely time frames. A simplified high-level summary (refer Annex 5 for SOE Act Implementation Plan Summary) was attached to a revised draft Cabinet paper (refer Annex 6 Summary Draft Cabinet Paper on SOE Reforms) to formalise action on the Budget decisions. This paper was submitted to the Minister in late February, but (at the time of writing) has not yet been submitted to Cabinet. The Minister has indicated that Cabinet will consider the paper at its meeting on 15 March and that he expects the paper's recommendations to be adopted. In this event, Department of Finance and Treasury officials would be directed "to provide drafting instructions to the Attorney General's Chambers for an SOE Bill - which is based on international best practice but tailored to Solomon Island conditions - in time for introduction at the next sitting of Parliament" (expected to be in June 2007).

The second TA output, private sector participation in prioritised SOEs, involved initial identification of target PSP initiatives and carrying out of preliminary work on a number of SOEs. TA work on specific SOEs included (i) resolving the status and future of the assets and liabilities of the former Livestock Development Authority after four to five years of no real progress – the TA helped arrange payments to former staff and commercial creditors, and land and other assets which had been “frozen” were made available for productive use by Government, former owners, etc; (ii) advice and inputs to the General Manager and new Board of the Commodities Export Marketing Authority (CEMA) re restructuring CEMA to exit all commercial functions in favour of increased private sector participation; (iii) support for the new Chairman of Solomons Islands Printers Ltd to develop and implement a “turnaround” strategy based on full

commercialisation and restructuring the balance sheet; (iv) support for the management team of Solomon Islands Post to conduct a strategic stocktake of options based around increased outsourcing of bureau services and Public Private Partnerships with a commercial bank and a money transfer firm. In addition, advice and inputs were provided on existing ERU initiatives such as Solomon Airways, SIEA, SIWA, and Sasape Marina. The major transaction (incomplete as of the time of writing) involved implementing a SIG policy decision to combine Home Finance Limited with the housing activities of National Provident Fund, subject to meeting NPF commercial criteria.

In late November 2006 the TA utilised the Finance Minister's renewed focus on amalgamating HFL and NPF housing schemes to draft a paper for him to present to Cabinet in early December 2006 seeking Cabinet approval for a strategy to sell HFL to NPF and for its implementation to start immediately (refer Annex 7 Draft Cabinet Paper on Strategy to Sell HFL to NPF). Cabinet approved the sale strategy and process on 1 February 2007 when the paper was finally presented to it. Since then the TA has continued to assist HFL and PS Finance to prepare to implement the sale process. This has involved drafting sale-process documentation and further compiling information on HFL for the "due diligence" inspection by the prospective buyer (NPF) and by the HFL Board. There remain several weeks work yet to complete compilation of information needed to facilitate due diligence.

The TA's third output, adequate legal and regulatory frameworks for those sectors in which privatised SOEs will operate, saw the TA developing sector stakeholder understanding and support, and securing ERU and PS Finance support, for an economy-wide approach to economic regulation rather than a sector-specific approach. A workshopped stakeholder discussion paper (refer Annex 8 Economic Regulation Discussion Paper) and then a Cabinet paper were drafted on economic regulation for all sectors, including for privatised SOEs. The TA work on this matter was completed but had been extended to cover proposals for a regulatory policy and regime of general application, rather than SOE-specific or sector-specific policies and legal frameworks. Cabinet support for the recommended approach has yet to be confirmed, but the approach is included in the latest Cabinet paper.

In terms of a reporting and monitoring regime for SOEs remaining under state ownership, the TA found that there was, with a couple of exceptions, almost no regular, timely and relevant performance reporting to boards, executive management and SIG (refer Annex 9 Stocktake of SI SOE Finances). Following understanding and support from the Auditor General, the TA obtained policy support from PS Finance and Minister of Finance for two Cabinet papers, one for establishing timely reliable up-to-date audited financial reporting by all SOEs; and another for implementing a sector-wide approach to SOE performance reporting and improvement. Initially a two-part approach was used: (1) SI Post was approached to be the primary "reference site" to trial and demonstrate to other SOEs that it is possible for SOEs to implement the internal changes needed to produce reliable timely performance measurement and reports based on those measurements; and that the boards and management get real advantages from these changes; and (2) the Investment Corporation of the Solomon Islands (ICSI), which is the holding company for a number of SOEs, and had a number of commercially-experienced and well-respected directors within the group, was approached to provide a good example of promoting timely and reliable reporting to shareholders.

Considerable progress was made with SI Post through to September 2006 on understanding their business issues and organisational strengths and weaknesses, then suggesting improved analysis and reporting in conjunction with induction of their new board. But the loss of their general ledger for 2001-2004 undermined efforts to use them as an effective model. The ICSI GM and Board had to concentrate on issues in their larger investments, but their efforts to improve reporting by their smaller subsidiary companies like SI Printers Ltd and Sasape Marina also helped to expose the limits of good governance efforts in the face of missing financial records – the same situation as at SI Post. A third initiative was launched, in collaboration with the Office of the Auditor-General and the Prime Minister’s Office, to directly address and resolve this very widespread problem of late and/or missing SOE financial records. This emerged as a fundamental barrier to progress – not only progress with better reporting but also with strengthening the very foundations of SOE accountability and good governance.

The final TA output required on-the-job training/capacity building for key stakeholders in government and SOEs. The TA had success in identifying and mobilising potential “change champions”, key stakeholders at SOE CEO/GM and board level who were prepared to lead early performance improvement initiatives and also act as examples to others. Re-usable performance improvement training material was produced on such topics as financial planning and analysis, organisational performance reporting and corporate planning. Pijin versions of some materials were developed in collaboration with the local ERU counterpart, who was supported in gaining experience in its use, acting as a co-presenter at a workshop. Local team members were also trained and involved in delivering workshops, so as to build their capability to act as local trainers during and after the TA. Overall, the local team members have acquired considerable extra capability to be effective supporters and practitioners of further SOE reform: they are well-informed advocates of the policy approach, experienced in the processes of problem analysis and design and solutions, and increasingly skilled in implementation of the solutions.

Within the limits of missing records and unaudited financial statements, a financial stocktake of the SOE portfolio, examining trends in Solomon Islands State Owned Enterprises Finances, was developed early in the TA. This initially served to highlight the extent to which SOEs were unaccountable for their actions, and operated beyond any effective central control by SIG. It was updated as further information became available throughout the remainder of the TA. It shows the status of these twin problems of SOEs not being accountable for their actions and not being responsive to government policies, and serves as a tool for ERU in monitoring and reporting on the aggregate impacts of SOE financial performance (refer to Annex 9 Stocktake of SI SOE Finances).

Additional work program activities undertaken during the TA included managing the interface with other TA and development assistance programs involving SOEs; working with selected individual SOEs (rather than operating on a sector wide basis as originally planned) on identifying and remedying performance problems; and using a TA “Reference Group” to provide guidance and feedback on matters requiring local knowledge and understanding, such as issues identification, stakeholder management, and customisation of technical solutions.

Although the paper submitted to Cabinet in late February 2007 focused only on the immediate action required, the TA’s recommended approach to SOE reform and PSP remains as summarised in the earlier draft Cabinet papers on SOE Reforms:

- i) Passing a State-Owned Enterprise Act to introduce an effective and consistent framework for good governance across all state-owned enterprises;
- ii) Implementing a four-part initiative (extra accountants, auditors, a “clean up team” and OAG Special Audit support) to produce up-to-date audited financial statements;
- iii) Improving SOE performance through addressing the following priorities: bringing financial management reporting up to date; identifying and resolving debt issues; adequately providing for doubtful debts; commencing preparation of business planning; considering changes to the SOE business model to require pre-payment by customers; updating asset registers and revaluing significant assets, and preparing updated realistic budgets for the current year, with projections for the following two financial years;
- iv) Through a formal SIG planning process or otherwise, clarifying SOE objectives, SIG expectations of SOE performance and linking planning to SIG budgeting;
- v) In the area of economic regulation, issue a Government Policy Statement on licensing regimes not preventing competition; price setting processes to include public consultation and expert advice; showing that various SOE reforms are proceeding from a common framework in a consistent way that will give consumers a reasonable deal; and opens up privatisation as a reform option in appropriate circumstances;
- vi) In implementing the initiatives to produce up-to-date audited financial statements, clarifying SOE objectives, and getting better and more consistent results from economic regulation of SOEs, ensure that existing legislation is strictly complied with, including existing statutory procedures and restrictions;
- vii) Late November 2006 discussions between the TA and senior officials of the Department of Finance and Treasury essentially resolved the future role of the Investment Corporation of Solomon Islands (ICSI). The resolution comprises two elements: (1) Cabinet agreement that transforming SOEs into successful businesses depends crucially on ensuring that the boards of directors appointed to oversee each SOE comprise people whose combined skills and experience enable them to perform this role effectively; and (2) noting that where an insufficient mix of people is available to oversee effectively a particular SOE, as a transitional measure the government has the option of relying on ICSI to own the SOE as a subsidiary and oversee its performance until sufficient directors with the required skills either become available or are trained, after which ICSI would be required to transfer ownership of the subsidiary to the government.

This means that ICSI’s role does not need to be enshrined in legislation, with some attendant risks, but remains a viable transitional option where insufficient suitably skilled people are available to oversee an SOE. Full details of what this will entail and its legislative implications will be resolved by the TA in conjunction with the Department of Finance and Treasury shortly in the context of preparing drafting instructions for the Attorney General;

- viii) Publication of SOE performance targets for service delivery; and a regime of performance reporting to Ministers; and developing an SOE Monitoring Unit within the MOFNRP for performance monitoring and advice to the Minister of Finance on SOE ownership issues (these requirements would be developed in the context of introducing an SOE Act);

- ix) For implementation of an SOE Act, as in other countries Solomon Islands would likely benefit from a delayed implementation date (e.g. passing the Act in mid 2007 with effect from 1 January 2008). This would give both SOEs and officials more time to prepare properly for their new responsibilities and, thereby, increase the likelihood of successful implementation; and
- x) If SIG resolves to focus on core functions of government, and divest business activities, development of a broadly-based “Alternative Service Delivery” framework of policies and practices for SOE action and PSP involvement should be considered.

## **1. Introduction**

This Final Report presents the results of ADB TA No. 4482-SOL: State-Owned Enterprise Reforms & Private Sector Participation. It describes in detail consultant activities and achievement of outputs. In addition, to help in drawing lessons for future reform, this report:

- compares activities and outputs with plans – the original plan and the amended plan agreed in response to the Mid-term Report – and comments on the variations;
- summarises the issues to be addressed in order to make better progress with future reforms of State-Owned Enterprises (SOEs), and suggests solutions to those issues; and
- outlines suggested future activities for SOE reform after the TA finishes at the end of the first quarter 2007.

### **1.1 TA Objectives**

The goal of the TA was to support the SIG, through the Economic Reform Unit (ERU) of the Ministry of Finance, National Reform and Planning, in its efforts to improve the environment for the private sector, in line with the strategic focus of ADB's country strategy and program for Solomon Islands. The purpose of the TA was to assist the Government to improve SOE ownership arrangements, accountability, and performance.

### **1.2 Planned TA Outputs**

The five approved TA outputs were:

- a sound government policy on SOE ownership, performance, and divestment;
- private sector participation in prioritised SOEs;
- adequate legal and regulatory frameworks for those sectors in which privatised SOEs will operate;
- reporting and performance monitoring regime for SOEs that will remain under State ownership; and
- on-the-job training for key stakeholders in government and SOEs.

### **1.3. Planned TA Inputs**

A total of 21 person months of international consulting time and 18 months of domestic consulting time was allocated to this TA. Under the contract between the ADB and Vinstar, the TA was scheduled to be completed by 31 March 2007. The allocation of consulting time by TA team members was as follows:

- International Privatisation Specialist/Team Leader – 9 months
- International Corporate Governance and Financial Specialist – 8 months
- International Legal and Regulatory Expert – 4 months
- Domestic Financial Expert – 12 months
- Domestic Legal Expert – 6 months

### **1.4. Mobilisation of Consultants**

The International Privatisation Specialist/Team Leader made a total of 5 field visits to Honiara between May 2005 and March 2007. Eight field visits were scheduled by the

International Corporate Governance and Financial Specialist and four by the International Legal and Regulatory Expert. All three international consultants also contributed inputs from home office. The domestic Financial Expert and Legal Experts contributed on an intermittent part time basis over the duration of the project.

## 2 Achievement of Planned TA Outputs

This section reviews each of the planned TA outputs, and summarises actions taken, written outputs produced, achievements and issues that will influence long-term success, and future suggested action.

It also comments on work that was not included in the original Terms of Reference. This additional work was confined to “interface issues” in related areas of policy or practice. That work became necessary to remove obstacles to progress and/or take advantage of opportunities to create conditions more favourable to achievement of the planned outputs.

### 2.1 Sound government policy on SOE ownership, performance, and divestment

Actions Taken	Reference
<ul style="list-style-type: none"> <li>Undertook situation analysis, based on available ERU documentation of existing policies, including earlier TA reports; interviews with ERU &amp; ICSI GM; inputs from local team members.</li> </ul>	SOE Reforms Issues Analysis, <b>Annex 1</b>
<ul style="list-style-type: none"> <li>Identified issues with formal policies &amp; actual practices, and the wider institutional context for both.</li> </ul>	As above
<ul style="list-style-type: none"> <li>Prepared and presented initial conclusions and recommended actions at a workshop for ERU; and used draft Q&amp;A, discussion papers, etc to illustrate and expand on recommended approach.</li> </ul>	The Case for Change, <b>Annex 10</b>
<ul style="list-style-type: none"> <li>Developed a discussion paper on governance aspects of SOE ownership and performance, and delivered it initially to ERU then to seminars of SOE directors and CEOs/GMs plus other stakeholders in SOE reform.</li> </ul>	SOE Governance Discussion Paper, <b>Annex 2</b>
<ul style="list-style-type: none"> <li>Documented the results of the discussion (feedback from participants and TA answers/comments); circulated them to participants; then staged a second round of workshops for stakeholders to discuss the implications, with Minister of Finance giving lead speech and gaining media coverage for issues.</li> </ul>	Feedback at SOE Governance Presentations, <b>Annex 11</b> +
<ul style="list-style-type: none"> <li>Advised ERU on policy framework for ongoing process of divestment of SolAir.</li> </ul>	October 2005
<ul style="list-style-type: none"> <li>Prepared a discussion paper for ERU on equity and SIEA recapitalisation issues.</li> </ul>	Governance Workshops, <b>Annex 12</b>
<ul style="list-style-type: none"> <li>Advised ERU on issues to be addressed on possible divestment of Sasape Marina and SI Printers</li> </ul>	Privatisation Issues, <b>Annex 13</b>
<ul style="list-style-type: none"> <li>Prepared a discussion draft SOE Act and refined it in light of feedback from ERU officials.</li> </ul>	Draft SOE Act, <b>Annex 3</b>
<ul style="list-style-type: none"> <li>In August 2006 drafted set of Cabinet papers for the SOE reform programme, including a summary paper on SOE reform, policy approval for a SOE Act, proposal for achieving up-to-date and audited SOE accounts, clear SOE objectives focused on contributions to strategic development goals, published measurable performance targets, and defined Community Service Obligations.</li> </ul>	Draft Cabinet Papers, <b>Annexes 14 to 20</b>
<ul style="list-style-type: none"> <li>In November 2006, in light of senior official feedback (PS Macro-Policy), prepared succinct single Cabinet paper summarising the case for SOE reforms and incorporating the key recommendations in the set of detailed papers prepared in August 2006.</li> </ul>	Draft Cabinet Paper, <b>Annex 21</b>
<ul style="list-style-type: none"> <li>In January &amp; February 2007, further streamlined the previous draft Cabinet paper, in light of further official feedback, to focus basically on obtaining approval for</li> </ul>	Draft Cabinet Paper, <b>Annex 6</b>

<p>drafting a new SOE Act in time for its introduction in 2007.</p> <ul style="list-style-type: none"> <li>• TA, ERU and Law Draftsman reached a common understanding of the policy and cabinet processes, and the legislative process; and agreed on respective roles for taking the SOE Act through these processes.</li> <li>• Helped to stage a number of SOE GMs’ Forums to facilitate communication between SOEs and government; and help construct a sector-wide picture of issues and, thereby, encourage senior managers to collaborate to resolve them.</li> <li>• Developed a draft SOE reform implementation Action Plan in 2007 to help ERU and SIG to appreciate and manage: the range tasks needed to implement the reforms envisaged; the links between tasks (including critical dependencies); people responsible for carrying them out; key milestones to be achieved, and the targeted/ likely time frame for achieving tasks and milestones.</li> <li>• Sought further available information to update the November 2006 SOE financial stock-take report and, thereby, enable SIG to make better informed decisions on the future of individual SOEs.</li> </ul>	<p>Seminar Program <b>Annex 22</b> + Governance Presentations, <b>Annex 23</b></p> <p>Reforms Action Plan <b>Annex 4</b> + Act Plan Summary <b>Annex 5</b></p> <p>Stocktake, <b>Annex 9</b></p>
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<b>Achievements</b>
<ul style="list-style-type: none"> <li>• Among SOEs and their local advisers, built understanding, trust and support for the reform’s central focus – good governance as the tool for performance improvement – and the need for an SOE Act;</li> <li>• Demonstrated that local capability could be built to met the proposed requirements under the new SOE Act by helping individual SOEs, and their local accounting and legal advisers to make governance improvements with existing resources.</li> <li>• Among relevant officials – including PS Finance, PS Planning, Prime Minister’s Chief of Staff, and ERU counterparts – built SIG’s understanding and support for an SOE reform programme, based around an SOE Act, with emphasis on better performance in sustainable service delivery. Also built SIG’s confidence in local readiness and willingness to reform - for example, in September 2006, the views expressed by participants at an SOE GMs’ Forum meeting helped demonstrate to SIG that these reforms were needed to achieve the new government’s objectives, the changes were achievable because some individual SOEs were already applying these principles in practice, and that most SOE GMs were keen supporters of these reforms.</li> <li>• Among SOEs and relevant officials, also built stakeholder understanding and support for idea that effective regulation is an alternative to ownership of a monopoly service provider (especially through discussion paper under Output Three – see below).</li> <li>• The Minister of Finance in the 2007 Budget announced the key SIG policy decisions that were needed to implement the proposed program of SOE reforms, including: a new SOE Act this year; updating all SOE accounts; developing and publishing service delivery targets for all SOEs; reviewing consumer protection laws; and replacing annual subvention payments with targeted subsidies for mandated services – conditional on proof of good governance and a financial justification.</li> <li>• The Minister of Finance has indicated he will submit a paper on an SOE Act to Cabinet for consideration on 15 March 2007, seeking Cabinet’s approval for the Department of Finance and Treasury officials “to provide drafting instructions to the Attorney General’s Chambers for an SOE Bill – based on international best practice but tailored to Solomon Islands conditions – in time for introduction at the next sitting of Parliament” (which is likely to be in June 2007).</li> </ul>

### Issues

- A continuing effort will be required to build and retain trust in SOE reform and overcome deep-seated opposition caused by a strong negative local perception – based partly on past experiences – that SOE reform is focussed solely on divestment; is driven more by ideology than proven practical benefits; and/or is inappropriate for Solomon Islands circumstances.
- The inter-dependence of the different parts of the SOE reform program is both a strength and weakness – there is increasing appreciation of how the various elements can and should fit together, but that does make the reform package larger and more challenging and time-consuming for the government to progress in total.
- It will take years – not months – to improve SOE performance in terms of reliable, cost-effective service delivery and financial viability by overcoming three key current weaknesses: inadequate governance and accountability arrangements for SOEs; a general lack of reliable, up-to-date financial information on SOEs to enable directors and managers to make well-informed decision and be held accountable for them; and a shortage of people with the necessary commercial skills and experience to be effective SOE directors and SOE managers (it helps that the first and second of these have been publicly acknowledged by SIG in the 2007 Budget speech).

### Recommended Future Action

- Stakeholder management will be helped by continuing SOE GMs' Forums – a TA innovation that was taken over and will be continued under the joint sponsorship of Permanent Secretaries of Finance and Planning.
- Especially given the statements from senior officials about government wanting to quit ownership and operation of service delivery functions (see below) it may become increasingly important to ensure that government is well-informed about the benefits of “better regulation” rather than “more regulation” of major service providers.
- As noted below (s. 2.5) under training and capacity building, Solomon Islands may benefit from a delayed implementation date for a new SOE Act – e.g. passing the Act mid 2007 with effect from 1 January 2008. This would give both SOEs and officials more time to prepare properly for their new responsibilities.
- If government does adopt and implement a “minimalist” approach that it has outlined for core government functions – especially the idea that the private and NGO sectors take over central government ownership of service delivery capabilities, this would suggest that divestment of business activities to focus on core functions of government may come on to the political agenda. This would imply a broadly based “Alternative Service Delivery” (ASD) framework of policies and practices within which SOE-by-SOE analysis and action would take place. An ASD framework would include:
  - clarity about which services should have specific community policy objectives, and which should be left entirely to market-based decision-making – this would link to the government’s announced emphasis on participatory planning to identify and prioritise community policy objectives.
  - clear and public performance specifications and measurements for those services that are subject to community policy objectives – this could link to the government’s announcement of an enhanced role for provincial bodies and NGOs (especially the churches) in monitoring and supplementing the service delivery performance of central government.
  - well-designed procedures supported by expert resources to run a scheme for targeted subsidies for non-commercial service delivery (“Community Services Obligations” - CSOs) – including permanent resources such as templates for contracting and reliable transparent contract tendering and contract administration, backed by ad hoc expert resources skilled and active in contract specification, contract monitoring, and enforcement (experience is already being gained through ERU’s role in March 2007 moves to tender for private supply of extended rural banking services)..

## 2.2 Private sector participation (PSP) in prioritised SOEs

Actions Taken	Reference
<ul style="list-style-type: none"> <li>• Reviewed past and existing ERU initiatives to divest SOEs and/or implement other alternatives to government ownership; analysed situation; identified issues; and modified draft work plan accordingly.</li> <li>• Identified target PSP initiatives that the TA would tackle and carried out preliminary work.</li> <li>• Performed legal and policy analysis of LDA winding up which led to a recommended change in approach. Consultation and collaboration with relevant officials (debt management, payments, ERU, Attorney General's Office) to develop and implement solutions for staff owed unpaid wages, commercial creditors, and "frozen" land and fixed assets.</li> <li>• Provided advice and inputs to the General Manager and new Board of the Commodities Export Marketing Authority (CEMA) re restructuring CEMA to exit all commercial functions in favour of increased private sector participation.</li> <li>• Provided advice and inputs for the new Chairman of Solomons Islands Printers Ltd to develop and implement a "turnaround" strategy based on reversing past policies of excessive staff loans, introducing full commercialisation (e.g. proper job costing and period contracts for repeat business), and restructuring the balance sheet – including possible sale of prime real estate not needed for commercial operations. Later ran a seminar for Solomon Island Printers Ltd to discuss both job pricing by the company, and options for its future.</li> <li>• Provided advice and inputs for the management team of Solomon Islands Post to conduct a strategic stocktake of options based around increased outsourcing of bureau services and Public Private Partnerships with a commercial bank and a money transfer firm.</li> <li>• Completed an initial analysis and consultation regarding PSP solution to future of Home Finance Co Ltd. The pre-requisite to further action on HFL was valuation of the loan portfolio, valuation of its real estate assets (including owned in "fixed term estate" and assigned as loan collateral), and assessment of bad debt provisioning by the domestic financial consultant. However during the first year of the TA, and prior to the policy decisions of the new government concerning HFL and NPF, cooperation was not forthcoming from the company in arranging meetings to access information needed, blocking progress.</li> <li>• Liaised with ERU, other PSP consultants to ERU, and ADB, and gave feedback re the implications that the current and proposed legal framework have for related ADB-funded TAs.</li> <li>• Analysed and advised on existing ERU initiatives, including ERU decision to commence privatisation of both Sasape Marina and Solomon Islands Printers - the TA provided copies of pro-forma documents for privatisation, analysed and advised on commercial issues and government policy decisions impacting on value and viability, made suggestions on how each privatisation should proceed, and helped ICSI to undertake pre-sale "grooming" of SI Printers to enhance value, and test validity of current pricing policies.</li> <li>• As regards the proposed amalgamation of HFL and NPF housing schemes, once the new government policy emerged the TA: <ul style="list-style-type: none"> <li>- Resolved conflicts of interest issues over appointment of TA team member and NPF board member (Gabriel Suri) as HFL chairman.</li> <li>- Advised PS Finance as HFL shareholder and incoming HFL board chairman on implementing a SIG policy decision to combine HFL with</li> </ul> </li> </ul>	<p>SOE Status &amp; PSP Opportunities, <b>Annex 24</b></p> <p>LDA Lands, <b>Annex 25</b> + Winding Up LDA, <b>Annex 26</b> + Assets/Liabilities of LDA, <b>Annex 27</b></p> <p>CEMA Presentation <b>Annex 28</b></p> <p>Turnaround Presentation, <b>Annex 29</b> + Financial Presentation, <b>Annex 30</b></p> <p>Strategic Stocktake, <b>Annex 31</b></p> <p>Analysis and Consultation, <b>Annex 32</b></p> <p>Planning for SOE Reforms, <b>Annex 33</b></p> <p>Sale Preparation, <b>Annex 34</b></p>

<p>the housing activities of National Provident Fund – subject to meeting NPF commercial criteria.</p> <ul style="list-style-type: none"> <li>- Provided advice and support to the new board on responsibilities of directors and issues such as conflict of interest.</li> <li>- Secured HFL board support for proposed approach.</li> <li>- Designed and initiated detailed work on evaluation of assets and liabilities as a basis for (1) HFL Board to enable “due diligence” by NPF; and (2) the TA to advise SIG on a possible transaction.</li> <li>- Undertook legal analysis which revealed that most HFL mortgage documentation has been registered under the names of HFL’s predecessors, and will at some stage need to be re-registered – briefed the chair of HFL on this issue.</li> <li>- Helped NPF respond to Finance Minister’s mid-November 2006 invitation to submit a plan of action to progress the amalgamation of the HFL and NPF housing schemes.</li> <li>- Prepared analysis of sale strategy issues made available to all the parties involved to ensure they share a common understanding and acceptance of the parameters within which a mutually acceptable sale /purchase agreement is likely to occur.</li> <li>- Briefed Department of Finance and Treasury officials and the Minister of Finance on a strategy for the sale of HFL to NPF, which included the fallback option of a competitive sale process if a mutually acceptable sale price cannot be reached via bilateral negotiations.</li> <li>- Prepared HFL sale strategy draft action plan in November 2006 for managing/monitoring the sale process, and currently revising this plan to reflect delays in implementing various aspects of it.</li> <li>- Drafted Cabinet paper on HFL/NPF sale strategy (in late November 2006), seeking Cabinet approval for the strategy and an immediate start to implementing it. This paper sought approval on the basis that SIG expected future HFL housing schemes to be on a fully commercial basis (as expressly stated by the Minister of Finance). Previously the TA had understood that a degree of subsidisation may have been envisaged.</li> <li>- In early December, the TA drafted a brief Request for Tenders for HFL to seek professional services to value its real estate interests, including real estate owned by HFL and real estate assigned to HFL as loan collateral.</li> <li>- In February 2007, once Cabinet had endorsed the sale strategy and process, the TA briefed separately members of the HFL board, NPF board, and officials of the Ministry of Ministry and Treasury, on the next steps in the sale process and their respective roles and duties.</li> <li>- Since early February 2007, the TA has focused on assisting HFL to continue to compile vital information required to facilitate a “due diligence” inspection of HFL’s business operations and prospects, and its assets and liabilities.</li> <li>- Also in February 2007, the TA has begun preparing some of the key formal documents required to enable the sale process to proceed, including a draft Heads of Agreement, with a draft Sale and Purchase Agreement in preparation (as at the time of writing)</li> </ul> <ul style="list-style-type: none"> <li>• In late February 2007, the TA received an informal expression of interest in the possibility of purchasing Sasape Marina Ltd and investing in restoring its seriously run-down marine slipway facilities at Tulagi and developing an apprenticeship scheme for skilled trades people required for this industry. The TA plans to report to ERU officials before the end of March 2007.</li> </ul>	<p>NPF Board Resolutions, <b>Annex 35</b> + Advice for HFL Chair, <b>Annex 36</b> + Speaking Notes, <b>Annex 37</b></p> <p>Action Plan for HFL, <b>Annex 38</b></p> <p>HFL and Affordable Housing, <b>Annex 39</b></p> <p>Sale of HFL, <b>Annex 40</b></p> <p>HFL Sale Process, <b>Annex 41</b></p> <p>Cabinet Paper, <b>Annex 7</b></p> <p>RFPs to Value Property, <b>Annex 42</b></p> <p>HFL Sale Process Briefing, <b>Annex 43</b></p> <p>Draft Heads of Agreement, <b>Annex 44</b></p>
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### Achievements

- Developed legal opinions that resolved the status and future of the assets and liabilities of the former Livestock Development Authority: this overcame problems that for some years had stalled release of the assets into productive use, and delayed payment of ex-staff and other creditor claims.
- Resolved the status and future of the assets and liabilities of the former Livestock Development Authority after four-five years of no real progress – the TA helped arrange payments to former staff and commercial creditors, and land and other assets which had been “frozen” were made available for productive use by Government, former owners, etc.
- The GM of CEMA has facilitated the outsourcing of Ministry of Agriculture farm extension services to contractors previously working for CEMA, and developed proposals for restructuring the organisation’s balance sheet so as to extinguish remaining debts, free land and assets for commercial use, cease all commercial trading activities, and refocus the operations on export certification based on ISO procedures.
- On 2 February 2007 Cabinet endorsed the HFL NPF sale strategy and sale process, as recommended in the draft Cabinet paper prepared by the TA in November 2006, thereby enabling the sale process to progress.
- Minister of Finance accepts that the successful sale of HFL to NPF, while relatively small in financial/resource terms, would have value beyond its size as an example of a successful privatisation (i.e. yielding worthwhile tangible services benefits to the people and financial benefits to the government). It would also show that these benefits stem from clear commercial goals, better management and governance and accountability arrangements.

### Issues

- Initially barriers were placed in the way of TA access to financial information, then the true extent of the problems of late and incomplete financial statements emerged over time.
- In some of those few SOEs where the TA had access to the detail of business practices, the apparently excessive benefits received by the board, management and staff – especially through questionable means such as “advances” or “loans” that are not repaid – was a common problem. It is highly likely that this motivated these SOEs to resist private sector participation that would end such questionable practices.
- Despite support by some Cabinet Ministers for some PSP actions, at Cabinet level the previous government did not have a transparent or operational policy for PSP. The current government announced that it intended to overcome past problems caused by a lack of transparent or operational policies across all sectors, but this was naturally taking time to work through.

### Recommended Future Action

- To simplify the issues, three areas will determine the future use of PSP in SOE reform:
  - leadership through policy clarity and action at Cabinet level
  - integrity through action to restore good corporate governance at board and management levels
  - transparency through published, timely and reliable (audited) reporting.
- Dealing with each in turn:
  - The new policy framework is now at the crucial stage of “translation and implementation” when detailed policies and plans are being developed. Cabinet’s response to the SOE reform package will determine the future path and priority for SOE reform. If, in addition, Cabinet agrees to implement the proposed strategy for selling HFL to NPF, the result of this sale could provide a valuable champion of the benefits of privatisation that could encourage the government to progress further privatisations.
  - Company directors with a proven track record in good corporate governance are scarce. The ICSI model could be extended to become a holding company for all SOEs that monitored and mentored directors of all subsidiary companies. Longer-term, outsourcing, with a strong emphasis on

service delivery performance, may be a more powerful and more practical way to overcome the danger that bad practices are even more widespread and deep-seated than the TA has been able to observe, and that such SOEs will therefore resist any PSP reforms – especially resisting preparatory external scrutiny and analysis – because their management, staff and directors are more concerned with their personal benefits than the intended benefits for the nation and their intended customers.

- Unless and until an initiative is launched to complete up-to-date audited annual financial statements for all SOEs, it will be very difficult to make progress in applying standard divestment/PSP approaches.
- Published, simple performance objectives for service delivery that ordinary customers of SOEs can monitor for themselves would bring transparency to the most important area: results in terms of services to the people who are intended to benefit from the SOEs' existence.

### 2.3 Adequate legal and regulatory frameworks for those sectors in which privatised SOEs will operate

Actions Taken	Reference
<ul style="list-style-type: none"> <li>• Performed initial situation analysis and issues identification, which led to conclusions that:                             <ul style="list-style-type: none"> <li>- a SOE Act supplemented by Community Service Obligations was required to provide a framework that would apply strong commercial disciplines to SOEs that were NOT privatised and, in addition to the direct benefits of such a move, would reduce the difficulties in transitioning from public to private ownership;</li> <li>- a SOE reform perspective did not suggest there was no reason for changing the current sector-based legal and regulatory solutions to technical standards and health and safety objectives.</li> <li>- a sector-based approach to economic regulation was inappropriate – whether it applied to all SOEs or to each of the separate sectors in which the main public utility SOEs operate.</li> </ul> </li> <li>• With ERU support, extended this legal/public policy analysis to laws and practices of economic regulation that apply across all areas of the economy.</li> <li>• Prepared supporting analysis of issues commonly addressed by regulation – this analysis examined in what ways the SI issues differ from and/or resemble the issues faced by other comparable countries.</li> <li>• Developed a discussion paper, workshopped it with stakeholders, and gave a presentation to ERU on where and how economic regulation could be improved.</li> <li>• Provided stakeholders and ERU with briefings summarising how the TA's proposals on economic regulation would work in practice, and reassuring them that they are compatible with the other broad area of sector-specific regulation (especially technical and safety-related regulation).</li> <li>• Reached agreements in principle with PS Communication and Transport and the Telecommunications Authority regarding the compatibility of the TA's economic regulation proposals with their proposals for telecommunications and air transport.</li> </ul>	<p>Analysis for Legislative Framework, <b>Annex 45</b></p> <p>Economic Regulation Discussion Paper, <b>Annex 8</b></p>

<b>Achievements</b>
<ul style="list-style-type: none"> <li>• Improved sector stakeholder understanding and support, and secured ERU and PS Finance support for an economy-wide approach to economic regulation rather than a sector-specific approach.</li> <li>• Drafted Cabinet paper on economic regulation for all sectors, including for privatised SOEs.</li> <li>• The Minister of Finance in the 2007 Budget announced a review of consumer protection laws and regulations</li> </ul>

<b>Issues</b>
<ul style="list-style-type: none"> <li>• The 2007 Budget announcement of a review of “consumer protection laws and regulations” is a potential problem as well as a potential opportunity for improvements. This is because an unfortunate by-product of the TA’s fact-finding on current economic regulation was a proposed strengthening of an existing price control regime. This appeared to be a response to the TA’s finding that the current regime had fallen into disuse apart from price control of fuel – but the response ignored the TA’s finding that, because of the development of competition especially from imports, the failure to monitor and enforce other controls apparently was having only favourable consequences for consumers. Strengthening controls is therefore likely to be harmful to consumers. The TA has highlighted this danger to the ERU.</li> </ul>

<b>Recommended Future Action</b>
<ul style="list-style-type: none"> <li>• The TA completed its work on this matter – which was extended to cover proposals for a regulatory policy and regime of general application rather than SOE-specific or sector-specific policies and/or legal frameworks – but “ownership” of this expanded deliverable is unclear. Which officials will take responsibility – ERU or elsewhere in SIG?</li> <li>• Political support for the type of reforms we propose has yet to be confirmed.</li> <li>• There may be a danger that the policy direction is now “more regulation” rather than “better regulation”.</li> </ul>

## 2.4 Reporting and performance monitoring regime for SOEs that will remain under State ownership

<b>Actions Taken</b>	<b>Reference</b>
<ul style="list-style-type: none"> <li>• Performed initial situation analysis and issues identification, which revealed that in almost all cases there was no regular, timely and relevant performance reporting to government ministers, SOE boards or SOE top management.</li> <li>• Obtained understanding and support from Auditor General for an initiative to establish the basic foundation of timely reliable audited financial reporting by all SOEs, and made a joint presentation to the Permanent Secretaries’ Forum that secured general support from the PSs and specific sponsorship from then PS Finance – but change of government intervened before any implementation action began, and personnel changes removed the base of support.</li> <li>• Completed the work on financial reporting and performance monitoring by obtaining support of new PS Finance and, on his instructions, drafting a Cabinet paper proposing an initiative to establish the basic foundation of reliable audited up-to-date financial reports from all SOEs.</li> </ul>	<p>SOEs and National Planning Workshop, <b>Annex 46</b>; SOE Audited Accounts, <b>Annex 47</b>; SOE Reforms Presentation, <b>Annex 48</b> Draft Cabinet Paper re up-to-date SOE Accounts, <b>Annex 16</b></p>

<p>reliable audited up-to-date financial reports from all SOEs.</p> <ul style="list-style-type: none"> <li>• The TA found support among SOEs for improving financial and non-financial performance reporting to the Board and General Manager, but most SOEs were reluctant to expose the extent that their current performance reporting was weak or non-existent – and there was no pressure for them to change because there was insufficient understanding or commitment at board level to drive the required improvements.</li> <li>• Attempted to position ICSI as an “example of excellence” that imposed and practiced high standards in performance reporting and performance monitoring, and could possible operate as the driver of a longer-term SOE performance reporting and monitoring regime, but these discussions stalled partly because of unresolved political issues around whether or not there was a longer-term role for ICSI itself, and pressure on ICSI board and management to address other more immediate issues. Further, until such time as ICSI’s subsidiary companies produce financial reports on a timely basis, enabling ICSI to adequately report, using ICSI as such a model is not viable.</li> <li>• Built skills/awareness through tailored workshops for a selection of SOEs prepared to take the lead in adopting good practices – the intention was that these would be led by potential “change champions” who would provide an example to others that performance improvement initiatives can be implemented and do pay off in terms of benefits outweighing the costs of change.</li> <li>• Made limited progress with these targeted initiatives to create capability within SOE sector at three levels:             <ol style="list-style-type: none"> <li>1. reporting to board – used HFL board induction as model;</li> <li>2. reporting to management – piloted with NPF as a major then worked with SI Post (see below)</li> <li>3. reporting to the public – PS Finance is championing this initiative, and announced it to SOE GMs’ Forum; TA drafted a Cabinet paper on published performance targets for each SOE.</li> </ol> </li> <li>• With ERU local counterpart, Dalcy Tozaka, developed and jointly delivered (English and Pijin) further training in organisational performance measurement and management for SI Post.</li> <li>• Followed up with key SI Post managers by demonstrating a systematic approach to gathering data and analysis aimed at developing performance indicators and identifying where additional data is required for strategic and business planning.</li> <li>• Developed and delivered an alternative sector-wide solution that would drive reporting and performance monitoring through publication by each SOE of a short-list of observable performance targets for service delivery – see below under achievements.</li> </ul>	<p>e.g. Performance Measurement and Reporting for NPF, <b>Annex 49</b></p> <p>Draft Cabinet Paper, <b>Annex 17</b></p> <p>As for <b>Annex 49</b> – NPF</p> <p>SI Post Strategic Stocktake, <b>Annex 31</b></p>
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<b>Achievements</b>
<ul style="list-style-type: none"> <li>• Sought to establish one SOE as the primary “reference site” to trial and demonstrate to other SOEs:             <ol style="list-style-type: none"> <li>1. that it is possible for SOEs to implement the internal changes needed to produce reliable timely performance measurement and reports based on those measurements; and</li> <li>2. that the boards and management get real advantages from these changes.</li> </ol> <p>SI Post was initially chosen and considerable progress was made in August/September 2006 on suggesting improved analysis and reporting but the loss of their general ledger for 2001-2004 undermined further efforts to use them as an effective model.</p> </li> <li>• Gained policy support from PS Finance and Minister of Finance for two draft Cabinet papers             <ul style="list-style-type: none"> <li>• establishing timely reliable up-to-date audited financial reporting by all SOE; and</li> <li>• implementing a sector-wide approach to SOE performance reporting and improvement.</li> </ul> </li> <li>• The Minister of Finance in the 2007 Budget announced the key SIG policy decisions that were needed</li> </ul>

to implement the proposed program of SOE reforms, including updating all SOE accounts; and developing and publishing service delivery targets for all SOEs.

### Issues

- The practice of some SOE boards and managers awarding questionable and excessive benefits to themselves – noted in s.2.2 above – is not just an impediment to privatisation and other forms of private sector participation. It is also a barrier to performance improvement in SOEs remaining in government ownership. This is because tools of performance improvement, such as publication of up-to-date audited accounts, production of regular reports for boards and management, sound financial analysis of results, etc, would all expose these unacceptable practices.

### Recommended Future Action

- It has been agreed in principle with ERU that, under the proposed SOE Act, the Ministry of Finance needs a capability (“SOE Monitoring Unit”) for SOE performance monitoring and advice to the Minister of Finance on SOE ownership issues.
- A proper regime for performance reporting to Ministers will also need to be addressed as part of fully implementing the SOE Act.
- An initiative to achieve up-to-date audited accounts for all SOEs may be promoted by government to donors who would need to support it with a short-term team effort to get rid of the backlogs.
- This will need to be followed by capacity building on financial management planning and reporting which is also weak i.e. improved internal management reporting as well as external accountability reporting.
- Improving SOE performance will require addressing the following priorities: bringing financial management reporting up to date; identifying and resolving debt issues; adequately providing for doubtful debts; commencing preparation of business planning; considering changes to the SOE business model to require pre-payment by customers; updating asset registers and revaluing significant assets, and preparing updated realistic budgets for the current year, with projections for the following two financial years.
- Published performance targets to enable customers to monitor SOE delivery may be introduced.

## 2.5 On-the-job training/capacity building for key stakeholders in government and SOEs

Actions Taken	Reference
<ul style="list-style-type: none"> <li>• Performed initial situation analysis and issues identification which revealed the needs:                             <ul style="list-style-type: none"> <li>– at ministerial and officials levels to demonstrate that reform was both desirable and possible</li> <li>– at SOE level to create a demand for training and capacity building that would enhance the performance of the SOE – rather than merely increasing the supply of training that would enhance the employability/remuneration of employees</li> <li>– generally to distinguish between capacity to change/reform and capacity to operate effectively after successful reform had created a new working environment.</li> </ul> </li> <li>• Drafted a “case for change” document in the format of “Frequently Asked Questions” (FAQs) on why SOE reform &amp; increased PSP were needed.</li> <li>• Developed and delivered an initial workshop for ERU and local team members on change management, stakeholder management and communication.</li> </ul>	<p>The Case for Change, <b>Annex 10</b></p> <p>Workshop on Change Management, <b>Annex 50</b>; Communications and Stakeholder</p>

<ul style="list-style-type: none"> <li>• Throughout the assignment, the TA international experts worked with local team members and local counterparts to increase their capability to contribute longer-term to continuing SOE reforms.</li> <li>• Introduced SOE GMs’ Forums as a means of building understanding and support for SOE reform among this key stakeholder group.</li> <li>• Planned and organised prompt responses to the SOEs’ training and development needs as revealed by responses to questions at SOE GMs’ Forums and feedback to seminars on governance.</li> <li>• In September 2005 held five seminars on SOE corporate governance, focusing on its legislative basis, for SOE directors, managers and other stakeholders such as lawyers and accountants, Chamber of Commerce, etc, and documented the feedback received in the form of participants’ questions and comments</li> <li>• In October 2005 followed up with two workshops for SOE managers and directors/stakeholders respectively to discuss written summaries of the feedback, and build a network of stakeholders who understand and support the need for the SOE reforms that the TA is assisting</li> <li>• In November 2005 held three series of two-day seminars on Planning and Financial Management for directors and managers of SOEs based in Honiara.</li> <li>• Local ERU counterpart was supported in being Facilitator of an SOE GMs’ Forum.</li> <li>• In November 2006 the TA prepared a draft action plan for implementing the proposed sale of HFL to NPF (since updated) with several goals: (1) to show ERU counterparts what was involved in the sale process, (2) to provide a basis for them to assume managing the sale process when the TA ceases, and (3) to provide a basis for keeping other stakeholders informed of progress in the process and thereby manage their expectations.</li> <li>• In January 2007 the TA briefed the HFL Board on the sale process and their roles and duties in relation to it.</li> <li>• Also in January, the TA helped the HFL board to resolve a perceived potential conflict of interest between HFL and the TA domestic financial experts.</li> <li>• In February 2007, the TA prepared a draft SOE Act implementation action plan with similar goals to that for the proposed HFL sale.</li> </ul>	<p>Management, <b>Annex 51</b></p> <p>SOE PSP Seminar Programme, <b>Annex 22</b></p> <p>Feedback from Governance Seminars, <b>Annex 11</b></p> <p>Governance Discussion Paper, <b>Annex 2</b>; Governance Feedback, <b>Annex 11</b></p> <p>Stakeholder Workshops, <b>Annex 12</b></p> <p>Seminars Programme, <b>Annex 52</b></p> <p>SOE GMs Forum, <b>Annex 53</b></p> <p>Action Plan, <b>Annex 38</b></p> <p>Sale Process Briefing, <b>Annex 43</b></p> <p>Resolution, <b>Annex 54</b></p> <p>Plan Summary, <b>Annex 5</b></p>
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<b>Achievements</b>
<ul style="list-style-type: none"> <li>• PS Finance and PS Planning jointly took over the sponsorship of the SOE GMs’ Forums, which the TA had initiated.</li> <li>• Identified and mobilised potential “change champions” – key stakeholders at SOE CEO/GM and board level who are prepared to lead early performance improvement initiatives and also act as examples to others.</li> <li>• Re-usable performance improvement training material was produced on such topics as financial planning and analysis, organisational performance reporting, corporate planning.</li> <li>• Pijin versions of some material were developed in collaboration with the local ERU counterpart, and she was supported in gaining experience in its use – acting as a co-presenter at a workshop.</li> <li>• Local team members have acquired considerable extra capability to be effective supporters and</li> </ul>

practitioners of further SOE reform: they are well-informed advocates of the policy approach; experienced in the processes of problem analysis and design and solutions; increasingly skilled in implementation of the solutions; and trained in delivering workshops and training.

### Issues

- Limited progress has been made with SOE skills transfer, partly because pressures for SOEs to improve performance are ineffective and, as a result, there are limited incentives for the target people to acquire these skills: e.g. skills transfer that enhances the individual's employability may be well attended but not if the skills will help only with improving the performance of the particular SOE. Also, SOE directors, managers, staff who benefit personally from ineffective governance are directly conflicted by attempts to improve governance.
- Skills transfer to the officials who will operate the new system could not occur because the system under the proposed new SOE Act was not yet in place and these people were not appointed.
- Therefore, one challenge is to ensure that the new SOE Act's good governance provisions increase the demand for skills acquisition and capacity building that is related to SOE performance improvement – not just increase the supply of training, and not just add to the opportunities for SOE managers and staff to acquire professional skills that benefit individuals..
- Another challenge is to ensure that the proposed SOE Act implementation strategy provides adequate preparation time, and that this preparation time be used effectively through a systematic preparation programme – training and capacity building will need to be properly planned, resourced and delivered.. (The TA has proposed that, as has been done by other countries, Solomon Islands should implement the new SOE Act in stages in order to give both SOEs and officials time to prepare properly for their new responsibilities.)
- There is an unresolved issue about how best to handle the presentation of external experts' analysis and recommendations to political decision-makers – e.g. should local officials or TA be responsible and resourced for writing reports to Ministers and formal Cabinet submissions? Or is the capability of local staff to write such material an important test of understanding and ownership (as well as using their comparative advantage and respecting their status as “in line” advisers)?

### Recommended Future Action

- ERU and local team members are the repository for the training materials that have been developed and delivered. This is a temporary solution, but longer-term it is suggested that, for the three main targets:
  1. at SOE board level, training for directors should be shared with the private sector and be held by some professional body separate from the government. Longer-term, an Institute of Directors would be an ideal solution, but short-term there would be merit in getting both the Society of Accountants and the Law Society to act as repositories for a “library” of good practice guidelines and related material, so that the relevant professionals could assist as required, and possibly serve as directors.
  2. at SOE staff and management level, the material should also be shared with the private sector, and be kept and used by the main local training providers of management training (e.g. USP, SICHE, IPAM); but also made available, through their respective professional bodies, to local accounting and legal practitioners who provide services to SOEs.
  3. at officials level, if a new organisation is established within the public sector to administer the SOE Act and advise on SOE ownership issues, then this organisation should be the repository for material related to the SOE Act and overall policy for the SOE sector.
- Making best use of the improved local capability of professional advisers – especially the skills and experience of local TA team members – should be addressed by ERU. As noted above, local team members have acquired considerable extra capability to be effective supporters and practitioners of further SOE reform. Both CBL and Suri's Legal Practice are in the process of expanding and strengthening their practices: increasing their staffing and also taking significant initiatives to raise and maintain professional standards.

### 3 Additional Work Program Activities Undertaken: Managing Interface Issues

Actions Taken	Reference
<ul style="list-style-type: none"> <li>• As a by-product of the situation analyses and issues identifications for the formal outputs above, the TA found factors that, while outside the formal ToR, influenced the feasibility and political acceptability of the TA’s proposals, and/or the likely success or failure of the SOE reforms if implemented.</li> <li>• Formed a preliminary view (as highlighted in the TA Inception Report’s “Situation Analysis”) that these factors outside the TA were major impediments to its success: subsequent experience led the TA to identify more boundary issues, and reinforced the importance of overcoming these impediments.</li> <li>• Clarified the size and the scope of the problem in analytical terms – in simplest form it could be illustrated by the extent and number of gaps between institutions and practices in the public, private and mixed (SOE) sectors in Solomon Islands compared to those in other more successful countries</li> <li>• Discovered that this gap analysis was useful for analytical purposes – e.g. in developing proposals in interface areas like regulatory reform – <b>but</b> the TA Reference Group (see below) helped the TA appreciate that the results could not be presented simply as an unfavourable comparison between Solomon Islands practices and overseas examples (see caveat under “Issues” below).</li> <li>• Spent most time and effort outside the original workplan working with selected individual SOEs on identifying and remedying performance problems – as opposed to the sector-wide programme of on-the-job training/capacity building that had been planned (please refer to s. 2.5 above).</li> <li>• The other major effort went into the work with the TA’s “Reference Group” which was established to provide guidance and feedback on matters requiring local knowledge and understanding, such as issues identification and customisation of technical solutions. The Reference Group operated only in the first year of the TA, given the initial unavailability of local counterparts within Ministry of Finance to provide this support and guidance.</li> <li>• One of the issues progressed with help from the Reference Group, and in consultation with the SIG Machinery of Government and Leadership initiatives, was enabling SIG to appoint SOE chairmen for their commercial experience, integrity and ability rather than needing to appoint back-bench MPs in order to secure and protect a Parliamentary majority.</li> </ul>	<p>[Please refer to “Issues” sections in paragraphs 2.1 – 2.5 above]</p> <p>Issues Analysis, <b>Annex 1</b></p> <p>SOE Reforms Context, <b>Annex 55</b></p> <p>TA Local Reference Group, <b>Annex 56</b></p> <p>SOE Stakeholder Analysis, <b>Annex 57</b></p> <p>TA Local Reference Group, <b>Annex 56</b></p>

Achievements
<ul style="list-style-type: none"> <li>• Working with selected individual SOEs on identifying and remedying performance problems provided a practical demonstration that the changes that would be required under the proposed sector-wide reforms were: <ul style="list-style-type: none"> <li>– feasible in practice; and</li> <li>– also worth doing in terms of benefits created for the customers of the SOEs and improvements to the viability of the SOE itself.</li> </ul> </li> <li>• The TA built local capability to continue training and capacity building in SOEs, especially by involving local team members and local counterparts in “train the trainer” exercises.</li> <li>• Workshops and supporting training materials produced by the TA to support performance improvement by SOEs are available for further/continuing use.</li> <li>• The TA’s analysis built stakeholder awareness and understanding of the problems caused by the lack</li> </ul>

of a coherent and predictable set of SIG policies at Cabinet level – not confined to SOE policies, and also revealed that there is scope to make significant improvements.

### Issues

- Simply documenting and highlighting gaps compared to other countries’ “good practices” risks being seen as a focus on bad points, and thus inviting a defensive reaction;
- there is a widely-shared local priority for improved service delivery, and proposed SOE reforms will receive more support if they are linked to improved performance in this area;
- also, the Solomon Islands SOE sector is best viewed holistically as a system within a wider (social, political and economic) system – this is easier for local people to understand than piecemeal gap analysis, as well as more complete and more accurate
- from that (systems) perspective, the SOE system will tend to fail at its weakest points when placed under pressure – and some local stakeholders have come to see that their system has many weak points, is under considerable pressure, and therefore fails at many points – and all this adds up to difficulties in achieving improvements through partial solutions
- one recurring example from almost all SOEs is the loss of services due to poor or non-existent maintenance and replacement of SOE productive assets – a systems perspective leads on to identify external political and social pressures behind the immediate causes such as prices too low to include depreciation; failed credit control and debt collection; etc
- There are also internal points of failure such as extraction of cash/retained earnings as benefits for SOE “insiders” i.e. diversion of public monies to private hands by the practice in some SOEs of awarding excessive remuneration to directors, management and staff – in some cases using practices that are extremely questionable and possibly illegal such as “advances” or “loans” that are beyond the capacity of the “borrowers” to repay, are not enforced, and are not repaid.
- The proposed Electoral Integrity Act (scheduled for introduction in June 2007) would remove the necessity for a coalition government to appoint backbench MPs as Chairs of SOEs who, when combined with the number of Cabinet posts, are sufficient to secure and protect a Parliamentary majority. In the intervening period there is an opportunity to build on a number of planned or recently accelerated leadership or good governance initiatives, such as substantially increasing the role of Parliamentary Select Committees, and perhaps awarding their Chairmen remuneration and allowances in line with what is currently received by SOE board chairmen.

## 4 Final Focus of the TA

In late July 2006 Vinstar Executive Director Nalayini Brito visited Honiara and met with Government Counterparts and key team members. The aim of the meetings was to obtain updates on the status of the TA and determine the way forward based upon the expectations of the SIG and ADB following the ADB's Country Programming Mission to the Solomon Islands in June 2006. From these meetings with the Executing Agency and local counterparts and further discussions with ADB, it was resolved that in the final phase of the TA, four key tangible outputs would be pursued by the consultants: a general SIG SOE reform policy and supporting implementation measures; an SOE Act; completion of a financial stocktake of the SOE portfolio and the Home Finance/National Provident Fund housing activity combination as an example of a PSP transaction. The development of these outputs is as follows.

### 4.1 SIG SOE Reform Policy

An integrated package of reform proposals relating to SOE ownership, performance, divestment, financial reporting and economic regulation was drafted in August 2006 for ERU to consider, refine and present to Cabinet (attached as Annexes 14 - 20). September 2006 to January 2007 saw a process of feedback, clarification of policy and procedural issues, and rewriting – e.g. a summary draft Cabinet paper on the SOE Reforms program, which had been expected to be presented to Cabinet for approval in early December 2006, is attached as Annex 21. This included recommendations on introduction of a consistent legislative framework for SOEs (an SOE Act); a Government Policy Statement on SOE ownership and regulation; provision for CSOs; requesting donor support to update SOE financial accounting and reporting; and clarifying SOE goals and performance targets.

In the event, SIG decided that the Minister of Finance's Budget speech should announce the reform program and its key elements, and the Cabinet paper should be further simplified to focus mainly on approval for officials to provide drafting instructions to the Attorney General's Chambers for a new SOE Act. In light of this feedback, the TA rewrote the draft Cabinet paper late January 2007 (attached as Annex 6).

The 2007 Budget speech, as approved by Cabinet and delivered by the Minister of Finance and Treasury, included specific policy commitments to all the major elements of the recommended reform program: a new SOE Act this year; updating all SOE accounts; developing and publishing service delivery targets for all SOEs; reviewing consumer protection laws; and replacing annual subvention payments with targeted subsidies for mandated services – conditional on proof of good governance and a financial justification.

### 4.2 SOE Act

The consultants have drafted an outline SOE Act that is currently being refined and completed before being provided to ERU and the SIG Law Draftsman. The Act (Bill) will accordingly continue to evolve over time. At the time of writing, the timeline and process for finalisation of this proposed draft Act is as follows:

- Mid March 2007: Cabinet approval for officials to provide drafting instructions to Attorney General expected.

- March 2007: TA to assist Department of Finance and Treasury preparing drafting instructions and resolving legal drafting issues with Attorney General's Chambers.
- Draft SOE Bill ready for introduction to Parliament at its next sitting which, at the time of writing is expected to be in June 2007.

The current draft of the proposed Act is attached as Annex 3.

#### **4.3 Financial Stocktake of the SOE Portfolio**

To the extent permitted by current availability of Financial Information, this Stocktake has been further developed since the report included in the Draft Final Report (Appendix 2 Trends in Solomon Islands State Owned Enterprise Finances) and is attached as Annex 9 Stocktake of SI SOE Finances.

#### **4.4 HFL/NPF Transaction Status**

The TA utilised the Finance Minister's renewed focus on amalgamating HFL and NPF housing schemes to draft a paper for him to present to Cabinet in early December 2006 seeking Cabinet approval for a strategy to sell HFL to NPF and for its implementation to start immediately (refer Annex 7). Cabinet approval was obtained in early February 2007. Since then the TA has continued to assist HFL and PS Finance to prepare to implement the sale process.

#### **4.5 Handovers to ERU Counterparts**

The earlier drafts of this document, and the dialogue between the TA and SIG, ensured that this final report could be presented on the basis of "no surprises". In addition, the TA's final project and programme planning, using a proprietary software tool, proved a very effective way of helping ERU focus on future actions required by them, especially the counterparts who will henceforth take over from the TA on the various areas of continuing work. The electronic and hard copy records created by the TA will be absorbed into the ERU filing systems.

## 5 Conclusion and Final Recommendations

### 5.1 SOE Reforms

Although the paper submitted to Cabinet in late February 2007 focused only on the immediate action required, the TA's recommended approach to SOE reform and PSP remains as summarised in the earlier draft Cabinet papers on SOE Reforms:

- i) Passing a State-Owned Enterprise Act to introduce an effective and consistent framework for good governance across all state-owned enterprises (see Annex 3 for current suggested draft);
- ii) Implementing a four-part initiative as follows to produce up-to-date audited financial statements (also known as “annual accounts”):
  - a. Extra accountants to produce annual financial statements
  - b. A “clean-up team” shared across all SOEs of (e.g.) legal experts to resolve outstanding claims, debt-recovery experts, and asset realisation specialists.
  - c. Extra auditors to audit and report on the financial statements
  - d. Support for Office of the Auditor-General Special Audit to provide oversight, review findings and report further as required.
- iii) Improving SOE performance through addressing the following priorities: bringing financial management reporting up to date; identifying and resolving debt issues; adequately providing for doubtful debts; commencing preparation of business planning; considering changes to the SOE business model to require pre-payment by customers; updating asset registers and revaluing significant assets, and preparing updated realistic budgets for the current year, with projections for the following two financial years;
- iv) Through a formal SIG planning process or otherwise:
  - a. clarifying SOE objectives, and prioritising what the government expects in terms of SOE performance – especially those SOEs that provide infrastructure that supports business development and community life; and
  - b. linking planning to SIG budgeting where the plan objective is not commercially feasible (i.e. would cause the SOE to lose money). In such cases, SIG must either pay the SOE a subsidy to ensure the provision of services or change the plan objective to reflect the commercial situation and government's overall priorities.
- v) In the area of economic regulation, issuing a Government Policy Statement that:
  - a. directs that licensing regimes are not to prevent competition;
  - b. directs that any price setting process should include public consultation and the use of expert advice;
  - c. shows that various SOE reforms are proceeding from a common framework that deals with the various issues – competition, licensing, pricing, non-commercial services, etc – in a consistent way that will give consumers a reasonable deal; and

- d. opens up privatisation as a reform option, where the combination of regulation and privatisation offers consumers a better deal than unregulated government ownership.
- vi) In implementing three of the preceding initiatives (producing up-to-date audited financial statements, clarifying SOE objectives, and getting better and more consistent results from economic regulation of SOEs), ensure that existing legislation is strictly complied with – particularly various existing statutory procedures (and restrictions) that apply whenever the government wishes to:
- a. take decisions about SOE policy matters, and
  - b. communicate these decisions to the SOEs concerned.
- vii) Late November 2006 discussions between the TA and senior officials of the Department of Finance and Treasury essentially resolved the future role of the Investment Corporation of Solomon Islands (ICSI). The resolution comprises two elements: (1) Cabinet agreement that transforming SOEs into successful businesses depends crucially on ensuring that the boards of directors appointed to oversee each SOE comprise people whose combined skills and experience enable them to perform this role effectively; and (2) noting that where an insufficient mix of people is available to oversee effectively a particular SOE, as a transitional measure the government has the option of relying on ICSI to own the SOE as a subsidiary and oversee its performance until sufficient directors with the required skills either become available or are trained, after which ICSI would be required to transfer ownership of the subsidiary to the government.

This means that ICSI's role does not need to be enshrined in legislation, with some attendant risks, but remains a viable transitional option where insufficient suitably skilled people are available to oversee an SOE. Full details of what this will entail and its legislative implications will be resolved by the TA in conjunction with the Department of Finance and Treasury shortly in the context of preparing drafting instructions for the Attorney General. The recommended initial or transitional approach would be for the government to continue and expand the use of ICSI as a holding company in order to:

1. get best value from the limited stock of professional SOE Directors;
  2. enable ICSI Directors to mentor and develop the members of subsidiary boards – as well as monitor and report on performance;
  3. consolidate and focus SIG overall portfolio management of its investments in SOEs;
  4. standardise individual SOE behaviour on best practices in areas like financial management (e.g. general financial analysis and reporting, investment appraisal), SOE performance measurement and reporting, timely production of audited annual accounts, etc
  5. generally strengthen arrangements to ensure that continued SIG ownership is not a “soft option” for SOEs;
- viii) Reporting and performance monitoring for SOEs would include publication by each SOE of a short-list of observable performance targets for service delivery

to enable customers to monitor delivery; and a regime of performance reporting to Ministers.

- ix) The Ministry of Finance requires a capability (an “SOE Monitoring Unit”) for SOE performance monitoring and advice to the Minister of Finance on SOE ownership issues (this has been agreed in principle with ERU under the proposed SOE Act and this and the previous requirement could be developed as part and parcel of introduction of the SOE Act).
- x) For implementation of an SOE Act, as in other countries Solomon Islands would likely benefit from a delayed implementation date (e.g. passing the Act in mid 2007 with effect from 1 January 2008). This would give both SOEs and officials more time to prepare properly for their new responsibilities and, thereby, increase the likelihood of successful implementation. .
- xi) In terms of private sector participation in state commercial activities, if, as has been suggested, SIG resolves to focus on core functions of government, and divest business activities, this would imply that a broadly based “Alternative Service Delivery” (ASD) framework of policies and practices will be required, within which SOE-by-SOE analysis and action would take place.

These recommendations remain the TA’s view of what action and approach is required to enable SIG to implement the envisaged SOE reforms effectively.

## **5.2 Case for Extended TA Support to Assist in Implementation of SOE Act & Related Reforms**

The TA has proposed passing an SOE Act (including the provision of a draft Act) to introduce an effective and consistent framework for good governance across all state-owned enterprises and SIG has given all the indications that they are serious about implementing this at the impending parliamentary session in June/July 2007. The TA will continue to provide all the required support and inputs leading up to its expiry date of 31 March. However, SIG will need continued support and inputs from the TA in the period to June/July 2007 to make this happen. Further, should the SOE Act be successfully passed, support will be required in the form of training and implementation issues. The TA could provide this support using its existing team with a combination of field and home office time (as hitherto). The case for this extended support is best discussed at the forthcoming tripartite meeting.

## **5.3 Case for Extended TA Support to Assist in Implementation of Specific PSP Projects: Notably HFL Sale Process**

As regards the other broad aspect of the TA, increasing private sector participation in SOEs, it is clear that the SIG will need ongoing external specialist TA support to assist it in implementing transactions to achieve this goal. For example, the Ministry of Finance and Treasury will need some ongoing help from the TA to enable them to carry out the proposed sale of HFL to the NPF which seems likely to span a period of up to about two months after the scheduled end of the TA on 31 March 2007.

Such TA support is required because this sale process (like others) inevitably involves a range of difficult issues to resolve which require specialist commercial, financial and

sales-transaction experience to manage them effectively. In part, the brief for extended TA support for the HFL sale process is to provide backup guidance and mentoring to the ERU/ MF&T officials designated to manage SIG's involvement in the sale process. In part, however, it would also probably involve taking a lead role in analysing some situations/ issues and briefing officials and the Minister accordingly. The combination of roles could be managed by budgeting for a combination of: (1) some home-office time in NZ (communicating by email and phone etc); and if necessary (2) a visit to Honiara in early May 2007 to coincide with the point at which final aspects of the sale could be expected to be negotiated after the "due diligence" inspection has been completed by NPF.

The case for this proposed extra TA support, and any other that may be sought by SIG, could be refined in the context of the pending Tripartite discussions.

# **Annexes**

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- Annex 1: SOE Reforms Issues Analysis**
- Annex 2: SOE Governance Discussion Paper**
- Annex 3: Draft SOE Act**
- Annex 4: SOE Reforms Implementation Action Plan**
- Annex 5: SOE Act Implementation Plan Summary**
- Annex 6: Summary Draft Cabinet Paper on SOE Reforms**
- Annex 7: Draft Cabinet Paper on Strategy  
for Sale of HFL to NPF**
- Annex 8: Economic Regulation Discussion Paper**
- Annex 9: Stocktake of SI SOE Finances**

**Supplementary Annexes 10 – 57 are contained in a separate volume**

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## **Annex 1: SOE Reforms Issues Analysis**

### **1.1 Policy Development: Output One – Government Policy on SOE Ownership, Performance, and Divestment**

The TA found that, in effect, there was no government policy on SOE ownership and/or divestment mainly because there was no clear or effective policy on the central issue, namely performance. Firstly, despite dissatisfaction with SOE performance, this was seen as a series of specific problems rather than a general failure of the policy framework; and secondly SOE reform was widely perceived to have only one tool – namely privatisation in the sense of sale to the private sector. As a result, there was no political consensus on the need for reform or on what needed to be done – and therefore no political enthusiasm for systematic SOE reform that would be driven by a new set of SOE policies.

This situation causes major difficulties for the government. One issue is that the failure to detect recurring problems and apply the same proven solution across the whole sector makes SOE reform extremely inefficient and difficult to progress. A related issue is that, if the limited time that SIG makes available for SOE issues continues to be allocated only to SOE “problems”, there is a risk that new problems will continue to grow in those neglected areas that a more comprehensive reform policy would address – indeed in recent years Cabinet Ministers probably found new SOE problems growing faster than they could solve old ones.

Because comprehensive SOE reform was not a high priority at Cabinet level, the TA’s efforts to develop understanding of SOE problems and support for the need for systematic reform were therefore redirected towards other SOE stakeholders – especially relevant officials, SOE board members and senior managers, other international consultants to SIG, local professional advisers to SOEs, and other members of the local business community. This problem-solving approach led to a focus on reform by formalising SOE policies in a new legislative framework – centred on a SOE Act.

The suggested solution is based on the following analysis of the problems. First, there is a lack of external pressure for good performance by SOEs because of weaknesses in the governance and regulatory aspects of current ownership policies, especially in the following areas:

- governance by Parliamentary scrutiny of SOE annual financial reports
- governance by the government as owner, in terms of setting clear performance expectations
- governance at board level, in terms of maintaining the commercial viability of the organisation
- the absence of competition to provide comparisons and the threat of losing customers – or effective economic regulation to partially compensate for deficiencies in market competition.

Secondly, because neither governance nor competition create external pressure for good performance, internal weaknesses have developed in most Solomon Islands SOEs, as follows:

- lack of management capability and focus, in terms of:
  - planning and budgeting to achieve performance targets;

- prudent financial management, e.g. profitable trading, asset protection, liability controls
  - monitoring and reporting results, and taking corrective action where required.
  - lack of focus on customer needs as a driver for better performance in service delivery.
- Thirdly, the issue of government ownership and/or divestment has become linked to economic regulation to the extent that it is believed that government ownership is necessary because of a lack of either effective competition or effective economic regulation in the absence of such competition.

However, some early moves are both possible and desirable, because the proposed SOE Act is only part of the solution to this set of issues, and need not delay other reforms.

As indicated below in discussion of issues around the reporting and performance monitoring regime (or the lack of one), the TA considers that it is critically important for some reforms – especially reforms of governance, performance management, financial management and economic regulation – to occur as soon as possible, and to apply regardless of planned decisions on ownership or divestment in relation to particular SOEs. That step would help to ensure that, with or without the passing of a SOE Act, continued government ownership is not seen as an easy option, that all SOE performance is measured and managed, and that PSP options can then be assessed in the right context – see next section.

The future of ICSI is a major SOE ownership and governance issue that has been left to drift while ICSI's financial resources have run down. One solution is the potential for the government to use a strengthened and expanded ICSI as a holding company in order to:

- get best value from the limited stock of professional SOE Directors;
- enable ICSI Directors to mentor and develop the members of subsidiary boards – as well as monitor and report on performance;
- consolidate and focus SIG overall portfolio management of its investments in SOEs;
- standardise individual SOE behaviour on best practices in areas like financial management (e.g. general financial analysis and reporting, investment appraisal), SOE performance measurement and reporting, timely production of audited annual accounts, etc
- generally strengthen arrangements to ensure that continued SIG ownership is NOT a “soft option” for SOEs.

Another reform move that has been suggested from time to time is the establishment of an Institute of Directors, or similar body for professional directors.

## **1.2 Output Two - Private Sector Participation in Prioritised SOEs**

As noted in the previous section, a number of issues including a lack of political consensus on the problems created by government ownership of SOEs, and a narrow view that SOE reform was confined to privatisation, contributed to a lack of enthusiasm for SOE reforms – especially if such reforms were primarily privatisation. A major issue is widespread local prejudice against PSP.

Some of that prejudice may be well founded, inasmuch as the inadequacies of most of the institutions required for a well-functioning private sector have been identified in related ADB-funded TAs to do with the legal framework. The TA has found few local private sector firms that could be used as examples of excellence that SOEs could be encouraged to follow. This situation leads local stakeholders to be understandably sceptical about the advantages of private sector participation. If it is explained that PSP provides a range of alternative ways in which SOEs can benefit from private sector good practices, most local stakeholders are more receptive, but the issue of feasibility becomes a focus.

Realism about what PSP does and does not offer is itself another key issue – blind enthusiasm is as much a problem as blind prejudice. In particular, the TA encountered the issue that, for a number of SOEs, private sector participation will not necessarily result in immediate performance improvement – but will almost always result in price increases because SOE prices have generally been artificially low. This is not only because of direct government decisions, but also because of the operational and financial consequences of the management skill gaps in areas like business cases and costing. This TA also drew attention to the roles of lenders and customers as parts of private sector participation – participation in ownership and management is most important; but is not the complete picture, and these actions are not the only methods of PSP.

It is arguable that some PSP initiatives should be delayed until the legal framework etc is ready. If so, the TA's work on economic regulation in particular may need to be accelerated (see 3.3. below), but it will also be important to build stakeholder awareness that the necessary private sector institutions, and the sector's size and strength, will be built by pushing PSP – not by waiting for these things to develop before PSP is attempted. The government as owner and often lender/guarantor has options in relation to long-term SOEs, such as structuring SOE balance sheets in a way that will withstand scrutiny by commercial lenders, and requiring SOEs to publish service performance targets and/or standards that can be monitored by customers. A strengthened ICSI with a board of experienced and expert directors could have a lead role in this.

### **1.3 Output Three – Legal and Regulatory Frameworks**

To the extent that the TA could consult with stakeholders, it appeared to have built a consensus that most of the issues around legal and regulatory frameworks have now been resolved to the satisfaction of these participants in the process of problem identification and development of solutions. The two main initiatives that are proposed are a SOE Act (prepared by the TA in indicative draft form) and legislation for economic regulation, which is at a more preliminary stage of development. It has been agreed that, in principle, economic regulation should be of general application – i.e. not confined to the sectors in which privatised SOEs will operate. Also, economic regulation has been linked to ownership and/or divestment (please see 3.1. and 3.2. above) because of the prevailing perception that government must own entities such as public utilities.

There may be a need to draft legislation if the TA team's policy recommendations are accepted. The TA team would be able to do this, but the TA ToR does not cover this work.

### **1.4 Output Four – Reporting and Performance Monitoring Regime**

Currently there is no systematic well-defined general approach that could be called a regime. There is a paucity of current data and much of the recent data is either unaudited or is in the form of management accounts, which may be unreliable. This situation is not solely a result of the “tensions” as many SOEs had prepared financial statements only up to 1995 or 1996 before the tensions. The lack of timely financial reporting of even management accounts suggests that the majority of SOEs are “flying blind” and do not know their current financial position. The consequences were summarised by management expert Peter Drucker: “If you can't measure it, you can't manage it”.

NERRDP reported on the pervasive and corrosive failures of governance within the public sector, closely associated with private sector malpractice, and the TA's own preliminary investigations have found some supporting evidence and no contrary evidence. However, a key issue is that the vital link between governance and performance is not well

understood, with the result that resources committed to governance are seen by some stakeholders as resources being diverted away from performance.

There are also deficiencies in the existing legislative framework – namely provisions within the Companies Act and Public Finance and Audit Act that do not reflect modern good practices. These issues could be addressed by putting higher standards in the proposed SOE Act, and giving it precedence over the other two acts.

The foundations for good governance are further undermined by the lack of institutions and resources to support an awareness of good governance, good practices and good legislation. There are significant delays in completion of audits and these delays are worse for enterprises audited by the Auditor General's office, probably reflecting staff and skill shortages. Transparency in reporting and performance monitoring will therefore be a critical issue to create awareness, expose actual practices, and ensure that legislation is complied with.

### **1.5 Output Five - Training/Capacity Building**

The strategy to date has been to build demand for better performance by measurement highlighting the whole issue of performance and making it more manageable as well as more visible. Most of the institutions required for good performance within the private and public sectors are weak or missing. Inevitably, boards and businesses that feel weak or no effective pressure for better performance in service delivery will not develop the skills required to deliver better service.

Therefore, the reform actions for SOEs that remain in government ownership must compensate for this.

Training and capacity building needs include;

- governance at board level;
- the public service's ability to monitor, analyse and report to Cabinet on SOE performance;
- Cabinet's ability to clarify and manage public policy objectives (CSOs) for SOEs; and
- most areas of management within SOEs themselves – including business planning and budgeting, credit management, risk management, costing and pricing, asset management, cash flow management, etc.

A compelling “case for change” needs to be known, understood and accepted by most of the key stakeholders in SOE reform and PSP. Successful change will depend on initially on strong and well-informed support and leadership from the political level, but longer-term success will depend on strong and well-designed institutions that reflect a political consensus.

The TA's activities have raised the profile of issues that otherwise might not get discussed, and started building consensus at the level below that of the politicians to whom the TA had no formal access. Consensus on the problems is a useful starting point, but it proved to be equally important to show that progress is possible: therefore the TA has been gathering and sharing evidence of local “success stories”, and identifying and supporting local people for leadership/mentor roles in workshops and longer-term arrangements for SOEs.

Associated with demonstrating opportunities for progress, there is a need to show that reform can deal appropriately with issues of culture – the TA's local team members have a major role in this.

At some stage it will be important to get beyond the immediate focus on existing stakeholders and to start development of the coming generation – which will require the TA to help build local capability to train and develop directors and managers, and local

institutions that support good governance. In that context, the suggestion has been made that Solomon Islands should establish an Institute of Directors or similar body. The feedback to the SOE governance seminars provided useful insights into a lack of demand for directors' upskilling – especially from political appointees who are perceived as needing it most. One of the main drivers for the formation of an Institute of Directors was the perception that it could be an independent source of promotion of good corporate governance, e.g.:

- advice on selection criteria for directors
- disqualification from membership of persons who were found guilty of criminal acts that would indicate their unsuitability for a position of trust and responsibility; or who failed to obtain and maintain suitable formal training and awareness of relevant knowledge and skills
- codes of conduct for directors
- sponsorship of formal training and less formal opportunities for skill building
- other “good practices” in corporate governance.

In other words, it might not be possible to achieve early abolition of political appointments to SOE boards, but it might be possible to achieve some quality improvements in such appointments.

### **1.6 General: Managing Interface Issues**

This area of work is separate from the preceding formal work streams (which are drawn from the TA ToR) but it appears useful to bring all the interface issues together in one work area to:

- make it easier to size and scope them; and
- identify factors in the context that make SOE reform easy or difficult.

At present, most of the factors that influence the success of SOE reform – including factors influencing the successful operation of privatised businesses after reform – are either lacking or are negative influences. Therefore, one powerful single action that could be taken to address this set of problems would be to implement a coherent and predictable policy framework that would drive a coherent and predictable action programme at central government level. This step would enable specific reforms to be undertaken with confidence that other specific reforms – which influence the success of the first reforms – would also be put in place:

- (1) Economic regulation of general application (i.e. not just for the SOE sector) needs to be addressed in part as an alternative to SIG ownership.
- (2) Explicit subsidies for non-commercial objectives/activities (Community Service Obligations or CSOs) also need to be addressed in part as an alternative to ownership.
- (3) It will be important to build stakeholder awareness that the required private sector institutions, and the private sector's size, strength and overall capability to contribute to economic growth, will be built by pushing PSP – not by waiting for these things to develop before PSP is attempted.
- (4) Stakeholders must realise that the true extent of SOE problems have been masked by non-reporting, donor “bail-outs”, non-recovery of capital costs, etc, and as a result private sector participation will not necessarily result in immediate performance improvement – for example, it will almost always result in price increases because SOE prices are generally kept artificially low.

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- (5) Financial reconstruction of SOEs must align with and support comprehensive SIG debt management actions.
- (6) For SOEs that remain in government ownership, the overall framework and the specific reform actions must attempt to compensate for the deficiencies (referred to in the paragraph above) in both private and public sector institutions. In particular: an SOE Act is recommended to provide for adequate and consistent governance and ownership policies across all SOEs, and a new body to support the Minister of Finance in the proposed role as the representative of the government as shareholder. Provisions within the Companies Act and Public Finance and Audit Act that do not reflect modern good practices can be addressed by putting higher standards in the proposed SOE Act, and giving it precedence over the other two acts.
- (7) Training and capacity building is needed at every level from policy formulation to front line staff, including:
- a. governance at board level,
  - b. the public service's ability to clarify and manage public policy objectives (CSOs) for SOEs,
  - c. officials' advice to the Minister of Finance on SOE matters; and
  - d. most areas of management within SOEs themselves – including business planning and budgeting, credit management, risk management, costing and pricing, asset management, cash flow management, etc.
- (8) Transparency in reporting and performance monitoring will be a critical issue to create awareness, expose actual practices and ensure that legislation is complied with.

## **Annex 2: SOE Governance Discussion Paper**

Draft discussion paper for Economic Reform Unit, Ministry of Finance

### **Executive Summary**

- 1 This paper discusses the governance of state-owned enterprises. At the most general level, governance refers to the relationships between a state-owned enterprise's shareholders (i.e., the responsible Ministers), board and managers.
- 2 The purpose of this discussion document is to give visibility to the issues identified in the state-owned enterprises sector, and to propose a State-Owned Enterprises Act to introduce a modern, consistent governance framework across all state-owned enterprises.
- 3 Feedback is sought on this discussion document. We look forward to comments and suggestions about whether or not we have correctly understood the issues, and whether or not our proposed solutions will work in the Solomon Islands.

### ***The importance of state-owned enterprises***

- 4 The state-owned enterprises sector in the Solomon Islands has played a significant role in the economy and continues to do so. The activities of state-owned enterprises include essential services such as electricity, water, air transport, postal services, radio and the international ports. These make up a significant part of the economy.
- 5 The operation of the Solomon Islands economy is dependent on the effective operation of key utilities such as electricity, as having a reliable and efficient power supply is essential for society to operate. Similarly, the ports have a key role in facilitating imports and exports and in providing links to the provinces. So having well run state-owned enterprises that provide such services to government, business and citizens is important for the whole economy.
- 6 The financial performance of the state-owned enterprises is also very important. Successful state-owned enterprises can provide a financial return to government from the funds invested. An unsuccessful state-owned enterprises sector is a drain on Government resources and means that less is available for other types of expenditure such as education and health. As discussed below, the recent performance of state-owned enterprises performance has generally been poor.

### ***Good corporate governance***

- 7 Good corporate governance is an essential prerequisite to long-term effective and efficient operation of state-owned enterprises. The current experience in the Solomon Islands is that the lack of proper corporate governance is a significant contributor to the poor performance of state-owned enterprises, with flow-on effects to other sectors of the economy and the government's ability to fund social services.
- 8 There are five key aspects to good corporate governance. At each level of the "governance chain" (shareholder, board, chief executive, senior management) there should be:
  - 8.1 Clear objectives;
  - 8.2 Clear responsibility for achieving objectives;
  - 8.3 Authority to pursue the objectives;
  - 8.4 Accountability for performance; and
  - 8.5 Incentives to pursue the objectives.

### **The state's role in public sector governance**

- 9 As owner of the state-owned enterprises, the state should establish the governance structure, and monitor outcomes. The government plays a key role in establishing the enterprises, appointing the boards, and setting objectives for the boards.
- 10 It is equally important for the government to **not** get involved in the management of the enterprises. It is essential to observe the line between being an effective and active owner, and intervening to the extent it undermines the basic purpose of corporatisation and clouds the accountability of the boards of state-owned enterprises for performance.

### **The current situation**

- 11 The ADB Country Strategy and Program Update (2005-2006) Solomon Islands (August 2004) identifies five key problems with the state-owned enterprises sector:
  - 11.1 the creation of state-owned enterprises to engage in commercial activities risks crowding out of the private sector;
  - 11.2 the poor performance of state-owned enterprises has resulted in higher cost of inputs to private enterprises;
  - 11.3 inconsistent and unreliable service delivery and quality from state-owned enterprises;
  - 11.4 ineffective politically appointed boards of state-owned enterprises; and
  - 11.5 inappropriate mixing of regulatory and commercial functions causing mismanagement and poor governance of state-owned enterprises.
- 12 This paper addresses the last point – mixed objectives and poor governance. If the governance framework is not right – if objectives are not clear, performance transparent and accountability for performance clear – then poor performance will continue.

### **A separate State-Owned Enterprises Act**

- 13 We recommend that the Solomon Islands Government put in place a State-Owned Enterprises Act that applies a modern set of governance standards to all state-owned enterprises.
- 14 In overview, the recommended State-Owned Enterprises Act fits into the ownership and governance of state-owned enterprises in the following ways:
  - 14.1 the state-owned enterprises ownership and governance frameworks use:
    - (a) the existing corporate and commercial legal requirements, especially the Companies Act;
    - (b) the supporting corporate and commercial law institutions; and
    - (c) a special State-Owned Enterprises Act that provides for governance requirements appropriate for the unique position of state-owned enterprises.
  - 14.2 operations of state-owned enterprises are controlled by:
    - (a) the same economic regulation as applies generally to all businesses;
    - (b) monitoring of the accountability reports required of state-owned enterprises under the State-Owned Enterprises Act;
    - (c) extra transparency of state-owned enterprises performance and service delivery, imposed by the annual processes of the State-Owned Enterprises Act;
    - (d) the contractual obligations imposed by any Community Service Obligations (CSOs).

## **Rationale for a separate Act**

- 15 There are strong reasons for having a separate State-Owned Enterprises Act.
- 16 The only practical way to apply a modern set of governance standards to all state-owned enterprises, as we recommend, is by a single sector-wide Act. The alternative is to amend numerous establishment Acts and company constitutional documents, which is so administratively difficult as to be impossible in any meaningful timeframe. A single Act also provides a significantly easier way to update the governance regime in the future, for similar reasons.
- 17 There are significant benefits to having a consistent set of obligations and standards apply to all state-owned enterprises (such as reporting requirements, and the role of directors and shareholding Ministers):
  - 17.1 Ministers and advisors can build up expertise and efficiencies in performing the ownership role;
  - 17.2 a common framework enables comparisons between state-owned enterprises (such as their performance on meeting the reporting requirements). This can be effective in driving improvements to governance and performance;
  - 17.3 over time, a wider community of expertise on the state-owned enterprises model (directors, officials, accountants, lawyers) reinforces the disciplines and gains of the model.
- 18 State-owned enterprises require specific governance measures to reflect their unique characteristics:
  - 18.1 the business purpose, strategic focus and planning of the state-owned enterprise must remain aligned with the governments objectives (currently, in relation to a number of state-owned enterprises, this does not occur at all);
  - 18.2 any capital projects must meet the government's (owner's) investment criteria;
  - 18.3 dividend policy must similarly align with the government's (owner's) preferences;
  - 18.4 the operating and capital budgets, the balance sheet (especially borrowing, guarantees and lending) and general state-owned enterprises financial management must reflect the government's (owner's) wishes;
  - 18.5 accountability reporting must be made regularly against targets;
  - 18.6 director obligations must align with modern corporate governance;
  - 18.7 state-owned enterprises must liaise with and provide information to the government agency that acts as the owner's adviser/representative.
- 19 It is important to emphasise the instruments of control the government will continue to have over the direction and performance of the state-owned enterprise. These include:
  - 19.1 Appointing the board;
  - 19.2 Agreeing with the board the objectives of the state-owned enterprise, to be recorded in a statement of corporate intent (discussed below);
  - 19.3 Regular financial reporting as required by the State-owned Enterprises Act;
  - 19.4 The ability to contract for the delivery of non-commercial services. This can better facilitate the delivery of non-commercial services desired by the Minister while maintaining the transparency of any such arrangement;
  - 19.5 The ability to dismiss the board of a poorly performing enterprise. The performance of the board can be measured against the objectives agreed in the statement of corporate intent. As discussed below, we recommend that the State-Owned Enterprises Act provide that the principal objective of a

state-owned enterprise is to operate as a successful business. This will be the ultimate test of a board's performance.

### **Key features of a State-Owned Enterprises Act**

- 20 Key features of a State-Owned Enterprises Act include:
  - 20.1 setting the principal objective of a state-owned enterprise;
  - 20.2 clarifying the roles of directors and Ministers;
  - 20.3 reporting and transparency requirements;
  - 20.4 public finance management standards;
  - 20.5 provisions allowing for the government to procure non-commercial services (such as community service obligations);
  - 20.6 transitional mechanisms.
- 21 Clarifying the role of Ministers and directors, and introducing discipline and transparency into the setting of objectives for state-owned enterprises, has the potential to result in a step-change improvement in governance in the Solomon Islands state-owned enterprise sector. The government does not currently engage in setting long-term objectives systematically across the state-owned enterprise sector. This has been a significant driver of poor performance, as boards do not know where they are aiming for, and there is no way of assessing board performance and holding the board accountable. The State-Owned Enterprises Act puts objective setting, with accompanying transparency and accountability, at the centre of the governance framework.
- 22 Accurate, timely and transparent reporting of financial performance and service delivery is also very important for promoting long-term performance of state-owned enterprises. The State-Owned Enterprises Act establishes a framework of half year and annual reporting that sets proper standards for reporting and transparency.
- 23 This in turn allows the State-Owned Enterprises Unit (discussed below) to get an overview of the state-owned enterprises sector, and to advise the Ministers on the ownership role and the priorities in the sector.

### **Relationship to other legislation**

- 24 Approximately half of the current state-owned enterprises are statutory corporations, created by specific legislation.
- 25 The State-Owned Enterprises Act will work with this legislation, and not replace it. Outside of the areas addressed by the State-Owned Enterprises Act – role of the Minister, role of directors, setting commercial objectives, reporting and transparency, and community service obligations – the specific legislation would continue to apply.

### **International experience**

- 26 The State-Owned Enterprises Act model has been used successfully in Tonga, Samoa and New Zealand to introduce modern governance disciplines to the state-owned enterprise sector. This means there is a wide range of learning and expertise that the Solomon Islands can draw upon as it implements this governance framework.

## Annex 3: Draft SOE Act

### State Enterprises Act [2007]

**Please note: this is only an indicative draft, to illustrate the points discussed in the discussion document Legal Framework for Governance of State-Owned Enterprises (for the Economic Reform Unit, Ministry of Finance; ADB TA 4482-SOL)**

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	SCHEDULE 1
	STATE ENTERPRISES
	SCHEDULE 2
	CONSEQUENTIAL AMENDMENTS

AN ACT TO PROMOTE IMPROVED PERFORMANCE OF GOVERNMENT  
TRADING ACTIVITIES BY—

- (A) SPECIFYING PRINCIPLES GOVERNING THE OPERATION OF  
STATE ENTERPRISES; AND
- (B) AUTHORISING THE FORMATION AND OWNERSHIP OF  
COMPANIES TO CARRY ON GOVERNMENT TRADING  
ACTIVITIES; AND
- (C) ESTABLISHING REQUIREMENTS FOR THE ACCOUNTABILITY OF  
STATE ENTERPRISES, AND THE RESPONSIBILITY OF MINISTERS

**BE IT ENACTED** by the National Parliament of the Solomon Islands in Parliament  
assembled, and by the authority of the same, as follows:

1. (1) This Act may be cited as the State Enterprises Act [2007]  
(2) This Act shall come into force on such date as the Minister may appoint by  
notice published in the Gazette.
2. In this Act, unless the context otherwise requires,—  
“accountable ministers” means the Minister of Finance and the responsible  
Minister;  
“board” means—
  - (a) in relation to a State enterprise that is a company, the board of  
directors of the State enterprise;
  - (b) in relation to a State enterprise that is not a company, the persons  
occupying the positions in or in relation to the State enterprise that are  
comparable with those of the board of directors of a company;“community service obligation” means
  - (a) the provision of a good or service by a State enterprise to a consumer  
or user on any terms other than normal commercial terms applying from time  
to time;
  - (b) the entering into an agreement by the State enterprise on any terms  
other than normal commercial terms applying from time to time;
  - (c) the forbearance by a State enterprise to exercise a right or entitlement  
other than on normal commercial terms applying from time to time;
  - (d) the forgiveness or reduction by a State enterprise of a debt or an  
amount of money owed to the State enterprise other than on normal  
commercial terms applying from time to time; but
  - (e) does not include the State enterprise exercising its commercial  
judgment to make donations to worthy causes or to price goods and services at  
or below the cost of their production.“company” means a company formed and registered under the Companies Act or  
an existing company within the meaning of that Act;  
“crown” means Crown as defined in Interpretation and General Provisions Act;  
“government assistance” means any value provided to a State enterprise by the  
Crown other than value provided on terms consistent with an arms length  
commercial transaction or standard government policy, and includes  
(without limitation) tax rebates or waivers, guarantees provided for less  
than fair value, and loans on terms more favourable than would be expected  
in an arms length transaction;  
“Minister” means a Minister of the Crown;

Short Title and  
commencement—

Interpretation—

- “organisation” includes a company, a body corporate, a partnership, and a joint venture;
- “regulatory function” means any statutory power or function exercised by a state enterprise:
- “responsible minister, in relation to a State enterprise” means the Minister for the time being responsible for that State enterprise:
- “rules” means—
- (a) in relation to a State enterprise that is a company, the memorandum of association and articles of association of the State enterprise:
  - (b) in relation to a State enterprise that is not a company, the documents relating to the State enterprise that are comparable to the memorandum of association and articles of association of a company:
- “share” means—
- (a) in relation to a company that has issued shares, a share of any class:
  - (b) in relation to an organisation (other than a company) that has a capital, an interest in or right to the whole or any part of that capital, other than an interest or right as a creditor:
  - (c) in relation to a company or other organisation that does not have a capital,—
    - (i) an interest in or right to any part of the assets of the company or organisation, other than an interest or right as a creditor; or
    - (ii) where there are no assets, a direct or contingent obligation to contribute money to or bear losses of the company or organisation;—
- and “shareholder” has a corresponding meaning:
- “State enterprise” means an organisation that is named in Schedule 1:
- “statement of corporate objectives” means the current statement of corporate objectives for the State enterprise prepared pursuant to section [13] of this Act:
- “subsidiary” has the same meaning as in sections [148] of the Companies Act .

3. This Act shall bind the Crown.

Act to bind the  
Crown—

## PART 1 - PRINCIPLES

4. The purpose of this Act is to enhance the performance and accountability of State Enterprises so that they provide the best possible service for the people of the Solomon Islands and contribute to the greatest extent possible to the economic, social and cultural development of the Solomon Islands.
5. (1) The principal objective of every State enterprise shall be to operate as a successful business and, to this end, to be—
- (a) As profitable and efficient as comparable businesses that are not owned by the Crown; and
  - (b) A good employer; and
  - (c) An organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.
- (2) For the purposes of this section, a “good employer” is an employer who operates a personnel policy containing provisions generally accepted as necessary for the fair and proper treatment of employees in all aspects of their employment, including provisions requiring—

Purpose—

Principal  
objective to  
be  
successful  
business—

- (a) Good and safe working conditions; and
  - (b) An equal opportunities employment programme; and
  - (c) The impartial selection of suitably qualified persons for appointment;
- and
- (d) Opportunities for the enhancement of the abilities of individual employees.

- 6.** (1) The directors of a State enterprise shall be persons who, in the opinion of those appointing them, will assist the State enterprise to achieve its principal objective.
- (2) Every director of a State enterprise shall be selected and appointed or reappointed in accordance with the criteria for selection and procedure for appointment prescribed by regulations made under section [24(1)].
- (3) The appointment of a director of a State enterprise that fails to follow the criteria for selection and the procedure for appointment or reappointment prescribed by regulations made under section [24(1)] shall be null and void.
- (4) All decisions relating to the operation of a State enterprise shall be made by or pursuant to the authority of the board of the State enterprise in accordance with its statement of corporate objectives.
- (5) A director of a State enterprise must act in good faith and in what the director believes to be the best interests of the State enterprise.
- (6) The board of a State enterprise shall be accountable to the Accountable Ministers in the manner set out in Part 3 of this Act and in the rules of the State enterprise.
- (7) Directors of State enterprises shall act consistently with any regulations made under section [24(2)].
- (8) Any person who knowingly acts contrary to section 6(5) or section 6(7) is guilty of an offence and shall be liable to a fine of up to [        ].
- 7.** The Accountable Ministers of a State enterprise shall be responsible to Parliament for the performance of the functions given to them by this Act or the rules of the State enterprise.
- 8.** (1) Subject to this section and any regulations made under section [24(3)] the Responsible Minister may direct the State enterprise to provide a Community Service Obligation.
- (2) In making any direction under subsection (1) the Minister must act consistently with any regulations made under section [24(3)].
- (3) Any direction to a State enterprise to provide a Community Service Obligation that is not made consistently with any regulations made under section [24(3)] shall be null and void.
- (4) Any person who knowingly directs or attempts to direct a Director or the Board of Directors of a State enterprise to perform a Community Service Obligation other than in accordance with the provisions of this Act and any regulations made under section [24(3)] is guilty of an offence and shall be liable to a fine of up to \$50,000.
- (5) Any person who, while a director of a State enterprise, knowingly makes or takes part, or attempts to make or take part, in the making of a decision to perform a Community Service Obligation, other than in accordance with the provisions of this Act and any regulations made under section [24(3)] is guilty of an offence and shall be liable to a fine of up to \$50,000.

Directors and  
their role—

Responsibility  
of Ministers—

Non-  
commercial  
activities—

9. (1) The board of a State enterprise shall ensure any Regulatory Functions performed by the State enterprise are performed consistently with any regulations made under section [24(4)].
- (2) Any Regulatory Function performed by a State enterprise in a manner that is not consistent with the requirements of any regulations made under section [24(4)] shall be null and void.

Regulatory  
functions—

## PART 2 - FORMATION AND OWNERSHIP OF STATE ENTERPRISES

10. (1) The Minister of Finance and the Responsible Minister may from time to time, on behalf of the Crown, subscribe for or otherwise acquire shares in the companies named in Schedule 1.
- (2) The number of shares held by an Accountable Minister in a company named in Schedule 1 shall be the same as the number of shares in that company held by the other Accountable Minister.
- (3) Any money required to be paid by an Accountable Minister on subscribing for or otherwise acquiring shares pursuant to subsection (1) of this section shall be paid out of money appropriated by Parliament for the purpose.

Ministers  
may hold  
shares in  
State  
enterprises—

11. Where a State enterprise is a statutory corporation or other entity that has not issued shares, the Accountable Ministers shall exercise jointly the powers available to the Responsible Minister and perform jointly the functions of the Responsible Minister in relation to that State enterprise.

Ministers may  
exercise powers  
in relation to  
State  
enterprises—

12. (1) Notwithstanding any other provision of this Act or the rules of any company,—
- (a) The Accountable Ministers may from time to time, by written notice to the board, direct the board of a State enterprise to include in, or omit from, a statement of corporate objectives for that State enterprise any provision or provisions of a kind referred to in paragraphs (a) to (h) of section [13(2)] of this Act; and
- (b) The Accountable Ministers may, by written notice to the board, determine the amount of dividend payable by any State enterprise in respect of any financial year or years,—
- and any board to whom such a notice is given shall comply with the notice.
- (2) Before giving any notice under this section, the Accountable Ministers shall—
- (a) Have regard to Part 1 of this Act; and
- (b) Consult the board concerned as to the matters to be referred to in the notice.
- (3) Within [12] sitting days after a notice is given to a board pursuant to this section, the Responsible Minister for the State enterprise concerned shall lay a copy of the notice before the House of Representatives.

Powers of  
Accountable  
Ministers in  
respect of  
statement of  
corporate  
objectives—

## PART 3 - ACCOUNTABILITY

- 13.** (1) The board of every State enterprise shall deliver to the Accountable Ministers a draft statement of corporate objectives not later than [1 month] before the commencement of each financial year of the State enterprise.
- (2) Each statement of corporate objectives shall specify for the group comprising the State enterprise and its subsidiaries (if any), in respect of that financial year and each of the immediately following 2 financial years, the following information:
- (a) The objectives of the group:
  - (b) The nature and scope of the activities to be undertaken:
  - (c) The ratio of consolidated shareholders' funds to total assets, and definitions of those terms:
  - (d) The accounting policies:
  - (e) The performance targets and other measures by which the performance of the group may be judged in relation to its objectives:
  - (f) A statement of the principles adopted in determining the annual dividend together with an estimate of the amount or proportion of annual tax paid earnings (from both capital and revenue sources) that is intended to be distributed to the Crown:
  - (g) The kind of information to be provided to the Accountable Ministers by the State enterprise during the course of those financial years, including the information to be included in each half-yearly report:
  - (h) The procedures to be followed before any member of the group subscribes for, purchases, or otherwise acquires shares in any company or other organisation:
  - (i) Any activities for which the board seeks compensation from the Crown (whether or not the Crown has agreed to provide such compensation), including any agreement entered into pursuant to section [8] to provide a Community Service Obligation:
  - (j) Such other matters as are agreed by the Accountable Ministers and the board.
- (3) Each statement of corporate objectives shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed.
- (4) The board shall consider any comments on the draft statement of corporate objectives that are made to it not later than [14 days] before the commencement of the financial year by the Accountable Ministers, and shall deliver the completed statement of corporate objectives to the Accountable Ministers on or before the commencement of the financial year or such later date as the Accountable Ministers may determine.
- (5) A statement of corporate objectives for a State enterprise may be modified at any time by written notice from the board to the Accountable Ministers, so long as the board has first given written notice to the Accountable Ministers of the proposed modification and considered any comments made thereon by the Accountable Ministers within [1 month] of the date on which that notice was given.
- 14.** (1) Within [3 months] after the end of each financial year of a State enterprise, the board of the State enterprise shall deliver to the Accountable Ministers—

Statement of  
corporate  
objectives—

Annual  
report,  
accounts,  
and  
dividend—

- (a) A report of the operations of the State enterprise and those of its subsidiaries during that financial year; and
- (b) Audited consolidated financial statements for that financial year consisting of statements of financial position, profit and loss, changes in financial position, and such other statements as may be necessary to show the financial position of the State enterprise and its subsidiaries and the financial results of their operations during that financial year; and
- (c) The auditor's report on those financial statements.
- (2) Every report under subsection (1)(a) of this section shall—
- (a) Contain such information as is necessary to enable an informed assessment of the operations of the State enterprise and its subsidiaries, including a comparison of the performance of the State enterprise and subsidiaries with the relevant statement of corporate objectives; and
- (b) State the dividend payable to the Crown by the State enterprise for the financial year to which the report relates.
- 15.** (1) Within [2 months] after the end of the first half of each financial year of a State enterprise, the board of the State enterprise shall deliver to the Accountable Ministers a report of its operations during that half-year.
- (2) Each report required by this section shall include the information identified by the statement of corporate objectives.
- 16.** Any report prepared pursuant to section [14] or section [15] shall disclose whether the State enterprise has received any government assistance, and if so quantify in financial terms the amount of that assistance. Where the government assistance is not directly quantifiable an estimate must be made.
- 17.** (1) Within [12] sitting days of receiving all the following documents in respect of a financial year of a State enterprise, the Responsible Minister for the State enterprise shall lay the documents before Parliament:
- (a) The statement of corporate objectives of the State enterprise relating to that year and the succeeding 2 years; and
- (b) The annual report and audited financial statements of the State enterprise for the preceding financial year; and
- (c) The auditor's report on those financial statements.
- (2) Where a statement of corporate objectives for a State enterprise has been modified pursuant to section [13(5)] of this Act, the Responsible Minister shall lay before Parliament a copy of the notice making the modification within [12] sitting days after the date on which the Minister receives the notice.
- (3) Within [12] sitting days after a half-yearly report is given to a Responsible Minister pursuant to section [15] of this Act, the Responsible Minister shall lay a copy of the report before Parliament.
- 18.** Where information is required by section [17] to be laid before the House of Representatives by a certain time, the State enterprise shall separately and independently publish that same information within [one] week of that date [specify method of publication].
- 19.** (1) Subject to subsection (3) of this section, the board of a State enterprise shall supply to the Accountable Ministers or to such other person or class or classes of persons as either of those Ministers specifies such information relating to the

Half-yearly reports—

Government assistance to be disclosed—

Information to be laid before Parliament—

Information to be published—

Other information—

affairs of the State enterprise, or any of its subsidiaries, as either of those Ministers requests after consultation with the board (whether or not the information is of a kind referred to in the statement of corporate objectives).

(2) An Accountable Minister may request information to be supplied whether or not the supply of the information is required for the purposes of, or is contemplated by, this Act.

(3) The board of a State enterprise shall not be obliged by subsection (1) of this section to supply to any Minister any information relating to an individual employee or customer of the State enterprise, or of any subsidiary of it, or any other person, if the information supplied would enable the identification of the person concerned.

(4) Notwithstanding any Act or rule of law, the board of a State enterprise may direct an officer or employee of the State enterprise to comply with a request under subsection (1) of this section and the officer or employee shall comply with the request on being directed to do so.

(5) No person who acts in accordance with a request or direction under this section is liable to any person under any Act or rule of law by reason of acting in accordance with that request or direction.

**20.** (1) Every State enterprise and every subsidiary of every State enterprise has as its auditor the Auditor-General.

(2) Without limiting subsection (1), the board of a State enterprise may, after consultation with the Auditor-General and if its Responsible Minister so approves, appoint a person or firm that is qualified for appointment as an auditor of a company to be an additional auditor of the State enterprise or any subsidiary of a State enterprise.

Auditor-  
General to be  
auditor of  
State  
enterprises  
and  
subsidiaries—

**21.** Nothing in this Act shall be construed as requiring the inclusion in any statement of corporate objectives, annual report, financial statements, or half-yearly report referred to in sections [13 to 15] of this Act of any information [if to do so would, having regard to generally accepted standards of disclosure in commercial reporting, lessen the value of the State enterprise].

Protection from  
disclosure of  
sensitive  
information—

## PART 4 - MISCELLANEOUS PROVISIONS

**22.** A failure by a State enterprise to comply with any provision contained in Part 1 of this Act or in any statement of corporate objectives shall not affect the validity or enforceability of any deed, agreement, right, or obligation entered into, obtained, or incurred by a State enterprise or any subsidiary of a State enterprise.

Saving of  
transactions—

**23.** (1) Shares in a State enterprise held in the name of a person described as the Minister of Finance or the Responsible Minister shall be held by the person for the time being holding the office of Minister of Finance or Responsible Minister, as the case may be.

(2) Notwithstanding any other enactment or rule of law, it shall not be necessary to complete or register a transfer of shares of the kind referred to in subsection (1) of this section consequent upon a change in the person holding the office of Minister of Finance or Responsible Minister, as the case may be.

(3) Each Accountable Minister may exercise all the rights and powers attaching to the shares in a State enterprise held by that Minister.

Provisions  
relating to  
Ministers'  
shareholding—

- (4) An Accountable Minister may at any time or times, by written notice to the secretary of a State enterprise, authorise (on such terms and conditions as are specified in the notice) such person as the Minister thinks fit to act as the Minister's representative at any or all of the meetings of shareholders of the State enterprise or of any class of such shareholders, and any person so authorised shall be entitled to exercise the same powers on behalf of the Minister as the Minister could exercise if present in person at the meeting or meetings.
24. The Cabinet may, by Order in Council, make regulations for:
- (1) the selection, appointment and re-appointment of directors:
  - (2) the duties of directors:
  - (3) the making of directions to a State enterprise to provide a Community Service Obligation:
  - (4) the performance of Regulatory Functions:
  - (5) the transfer of Crown assets and liabilities to State enterprises, and any matter needed to give full effect to any such transfer.
25. (1) Where a State enterprise is registered under the Companies Act the provisions of this Act apply in addition to the Companies Act.
- (2) Where the provisions of this Act or any regulations made under this Act conflict with the provisions of any other enactment, the provisions of this Act or the regulations made under this Act, as the case may be, shall prevail.
- (cf section 34 of the Financial Institutions Act 1998)
26. The enactments specified in Schedule [2] to this Act are hereby amended in the manner indicated in that Schedule.
- Regulations may be made —
- Relationship to other legislation—
- Amendments and transitional provisions—

## PART 5 – FORMATION OF NEW STATE ENTERPRISES

*[To be discussed with ERU: is this needed? What level of detail is appropriate?]*

27. The Cabinet, through the Responsible Minister, may, from time to time, by notice in gazette, add the name of a company or the name of a company to be formed to Schedule 1.
28. (1) Notwithstanding any Act, rule of law, or agreement, the Accountable Ministers for a State enterprise named in Schedule 1 to this Act may, on behalf of the Crown, do any one or more of the following:
- (a) Transfer to the State enterprise assets and liabilities of the Crown (being assets and liabilities relating to the activities to be carried on by the State enterprise):
  - (b) Authorise the State enterprise to act on behalf of the Crown in providing goods or services, or in managing assets or liabilities of the Crown:
  - (c) Grant to the State enterprise leases, licences, easements, permits, or rights of any kind in respect of any assets or liabilities of the Crown— for such consideration, and on such terms and conditions, as the Accountable Ministers may agree with the State enterprise.
- Power to add to Schedule 1 by Order in Council—
- Transfer of Crown assets and liabilities to State enterprises—

(2) Any regulations made under section [24(5)] shall apply to any transfer, authorisation or grant made under subsection (1).

**29.** (1) For the purpose of facilitating the transfer of assets and liabilities to a State enterprise pursuant to this Act, the Cabinet may from time to time, by resolution, do any one or more of the following:

(a) Vest in or impose on a State enterprise any asset or liability, or any class of any such asset or liability, that the State enterprise has agreed to have transferred to it:

(b) Declare that a reference to the Crown or a Minister, officer, employee, department, or instrument of the Crown in any or all regulations, orders, notices, or documents shall be deemed to be or to include a reference to a State enterprise specified in the order:

(c) Declare that a State enterprise shall assume or continue to have the rights and obligations of the Crown or a Minister, officer, employee, department, or instrument of the Crown in respect of applications for rights, objections, or proceedings before any court, authority, or other person, being rights and obligations that the State enterprise has agreed to assume:

(d) Declare, in respect of any assets or liabilities transferred to a State enterprise pursuant to this Act, that the State enterprise shall be deemed to have specified rights or obligations in respect of those assets or liabilities, being rights or obligations that are required in respect of those assets or liabilities as a result of the change of ownership or responsibility from the Crown to the State enterprise:

(e) Declare that resolution by Cabinet made under this section shall be deemed to be notice to all persons, and that specific notice need not be given to any authority or other person:

(f) Direct any authority or other person to register or record any such vesting or declaration.

(2) Every Cabinet resolution made under this section may be made on such terms and conditions as the Cabinet thinks fit, and shall have effect according to its tenor.

**30** (1) In this section and in [sections 28 and 29] of this Act and in any regulations made under section [24(5)], unless the context otherwise requires,—

“agreement” includes a deed, a contract, an agreement, an arrangement, and an understanding, whether oral or written, express or implied, and whether or not enforceable at law;

“assets” means any real or personal property of any kind, whether or not subject to rights, and without limiting the generality of the foregoing includes—

(a) Any estate or interest in any land, including all rights of occupation of land or buildings:

(b) All buildings, vehicles, plant, equipment, and machinery, and any rights therein:

(c) All livestock, products from livestock, and crops:

(d) All securities within the meaning of the [Securities legislation]:

(e) All rights of any kind, including rights under Acts, deeds, agreements, or licences, and any kind of consent granted under the [planning legislation], and all applications for and objections against applications for such rights:

Cabinet  
resolutions  
relating to  
transfer of  
assets and  
liabilities—

Interpretation  
relating to  
transfer of  
assets and  
liabilities—

(f) All patents, trademarks, designs, copyright, and other intellectual property rights whether enforceable by Act or rule of law:

(g) Goodwill, and any business undertaking:

(h) All natural gas, petroleum, and other hydrocarbons:

“liabilities” includes—

(a) Liabilities and obligations under any Act or agreement; and

(b) Deposits and other debt securities within the meaning of the [Securities legislation]; and

(c) Contingent liabilities:

“rights” includes powers, privileges, interests, licences, approvals, consents, benefits, and equities of any kind, whether actual, contingent, or prospective:

“State enterprise” includes a subsidiary of a State enterprise:

“transfer” includes—

(a) Assign and convey; and

(b) Vest by Order in Council; and

(c) Confer estates in fee simple of land held by the Crown; and

(d) Grant leases, rights, and interests in any real or personal property;

and

(e) In the case of liabilities, the assumption by a State enterprise.

(2) In this section and in [sections 28 and 29] of this Act and in any regulations made under section [24(5)], a reference to “transfer”, “authorise”, or “grant” includes entering into an agreement to transfer, authorise, or grant, as the case may be.

(3) This section and [sections 28 and 29] of this Act and in any regulations made under section [24(5)] shall have effect, and assets and liabilities may be transferred pursuant to this Act, notwithstanding any restriction, prohibition, or other provision contained in any Act, rule of law, or agreement that would otherwise apply.

(4) Nothing in this Act shall limit any powers or rights that the Crown or a Minister has other than pursuant to this Act.

## SCHEDULE 1

### STATE ENTERPRISES

#### Section 2

- (a) [Home Finance Ltd]
- (b) Sasape Marina Ltd
- (c) Solomon Airlines Ltd
- (d) Solomon Islands Broadcasting Corporation
- (e) Solomon Islands Electricity Authority
- (f) Solomon Islands Plantations Ltd
- (g) Solomon Islands Ports Authority
- (h) Solomon Islands Postal Corporation
- (i) Solomon Islands Printers Ltd
- (j) Solomon Islands Water Authority

## SCHEDULE 2

### CONSEQUENTIAL AMENDMENTS Section 26

#### **Broadcasting Act (CAP 112)**

[To come]

#### **Electricity Act (CAP 128)**

[To come]

#### **Ports Act (CAP 161)**

[To come]

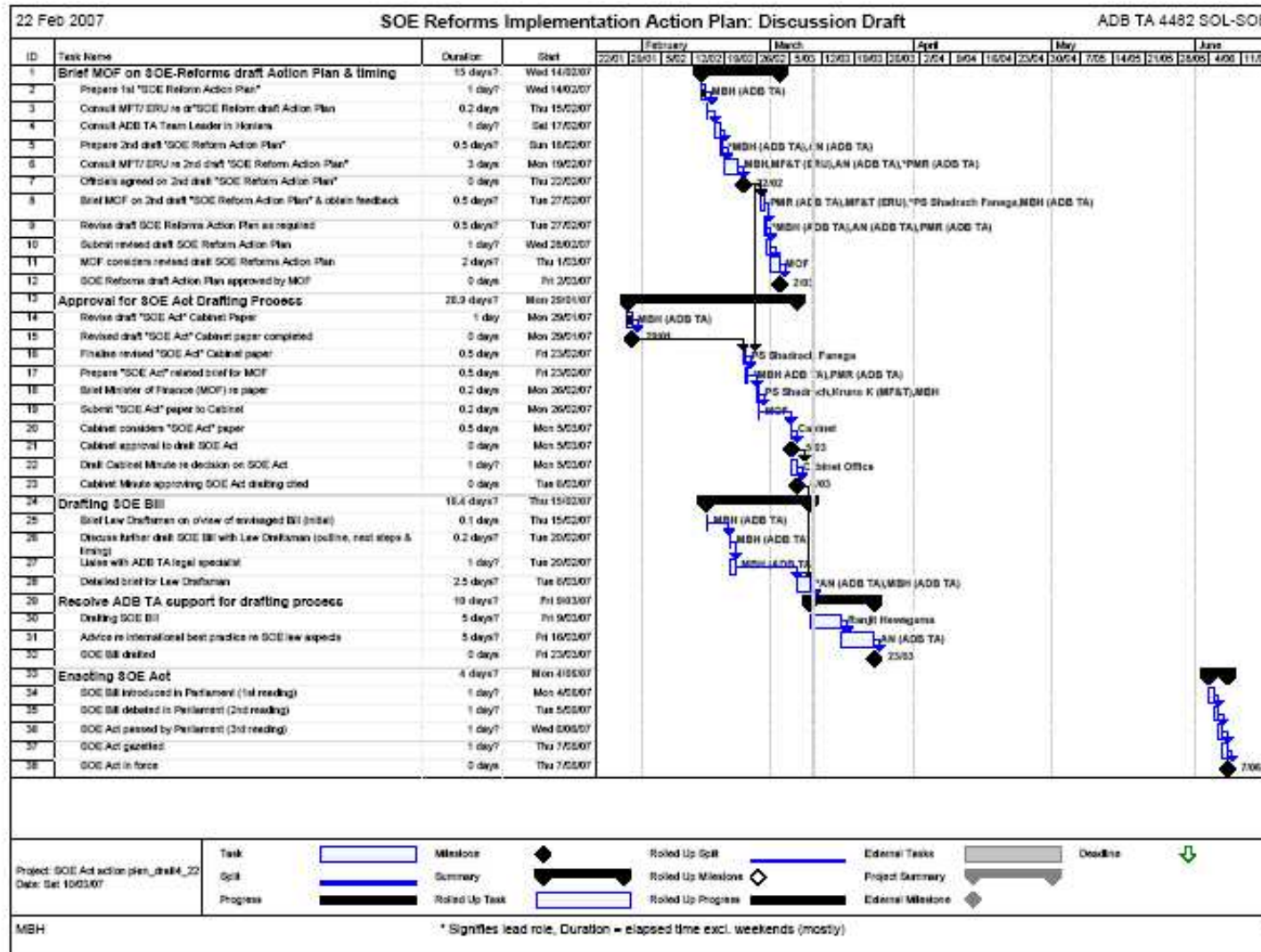
#### **Solomon Islands Postal Corporation Act 1996**

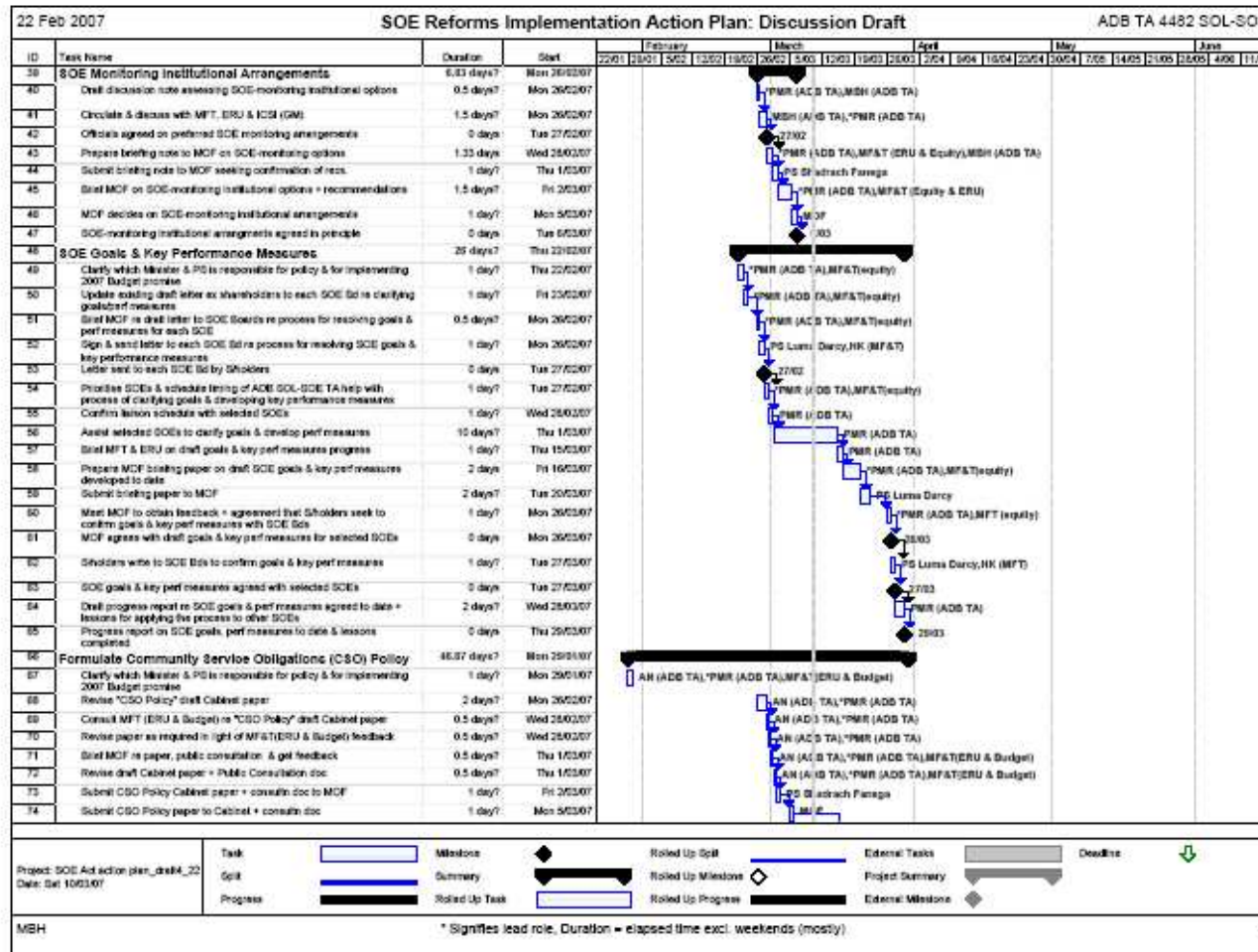
[To come]

#### **Solomon Islands Water Authority Act (CAP 150)**

[To come]

### Annex 4: SOE Reforms Implementation Action Plan



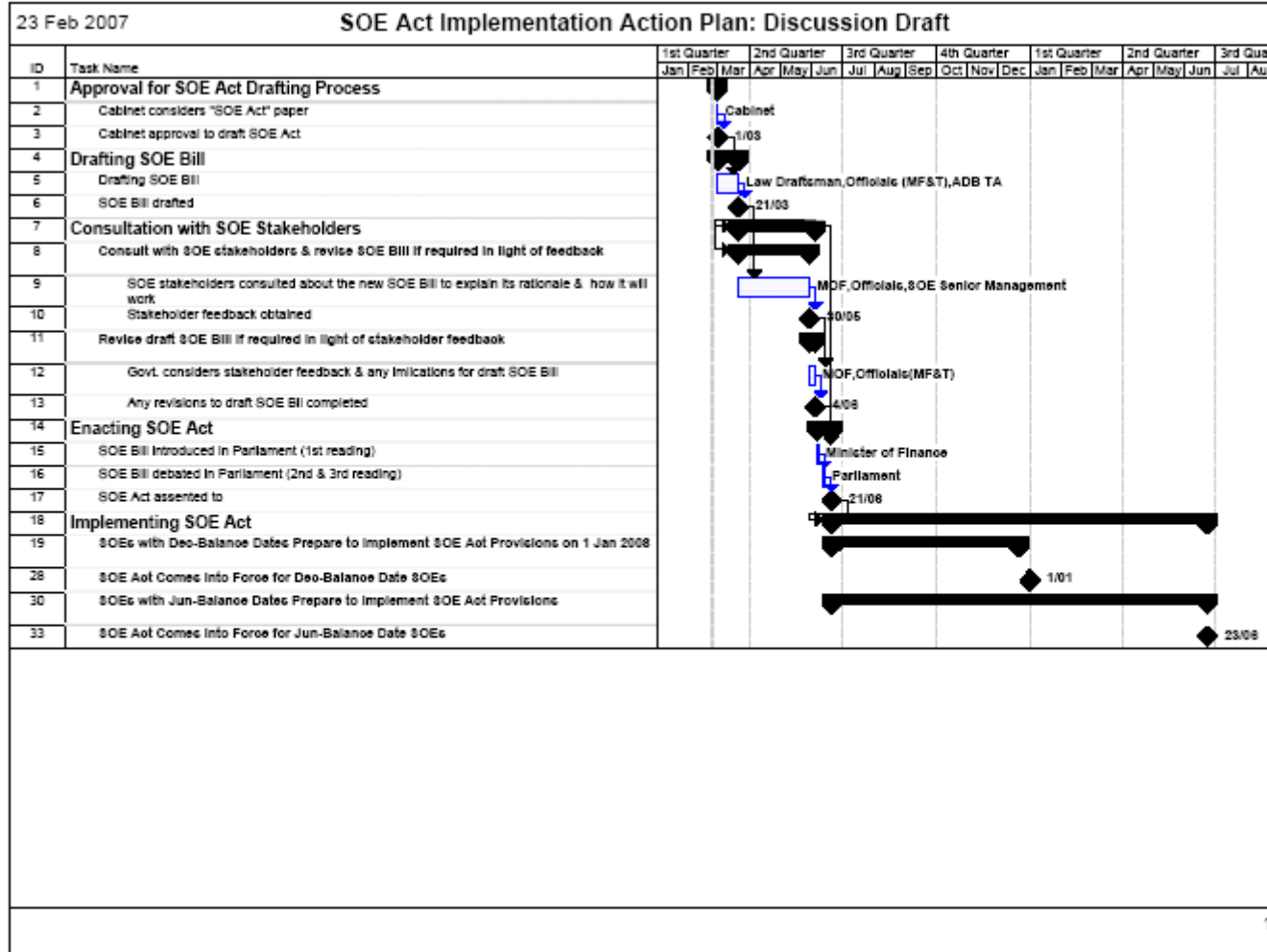




22 Feb 2007	SOE Reforms Implementation Action Plan: Discussion Draft	ADB TA 4482 SOL-SOE
<p>1 Brief MOF on SOE-Reforms draft Action Plan &amp; timing</p> <p>A discussion draft "SOE Reform Action Plan" is intended to help all the parties to easily plan, monitor and control the key tasks required to implement the various aspects of SOE reforms envisaged (in line with international best practice but tailored to Solomon Islands particular circumstances).</p> <p>The timing of various tasks, and their estimated durations, are suggestions for discussion. They will need to be confirmed to be useful.</p> <p>13 Approval for SOE Act Drafting Process</p> <p>The SOE Act is the vital underpinning of the SOE reforms. It provides the legal authority, and governance and accountability framework that governs all SOEs.</p> <p>The crucial underlying goal of the envisaged SOE reforms is to improve the quality, reliability and cost-effectiveness of services provided by Government-owned businesses!</p> <p>All the other aspects of these reforms are essentially means to help achieve this underlying goal and thereby enhance SOEs contribution to the economic growth of the Solomon Islands and well-being of its people. These other aspects include:</p> <p>(1) clearly setting the principal objective of each SOE = "to be a successful business";</p> <p>(2) clearly specifying the respective roles, powers &amp; duties of shareholder Ministers, and Boards of directors of each SOE;</p> <p>(3) providing clear processes for accountability including: setting strategic and performance goals specific to the SOE (e.g. via Statements of Corporate Intent and Business Plans), and regular reporting requirements.</p> <p>This Cabinet approval for drafting the SOE Bill is required ASAP to enable the Law Draftsman to be able to utilise the services of the ADB TA (SOL-SOE 4482) legal specialist before the TA project's scheduled finish date of 31 March 2007!</p> <p>24 Drafting SOE Bill</p> <p>33 Drafting SOE Act</p> <p>The current Parliamentary Session is expected to end on Fri 23 February. The aim is to have the draft SOE Bill ready for introduction (and enactment) during the next Parliamentary Session which seems likely to be in June 2007.</p> <p>Even if an SOE Act was passed in June 2007, its date of coming into force need not occur until later - by Order in Council - when other preparations to implement it had been completed.</p> <p>26 SOE Monitoring Institutional Arrangements</p> <p>One aspect of the preparation required for successful implementation of an SOE Act is the establishment of an SOE Monitoring Unit. An issue to be resolved is the institutional location of this unit. For example, would the monitoring unit be most effective if it resides within the Ministry of Finance and Treasury?</p> <p>Another aspect this issue, is to ensure that it is sufficiently resourced with suitably skilled staff and independent to be able to monitor and report to the Government on SOE performance and related issues (e.g. advice about terms of reference for director appointments).</p> <p>48 SOE Goals &amp; Key Performance Measures</p> <p>It is essential that each SOE has clear, prioritised strategic goals that it is expected to achieve by the Government and in accordance with any statutory duty it may have.</p> <p>To help an SOE's shareholders (Government), Board, Management and the public to assess an SOE's effectiveness in achieving these goals, it is vital that the shareholders and Board agree on a number of key performance measures of important aspects of performance that are consistent with achieving the desired goals.</p> <p>These strategic goals and key performance measures provide a consistent strategic and operational focus for an SOE - even though Board members may change - and help facilitate the accountability of the Board and Management teams.</p> <p>86 Formulate Community Service Obligations (CSOs) Policy</p> <p>Resolving Government policy on Community Services Obligations (CSOs) is not a task that the Government needs to have completed until the SOE Act has come into force.</p>		
MBH	* Signifies lead role. Duration = elapsed time excl. weekends (mostly)	4

22 Feb 2007	SOE Reforms Implementation Action Plan: Discussion Draft	ADB TA 4482 SOL-SOE
<p>Once the Act is in force, the Government needs to have in place a clear policy specifying:</p> <ul style="list-style-type: none"><li>(1) the criteria that would determine in what circumstances it would direct an SOE to provide a activity or services which would not be profitable for the SOE to do unless it was compensated for doing so;</li><li>(2) the Government's duty to make any such directive in writing to the SOE and table it before Parliament within a prescribed time; and</li><li>(3) to fairly compensate the SOE for any otherwise financial detriment from undertaking the activity or providing the community-oriented services.</li></ul> <p>An important reason for requiring payment of compensation is to ensure that the SOE Board and Management are not deflected from striving to run the SOE's business on a sound commercial basis, and be able to be held accountable for its decisions.</p> <p>To take advantage of the services of the ADB TA SOL-SOE 4482 team before the TA project's scheduled completion date of 31 March 2007, this work would need to be progressed within this time frame.</p> <p><b>EE: Resolution of Govt Policy on Economic Regulation</b></p> <p><b>Resolving Government Policy on Economic Regulation</b> is not an integral part of the SOE reforms which would be governed by the envisaged SOE Act.</p> <p>The aim of envisaged economic regulations is to provide a regulatory environment to manage or mitigate the socially undesirable impacts of market power: e.g. where a business has a natural (or artificially created) monopoly and could charge monopoly rents for its services). Partly the aim of such regulation is to protect consumers, and partly to avoid inefficient resource allocation decisions due to market power being used to squeeze out competitors and restrict the optimal size of a particular type of economic activity.</p> <p>The thrust of the envisaged policy approach is to ensure that any economic regulations are applied on an economy-wide basis or possible sector-wide basis (i.e. not on an individual firm basis). Such regulations would apply equally to an SOE or privately-owned business.</p> <p>Government policy on economic regulation does not need to be resolved as a condition of an SOE Act coming into force. Timing of resolving Government policy on this issue, therefore, is flexible.</p> <p>But to take advantage of the services of the ADB TA (SOL-SOE 4482) team services before the TA project's scheduled end on 31 March 2007, the suggested tasks would need to start being progressed ASAP.</p> <p>Also, given the monopolistic positions of some SOEs, it would be sensible to progress work on resolving Government policy on economic regulation sooner rather than later, to help to ensure that the businesses are put on a more efficient basis and therefore are more likely to perform better.</p>		
MSH	* Signifies lead role. Duration = elapsed time excl. weekends (mostly)	5

### Annex 5: SOE Act Implementation Plan Summary



## **Annex 6: Summary Draft Cabinet Paper on SOE Reforms**

22 February 2007

### **Memorandum from the Minister of Finance**

## **SOE REFORM ACTION OVERVIEW & RECOMMENDATIONS**

### ***Proposal***

1. Honourable Colleagues, this paper seeks Cabinet's agreement to instruct the Attorney General to draft a **State Owned Enterprises (SOE) Bill** to underpin a range of SOE reforms that are essential for our SOEs to contribute effectively to the economic growth and well-being of the Solomon Islands, especially in rural regions.
2. An SOE Act will provide a consistent **legal framework and powers** to govern SOE operations and enable effective measures to remedy their typically poor service-delivery and financial-performance. In line with the 6 February Budget Statement, the aim is to introduce a new SOE Bill during 2007. Its enactment is essential to underpin key aspects of SOE reforms and to improve SOEs performance.

### ***Need for SOE Reform to Remedy Poor Performance***

3. Honourable Colleagues, the Government owns a wide range of SOEs whose activities significantly affect our economic performance, including:
  - a. *Vital infrastructure services* (electricity, water, ports, airline, post, broadcasting);
  - b. *Development ventures* (canning, commodities export, fishing, forestry, livestock and plantations) many of which have failed commercially and ceased trading.
4. But many SOEs have performed poorly despite their favoured treatment compared with comparable privately-owned businesses (e.g. exemption from income tax). Too often our SOEs fail to supply quality services reliably and cost-effectively; to the direct detriment of our citizens. Too often they provide little or no return on the government's equity in the SOE, and incur sizeable debts that it ultimately must repay. This means that the government has less resources available to finance more worthwhile expenditure priorities that otherwise could have benefited many citizens.

### ***Causes of Poor SOE Performance that Require Remediating***

5. Honourable Colleagues, our SOEs' poor performance is the result of a mix of problems that need remediating as soon as possible. These problems include:
  - a. *A lack of clear strategic goals and performance targets* to guide each SOE's activities, and provide a basis for assessing its actual performance;
  - b. *A lack of accountability for actual performance* relative to goals or targets, and thus little incentive for an SOE's board and managers to improve its performance.
  - c. *Boards of directors often lack the mix of relevant skills* needed to carry out their role of overseeing the strategic direction of an SOE's activities;

- d. *Insufficient management and financial management skills* to run an SOE on a sound commercial basis in line with agreed goals and performance targets;
- e. *Prices charged for services are often insufficient to recoup supply costs* from customers – partly due to poor information about costs and partly due to political interference – so that the ongoing supply of these services is unsustainable;
- f. *Lack of up-to-date relevant information* on SOEs' operational and financial performance. This makes it difficult for boards and management to monitor and assess performance, and make informed business decisions; and
- g. *No coherent legal framework to govern SOEs*, their roles, and their shareholders' and directors' powers, duties, accountabilities for performance and governance arrangements to ensure each SOE is organised and managed so as to fulfil its role as effectively as possible.

### ***Solutions to Improve SOE performance***

6. Honourable Colleagues, an integrated solution is required to remedy these causes of poor SOE performance. An SOE Act will help us achieve these reforms by providing a consistent legal framework both to guide the reforms and to govern SOEs' ongoing operations, governance and accountability for performance. In particular, it will make clear the legal powers, duties and roles of Government Ministers, SOE shareholders and directors. A detailed brief to assist the Attorney General in drafting the Act has already been developed by the Department of Finance and Treasury, in conjunction with Asian Development Bank Consultants, and inputs from all SOEs. This brief is based on tailoring international best practice to Solomon Islands conditions.

7. The Act will also provide for Cabinet by Order in Council to make **regulations** that elaborate the standards applying to various issues (e.g. *directors* selection, appointment and duties; any *government directives* for an SOE to act non-commercially which should be explicit and compensate the SOE for any resultant costs; and the *transfer of Crown assets* to SOEs).

8. An SOE registered under the Companies Act, will be subject both to its provisions and those of the SOE Act. If the provisions of the SOE Act (or regulations under it) conflict with provisions of any other legislation, the provisions of the SOE Act (and its regulations) will prevail.

9. **Other aspects** of the envisaged solution later will include public consultation on a *draft policy statement* explaining that SOEs will be subject to the same regulation as comparable privately-owned businesses, and expected to operate similarly. The Department of Finance and Treasury will seek *donor support* to obtain a short-term team of extra accountants, legal experts and auditors to up-date SOE accounts and resolve any legal issues. Also, the Department will work with each SOE to clarify its goals and performance targets as a basis for improving the focus of SOE activities and strengthening accountability for their performance.

## Conclusion

10. Honourable Colleagues, it is vital that we approve the drafting of an SOE Bill as the cornerstone for reforming our SOEs so that they can achieve their full potential in contributing positively to the economic growth and well-being of our country. Your agreement to the following recommendations will help us to achieve this goal.

11. With your support for the recommendations below, the SOE Bill could be drafted ready for introduction when Parliament next sits (probably June 2007).

## Recommendations

12. **Cabinet** is therefore requested to:

- A. **Direct** Department of Finance and Treasury officials to provide drafting instructions to the Attorney General's Chambers for an SOE Bill - which is based on international best practice but tailored to Solomon Island conditions - in time for introduction at the next sitting of Parliament.
- B. **Note** At the various stages of the legislative process, Cabinet will have ample opportunity to consider detailed aspects of the Bill and, once the bill is enacted, later regulations that are envisaged.
- C. **Note** Other measures planned to help reform SOEs and improve their performance, that can start before an SOE Act exists, include:
  - 1. The Department of Finance and Treasury will prepare a *draft policy statement* about ownership and regulation of SOEs for public consultation before the legislation is finalised.
  - 2. The Department will seek technical help from donors to update all SOE financial statements and improve their financial management.
  - 3. The Department will also work with each SOE to clarify its goals and performance targets as a basis for improving the focus of its activities and strengthening accountability for its performance.

Minister of Finance  
Ministry of Finance and Treasury  
Honiara

## **Annex 7: Draft Cabinet Paper on Strategy for Sale of HFL to NPF**

### **Memorandum from the Minister of Finance**

## **STRATEGY FOR SALE OF HFL TO NPF & IMPLEMENTATION**

### **Proposal**

1. Honourable Colleagues, this paper seeks Cabinet's agreement to a **strategy** for selling Home Finance Limited (HFL) to the Solomon Islands National Provident Fund (NPF), and to its **implementation** without delay.
2. The essential purpose of this proposed action is to achieve GCCG Policy 7(i) which is to "combine the Home Finance Corporation [now HFL] and NPF housing Schemes into one affordable housing scheme."
3. High-level discussions with the NPF confirm that it has a strong interest in purchasing HFL as a basis for merging its own housing-finance related activities with those of HFL. The NPF aims to form a single, well-managed, financially strong, competitive entity. Its role would be to provide housing finance on a sustainable commercial basis to the Solomon Islands people, including in rural areas.
4. Honourable Colleagues, the NPF's goal is consistent with the outcomes the Government is seeking. The amalgamation of the two housing schemes would not result in undue market power. Instead it should stimulate competition by revitalising both schemes. It also would provide other benefits for the government, as elaborated later.
5. The sale process required to achieve this goal is likely to take about three months from when approval is given to begin it.

### **Sale Strategy**

6. Honourable Colleagues, GCCG Policy 7(i) implies a sale process involving negotiations solely with NPF. While this makes it more difficult to obtain a fair price for the company than via a competitive tender process, the government retains the option to sell HFL on a competitive tender if a mutually acceptable price and settlement terms are not reached.
7. NPF is aware the government has this fallback option. This should encourage it to make its best possible offer to secure the benefits expected from the amalgamation. These benefits include the opportunity to use its surplus cash to develop HFL land.

### **Sale Process**

8. Honourable Colleagues, the sale process would comprise the following steps:
  - a. **HFL shareholders to formally advise the HFL Board** of: (1) its intention to sell the company to NPF; (2) the planned sale strategy and process; and (3) their role and duties under that process.

- b. **HFL shareholders to confirm with NPF key HFL-sale/purchase issues**, including: (1) its intention to purchase NPF; (2) the key sale terms and conditions; and (3) the sale process.
  - c. **HFL Board and management to complete preparation for full disclosure of information to NPF** in strict confidence under the sale process.
  - d. **Government to inform the public of intended sale of HFL to NPF**, its rationale and expected benefits, and to assess public reaction before proceeding to the next stage in the sale process.
  - e. **NPF to carry out due diligence inspection of HFL** and submit an offer to HFL shareholders.
  - f. **HFL shareholders and NPF to negotiate a mutually acceptable sale/purchase agreement.**
  - g. **Government to decide whether to ratify agreement.**
9. The sale process is expected to take about three months to complete, based on informal consultations with parties and analysis of initial progress to date by HFL in getting its financial and other information to the level required for due diligence.
10. Annex 1 outlines the expected timeline for key aspects of the sale process.

### **Benefits Arising from Sale of HFL to NPF**

11. Honourable Colleagues, sale of HFL in its entirety to NPF would be likely to create worthwhile benefits:
- a. **Realise immediate economic value for the government** as owner of HFL in the form of cash that could be used to finance budget priorities. This value stems significantly from selling the valuable option to develop HFL's holdings of undeveloped land.
  - b. **Create a sound organisation for supplying housing finance** on a competitively priced normal commercial basis.
  - c. **Remove the government's exposure to significant financial risks from owning HFL.** For example, sale of HFL would enable the government (as its owner) to resolve some serious problems with the company, and discharge its liabilities to HFL as part of the sale.
  - d. **Help to ease downward pressure on deposit-interest rates** the low levels of which discourage saving and make it harder for people to obtain deposits for housing loans.
  - e. **Show the value of private sector participation in SOEs** where there is no compelling reason for the government to own them, and of good management.
12. Honourable Colleagues, entering into this sale process - and later selling HFL to NPF, if the process is successful – will in not limit the government's ability to implement a wide range of other measures to enhance the availability of affordable housing.

### **Recommendations**

13. It is therefore requested that Cabinet:

- A. **Note** That GCCG Policy 7(i) is to “combine the Home Finance Corporation [now HFL] and NPF housing Schemes into one affordable housing scheme.”
- B. **Agree** That to give effect to Policy 7(i) the Government should:
- a. Adopt the **sale strategy** of promptly entering into a bilateral sale process with NPF to negotiate the sale of HFL to NPF; but
  - b. Do so on the clear understanding that it would exercise its fallback option of selling HFL via competitive tender if a mutually acceptable settlement cannot be reached.
- C. **Agree** To adopt the **sale process** as outlined in paragraph 8 above.
- D. **Note** That this sale process includes an early **public information stage** which will allow the Government to explain the rationale and expected benefits of the sale, and to assess public feedback before proceeding with the rest of the sale process.
- E. **Direct** Department of Finance and Treasury officials – with support from the ADB TA on SOE Reform and Public Sector Participation - to begin immediately carrying out the agreed sale process.

Minister of Finance  
Ministry of Finance and Treasury  
Honiara

December 2006

## **Annex 8: Economic Regulation Discussion Paper**

# ***Discussion paper for Economic Reform Unit, Ministry of Finance***

## ***Economic Regulation***

## **Economic Regulation: Executive Summary**

### **Coverage**

*This paper discusses the principles of economic regulation, and the current regulation and practice in Solomon Islands markets. We discuss regulation that covers all markets, such as the Consumer Protection Act and the Price Control Act, and regulation that covers only one market, such as sector legislation like the Electricity Act and the Telecommunications Act. We have not considered the practice in some areas of requiring businesses generally to have a “licence”.*

### **Three Key Findings**

- 1 Our first finding is that licensing requirements in current sector legislation prevent Solomon Island consumers from getting the benefit of competition. Licensing that should be limited to issues of safety and technical standards are instead being used to prevent competition. In electricity, SIEA is in the awkward position of licensing competing generators; in telecommunications Telekom has been granted a 15-year exclusive licence; and in civil aviation the licensing regime is not well suited to fostering competition in domestic services.
- 2 Secondly, where price is regulated, regulators often lack the expertise and resources needed to set credible prices that consumers and businesses can rely on, and there is no public consultation before decisions are made. An example is the process for setting the fuel price, which then impacts on the price of electricity and water. There are positive examples too – the latest electricity pricing formula was developed by contracting in an expert, and SIWA consults before changing its price. However, it is very difficult to regulate prices without causing more problems than you solve.
- 3 The third finding is that the issue of uneconomic provision of essential services – to the poor and especially in high-cost rural areas - sits at the heart of the current issues with regulation in the Solomon Islands. The government has not identified what services it wants to be provided in circumstances where customers cannot meet all the costs – what quantity? what quality? what locations? and how are they going to be paid for? This explains the current approach to regulation, and the failure to make use of explicit alternatives – e.g. what are called Community Service Obligations.

### **The Impacts on SOEs**

- 4 One direct result is that utilities are protected from competition by licensing, in return for a non-specific commitment to provide rural services. Prices are set by having regard to political considerations rather than signalling what it costs to provide electricity, water, telecommunications, etc efficiently. Any proposal for change is met with the argument from the existing operator that this will undermine the cross-subsidy from the urban to rural areas and therefore the ability to provide rural services.

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### ***The Impacts on People***

- 5 The end result is that both rural and urban Solomon Islanders are losing. In urban areas the lack of competition or proper price regulation means prices are too high, service quality is too low, or both. Possibly costs are also higher than they would be in a competitive market. In the rural areas, no goals have been set and there is no check on whether current services are provided efficiently.

### ***Progress is Possible***

- 6 There is a risk that these issues appear too hard. However each issue tackled individually, within a consistent and principled framework, is doable.

### ***Separation gives Clarity, Focus and More Options***

- 7 There is an opportunity to get a more reasonable deal for both rural and urban consumers by separating the issue of rural services from economic regulation and from the issue of public versus private ownership, and dealing with rural services clearly and carefully as a government social policy issue.

### ***National Planning Can Produce Clear Shared Goals***

- 8 The government's goals for rural services, and how they will be funded, can be articulated during the national planning process, in consultation with the service providers. Agreements can be put in place as part of the reform of SOE governance, which proposes a mechanism for the government and the SOE to settle on transparent targets and funding mechanisms.

### ***Policy Statements – Faster and More Flexible than New Laws***

- 9 In the area of economic regulation, in the short term a Government Policy Statement could direct that licensing regimes are not to prevent competition, and direct that any price setting process includes public consultation and the use of expert advice. The various reforms of sector-specific legislation will embed these disciplines, and resolve any issues of regulatory independence.

### ***It's Time to Provide a Framework: Sound Steps towards Clear Goals***

- 10 Our consultation is happening at the same time as projects looking at specific sectors – telecommunications and civil aviation in particular. The sector reforms are guided by the same principles discussed in this paper, and should result in sound regulatory frameworks that give consumers confidence they will receive a reasonable deal. A Government Policy Statement on economic regulation, discussed in this paper, would show stakeholders that these reforms are proceeding from a common framework.
- 11 Sector reforms mean it is urgent to agree goals for rural services and how they will be funded. It will be difficult to put in place a framework that deals with the various issues – competition, licensing, pricing, rural services – without having debated these issues and knowing what those goals are.

## **Suggested Framework**

### ***The Benefits From Competition***

- 12 The absence of actual or potential competition creates a risk that consumers will not get a “reasonable” deal. By reasonable deal we mean the prices consumers pay, and the range and quality of the goods and services. We also mean a reasonable deal into the future, which highlights that consumers have an interest in making sure businesses have sufficient revenue to maintain equipment and preserve the capability to meet consumers needs, and incentives to invest and innovate.

### ***Problems Where There is No Competition***

- 13 A business with no competition has no pressure to keep costs and prices low, or to innovate. In such cases, economists say there is “market failure”. In the Solomon Islands, a number of the most significant examples of non-competitive markets are markets in which SOEs operate (electricity, water, post, etc). Improving the performance of SOEs is an important government priority, as the efficiency and reliability of these SOEs has a significant influence on the rest of the economy.

### ***First Response to “Market Failure”: Create Competition***

- 14 When responding to market failure, the government’s first priority is not to regulate but to overcome the lack of competition in the market. Often this involves taking another look at regulation that acts as a barrier to entry, such as licensing, import duties, foreign investment regulation, etc. For example, import competition ensures that Solomon Island consumers get a reasonable quality at a reasonable price in the important markets of milk, sugar, and flour. This is all the more interesting because these markets are, on paper, subject to price control, but this regulation is not enforced. Once it was thought regulation was needed, but this has not been the case.

### ***Economic Regulation is the Second-Best Option***

- 15 If competition is not feasible and the existing operator is misusing its market power, regulatory intervention will attempt to ensure current prices do not rise above competitive levels, while maintaining the firm’s incentives to make further investments. The problem is that price regulation is very difficult to “get right”. But, if competition in the market is not providing a sufficient level of consumer protection, then the government has an interest in addressing any issues of safety, misleading behaviour, and so on.

### ***The Place for Good Economic Regulation***

- 16 Good economic regulation will contribute to good performance by SOEs, and will also open up privatisation as a reform option, because it covers all sectors, and applies to both private sector businesses and SOEs i.e. regardless of ownership. The converse is also true – it is a bad idea to privatise a firm **if** that firm has market power **but** the government does not have effective economic regulation in place.

## General discussion

### Introduction

- 17 It is important to start with the question:  
*What problem is economic regulation addressing?*
- 18 One way of explaining the problem is:  
*Where the absence of actual or potential competition creates a risk that consumers will not get a “reasonable” deal*
- 19 By “reasonable deal” we mean the prices consumers pay, the range and quality of the goods and services, and other consumer interests such as safety, reliability, timeliness, etc. We also mean a reasonable deal into the future, which highlights that consumers have an interest in making sure there are incentives for businesses to invest and innovate.
- 20 A business with no competition has no pressure to keep costs and prices low. All around the world, businesses with no competitors have tended to pay their staff, managers and board members more than can be justified on reasonable grounds.
- 21 These firms are also under less pressure to innovate. This is serious, as it is innovation by firms that creates the most value for consumers over time. Innovation can mean adopting and installing new technology quickly, producing new products or services, making existing products more reliable, or improving processes to do things like delivering services faster.
- 22 These issues arise in markets that do not have an adequate level of competition. In the Solomon Islands, a number of the most significant examples are markets in which SOEs operate (electricity, water, post, etc). The performance of SOEs is an important government priority, as the efficiency and reliability of these SOEs has a significant influence on the rest of the economy. Good economic regulation is an important contributor to SOE performance.
- 23 Good economic regulation will also open up privatisation as a reform option. Economic regulation is of general application, designed to address issues that arise from a lack of competition, and other market failure. It will cover all sectors, both private sector businesses and SOEs. The converse is also true – privatising a firm with market power without having effective economic regulation in place is a bad idea.
- 24 Focusing on the lack of competition is appropriate. Just because something is essential does not mean it should be regulated. A good example is food production. The Solomon Islands does not regulate to require certain quantities of certain food to be produced. Similarly with transport, another essential input to the economy [check]. Something more is required before regulation is needed and is optimal.
- 25 Focusing on the problems caused by a lack of competition takes us to the next questions. The first question should be “is the level of likely competition acceptable?”, and then second “if not, what are the specific reasons for regulating?”.
- 26 When considering current and future regulation we need to consider both the legal framework and the institutions needed to implement the law.

## **Regulatory priorities**

- 27 When responding to this market failure, the government has a series of priorities.
- 28 The first priority is not to regulate but to consider whether the lack of competition in the market can be addressed. Areas to consider are:
- 28.1 Are our “market making” rules and institutions working appropriately? Are commercial law and related institutions facilitating market transactions and giving investors confidence in the basic operation of the market? Are common technical standards needed to facilitate competition in a particular market?
- 28.2 Are there barriers to entry into the market that can be removed? Often this involves taking another look at regulation that acts as a barrier to entry, such as licensing, import duties, foreign investment regulation, etc.
- 29 Second, if competition is not feasible and the incumbent firm is misusing its market power, regulatory intervention will attempt to ensure:
- 29.1 current prices do not rise above competitive levels, while maintaining the firm’s incentives to make further investments.
- 29.2 firms do not take advantage of any market power to harm competitors or lessen competition.
- 30 Also, if competition in the market is not providing a sufficient level of consumer protection then the government has an interest in addressing any issues of safety, misleading behaviour, and so on.
- 31 The regulatory objectives can be illustrated in the electricity sector, where competition in generation may be possible but competition in distribution is not. Similarly in telecommunications, competition between fixed line networks seems unlikely, but other markets may be competitive (e.g. ISP services).

## **Forms of economic regulation**

- 32 As will be clear from this discussion, economic regulation can be a broad term, and to avoid misunderstanding it is important to be specific about the types of regulation under discussion. This discussion document will address the following types (in varying degrees of detail):

### ***Competition law***

- 33 As part of the “market making” rules, it is common to have legislation prohibiting anti-competitive behaviour in the market. Firms should be prevented from acting in a way that undermines competition and the benefits consumers receive from competition. An example is price fixing.

### ***Consumer protection***

- 34 Regulation may protect consumers from “sharp” practices in the market, such as misleading advertising and labelling, or setting basic quality standards. This is aimed in part in giving consumers confidence in the market.

### ***Information disclosure***

- 35 In some markets, competition can be improved by giving competitors and consumers information they would not otherwise get (or would be too costly to collect). In these situations it is common to have information disclosure

regulations requiring firms with market power to disclose information on their pricing, asset base and service performance.

### **Price control**

- 36 Where the market is not competitive and the incumbent firm uses its market power to charge high prices (either as a result of inefficiency or in pursuit of monopoly profits), the government can consider correcting this by regulating the price.

### **Safety regulation**

- 37 In some circumstances it may be inappropriate to let safety standards be set by market participants. Examples include safety standards in electricity and gas. Again, this is aimed in part in giving consumers confidence in the market.

### **Technical regulation**

- 38 There are areas where the regulation of technical standards will facilitate market transactions and the efficient utilisation of resources, and can be seen as part of the “market making” rules. An example is the management of the radio spectrum.

### **Social regulation – Community Service Obligations**

- 39 The government will have important social goals in some markets. Principally, the government will be concerned to ensure essential services are widely provided and affordable. Regulatory interventions designed to provide for the provision of essential services where they would not otherwise be provided, or at prices below that which would otherwise be charged, are called Community Service Obligations.
- 40 This is clearly an area of significant challenges for Solomon Islands government policy, and is discussed in more detail below.

### **Regulatory institutions**

- 41 Having good legislation “on the books” is probably less than half the story. As important, if not more, is the institution that will administer the regulation.
- 42 Regulators bear a heavy burden. First, administering economic regulation can be difficult. A significant amount of information and expertise is required to police competition law, regulate prices in uncompetitive markets, and establish safety and technical standards.
- 43 Second, the regulator has a significant influence on the performance of the market over time. Whether existing firms invest for the future and whether new firms enter and compete will be significantly influenced by whether regulatory decisions are credible and predictable.
- 44 The quality of decisions by the regulator, and the success of a regime over time, will be heavily dependent on three key features.

### **Independence**

- 45 The person making the regulatory decisions must be independent. By independent, we mean the decision maker is fully incentivised to only consider the objectives of the regulatory regime when making decisions.

### **Expertise**

- 46 The problems regulators are required to consider are often complex. Any regulatory institution should have the resources and skills needed to resolve the problems it is asked to address.
- 47 In a small market such as the Solomon Islands this may mean being realistic about the level and complexity of regulation that is sustainable, and contracting in expertise when required.

### **Accountability**

- 48 A regulator should be accountable for its decisions. This can be achieved by:
- 48.1 *Criteria:* the objectives of the regulatory regime, and the criteria for any particular regulatory intervention, should be explicitly stated. The quality of any decision can then be measured against the relevant criteria. To illustrate, there is no criteria for imposing price control under the Price Control Act []. This means a decision to impose control cannot be tested, and so the regulator is unaccountable.
- 48.2 *Public participation:* an open process with opportunity for public participation creates a practical level of accountability, as the regulator must hear from and consider the views of those affected by the regulatory decision. In the Solomon Islands there may be practical challenges in engaging the affected communities in more remote areas, but this could be expected to yield valuable information and a sense of public engagement in the issues.
- 48.3 *Published reasons for decisions:* this brings together the previous two points. A requirement that the regulator publish the reasons for any decision forces the regulator to justify any decision against the relevant criteria, and increases the ability of those affected by the decisions to participate in the process.

### **The costs and risks of regulation**

- 49 Regulation is not without its costs and risks. The direct costs are the costs incurred by the regulator when administering the regulation and the costs incurred by firms when complying.
- 50 The indirect costs can be more significant. These include the risk that firms will delay or cancel investment because they perceive a risk the regulator will act in a way that prevents them from earning a commercial return on their investment, or firms deciding not to enter the market at all for the same reason. This can happen when the regulator favours short term price reductions over long term investment, or when regulatory decisions are simply unpredictable. In these situations the consumer loses the significant long terms benefits of investment, competition and innovation in the market.
- 51 Arguably this is what consumers are experiencing in Honiara with electricity and water services. Political and regulatory pressure may have kept prices below the level needed by the firms to maintain current networks and invest in new assets. By the time this lack of investment is impacting on consumers it is a significant problem and takes time to fix. The potential lesson is that if the regulatory regime, including market reforms, SOE performance improvement and economic regulation, is to return prices to an efficient and sustainable level, some prices may come down and some may need to rise. If the government is concerned about the level of price set by a competitive market or efficient

regulation then, as discussed below, it can engage the firm concerned on a transparent Community Service Obligation.

## **General regulation**

### **Introduction**

- 52 For the purposes of discussion, this paper divides economic regulation into two categories: regulation that applies (or could apply) to all markets (this section) and regulation that applies to a particular sector, such as electricity (the next section).
- 53 Three forms of general economic regulation are discussed in this section:
- 53.1 competition law;
  - 53.2 consumer protection law; and
  - 53.3 price control.

### **Competition law**

#### ***Current law***

- 54 The Consumer Protection Act 1995 (CAP 63) includes a number of competition law prohibitions. These are prohibitions against:
- 54.1 exclusive dealing (section 26);
  - 54.2 price discrimination that results in a substantial lessening of competition (section 27); and
  - 54.3 taking advantage of market power to harm a competitor (section 29).
- 55 Potential penalties are a \$3,000 to \$7,000 fine and 1-2 years imprisonment.

#### ***Institutional arrangements***

- 56 The Consumer Affairs Division is charged with administering the Consumer Protection Act. The Division is chronically under funded when compared to its responsibilities under the Act. When we spoke to the Division, one person was responsible for all duties under the Act and had no enforcement capabilities. A request had been made by the Division for additional resources.
- 57 None of the competition law prohibitions are currently enforced.

#### ***Discussion***

- 58 Competition law requires significant resources and expertise to be enforced. For example, establishing whether a firm has a “substantial degree of market power”, whether it has “taken advantage” of that power, or whether a particular arrangement “substantially lessens competition in a market” required a large amount of information and the application of economic and legal expertise. There is an active debate about the role of competition law in a small market, and in particular whether the costs of maintain a credible competition law regulator outweigh the benefits.
- 59 One approach may be to say “what is the harm of having these prohibitions on the books, just in case?”. The potential harm is two fold. First, this creates a risk for firms of the prohibitions being applied in a surprising and unpredictable way in the future. As discussed above, if regulation is to provide a framework that allows long-term investments to be made, it must be predictable. Second,

- and more fundamental, the government has an interest in the statute books reflecting reality. The rule of law is undermined if statutes are made that cannot be enforced.
- 60 A surprising omission from the Consumer Protection Act is the lack of any price fixing prohibition. There are two arguments in favour of a price fixing prohibition:
- 60.1 Price fixing is recognised as the most serious competition law offence. For a market to be competitive, competitors must compete on price and not agree on price. Price fixing arrangements have been compared to stealing from the consumer, and competition regulators internationally have made price fixing and “cartel behaviour” their top priority.
- 60.2 It does not require the same amount of economic and legal expertise to enforce. No economic tests such as market power or lessening competition need to be established. What is prohibited is an arrangement between competitors that fixes, controls or maintains price (regardless of the impact on the wider market). This could potentially be enforced as a criminal fraud offence.
- 61 Looking forward, one option would be to repeal the existing competition law prohibitions as being too difficult to enforce credibly in the Solomon Islands context, and replace them with a price fixing prohibition. A price fixing prohibition can be drafted so that it can be enforced in the same way as a criminal fraud offence, avoiding the need for a separate regulator or a high degree of competition law expertise.
- 62 We are aware further Trade Practices legislation has been proposed. We remain sceptical about whether this will be enforceable, and suggest the focus should be on establishing and enforcing a price fixing prohibition.

## **Consumer protection**

### ***Current law***

- 63 The Consumer Protection Act 1995 (CAP 63) includes a number of consumer protection provisions. These include:
- 63.1 an ability to set by regulation “approved standards”, such as minimum quality and performance, manufacture, and packaging (section 12);
- 63.2 product recall provisions (section 16);
- 63.3 an anti-hoarding prohibition (section 19); and
- 63.4 prohibitions against misleading or deceptive conduct (section 24), and misrepresentations (section 25).
- 64 Potential penalties are a \$3,000 to \$7,000 fine and 1-2 years imprisonment.

### ***Institutional arrangements***

- 65 The Consumer Affairs Division is also charged with administering these provisions. The same person responsible for the competition law regime is responsible for the consumer protection regime.
- 66 None of the consumer protection provisions are currently enforced. No regulations have been made under the Act. The Division currently acts as a consumer advocate, receiving consumer complaints and mediating solutions.

### **Discussion**

- 67 In an economy such as the Solomon Islands where most consumer goods are imported it is difficult to assess the need and role for regulation to set quality standards.
- 68 The prohibition against misleading conduct is a fundamental plank of consumer protection regulation, similar to the role of the price fixing prohibition in competition law. Ideally the Division would have the resources to promote awareness of this prohibition, and enforce it.
- 69 It may be an option to formalise the “consumer advocate” role of the Division.

### **Price control**

#### **Current law**

- 70 A price control regime is established by the Price Control Act 1982 (CAP 64). Key features of the Act are:
- 70.1 a Prices Advisory Committee to review prices and recommend to the Minister prices that should be controlled;
  - 70.2 the Minister may make orders controlling the price of any good or service;
  - 70.3 the Act does not prescribe a test to be applied when the Prices Advisory Committee and the Minister are considering imposing price control; and
  - 70.4 there is no provision for public consultation in the price setting process.
- 71 The Price Control (Application to Goods and Restriction of Prices) Order 1982 imposes price control on milk; meat; fish; sugar; flour; bath soap; washing powder; rice; cooking oil; curry powder; cabin biscuits; LPG; petroleum products; bread; electricity charges; water charges (schedule 1).
- 72 Prices are controlled in “controlled areas”, being the provincial capitals (schedule 2), according to prescribed formula, either cost-plus-mark up or maximum price (schedule 3). There is no prescribed price for electricity and water charges.

#### **Institutional arrangements**

- 73 One staff member in the Ministry of Commerce acts as the secretary to the Prices Advisory Committee and administers the Price Control Act.
- 74 In practice, only fuel is controlled. The two local suppliers of fuel regularly supply information according to a prescribed form, and prices are set. The separate regulation of electricity prices creates a link between fuel and electricity prices.

#### **Discussion**

- 75 The current regulation identifies a number of markets that we would expect to be sufficiently competitive, such as milk, flour, sugar and fish. In a competitive market we would expect price control regulation to be unnecessary, and to have a detrimental effect on consumers. Capping prices in a competitive market will result in less quantity being supplied than is optimal, and less investment by businesses in better processes and products in the future.
- 76 In a number of these markets, we would expect the best policy to be to rely on import competition. If local retailers of flour are charging prices that are too

- high, for instance, this provides an opportunity for another retailer to import flour and undercut them.
- 77 It may be there is a concern import competition is ineffective, due to factors such as uneven application of duties or unnecessary business licensing requirements. As discussed above, the proper response to these issues is to reduce the barriers to competition rather than regulate price. In any event, import competition has in fact been responsible for the current market outcomes.
- 78 Import competition may be less strong in rural areas, and the price control regime should be sensitive to the particular circumstances of the rural markets. The current price control regulation is stated to apply to Honiara and provincial capitals but, as noted above, is largely unenforced.
- 79 The current legal framework and institutional arrangements are flawed in a number of significant ways. Key issues are:
- 79.1 there is no competition test for the imposition of price control. This has resulted in price control being imposed (on paper, at least) in competitive markets;
  - 79.2 there are no accountability mechanisms. As discussed above, the framework should:
    - (a) set tests and criteria against which the regulator's decision can be measured;
    - (b) require that the process provide for public input;
    - (c) require the reasons for decisions to be published.
  - 79.3 on the current level of resourcing, the expertise does not exist to administer price control.
- 80 These issues are significant for Solomon Islands markets. While fuel is the only product that is controlled in practice, the price of fuel directly impacts on the price of electricity and makes up over 50% of the costs of SIWA. It is important that the process for setting the fuel price should include an opportunity for public submissions, and an appropriate level of economic and accounting expertise be contracted in when setting the price.

### **Options**

- 81 Reform of the price control regime is needed to address the issues identified above. When considering reform options, issues to be considered include:
- 81.1 the potential to “contract in” economic expertise when making decisions on whether to impose price control, and decisions on setting price. As discussed in the next section, this has already been done in the latest electricity regulation, where expert advice was sought;
  - 81.2 in Tonga, the expertise of the Pacific Forum Secretariat is used when setting fuel prices. Particularly if fuel is the only price controlled in practice, this option could be explored;
  - 81.3 in the next section we discuss sector-specific economic regulation. Currently sector-specific regulation also regulates prices under various statutes. The option of a “multi-sector regulator” could be considered;
  - 81.4 the viability of leveraging off the law and institutions of a close neighbour, such as Papua New Guinea.

### *Short term – Government Policy Statement*

- 82 In the short term, a number of the significant issues may be addressed by the government issuing a Government Policy Statement setting out the government's expectations as to how the Price Control Act should be administered by officials. This could include requiring officials to conduct a process that includes public consultation and the publishing of a report, and contracting in specialist economic expertise to advise on whether control should be imposed and the setting of prices.
- 83 This option is discussed further in the next section, as a way of improving the administration of the sector-specific legislation in the short term.

## **Sector-specific regulation**

### **Overview of sector-specific regulation**

- 84 In this section we discuss legislation that introduces economic regulation in a particular sector.
- 85 The sectors we have considered are:

Sector	Legislation
Aviation	Civil Aviation Act (CAP 47)
Electricity	Electricity Act 1969 (CAP 128)
Ports	Ports Act 1956 (CAP 161)
Post	SI Postal Corporation Act 1996
Radio	Broadcasting Act 1977 (CAP 112)
Telecommunications	Telecommunications Act 1972 (CAP115)
Television	Television Act 1995 (CAP 116)
Water	SI Water Authority Act 1993 (CAP 130)

### **Current issues**

- 86 This section discusses a number of issues arising under sector specific regulation. These are:
- 86.1 licensing;
  - 86.2 potential for competition in some activities;
  - 86.3 safety and technical regulation;
  - 86.4 information disclosure;
  - 86.5 price regulation;
  - 86.6 community service obligations.

### **Licensing**

- 87 Some of the sector specific legislation provides for licensing:
- 87.1 the Telecommunications Act provides for the Telecommunications Authority to licence a range of activities, including providing telecommunications, use of radio spectrum, importing equipment, and dealing in radio communication apparatus;
  - 87.2 the Electricity Act provides for the Solomon Islands Electricity Authority to licence other generators or operators, including setting conditions

- (which may include price). Regulations provide for the licensing of electricians and electrical contractors;
- 87.3 the Civil Aviation Act provides for licensing of various activities, including domestic air services;
- 87.4 the Solomon Islands Ports Authority can license pilots;
- 87.5 the Television Act requires broadcasters to have a licence, issued by the Television Board. Dealers and possessors of “receiving equipment” are also required to have a licence.
- 88 The reasons for any licensing regime need to be regularly revisited. There is a real danger that a licensing requirement can become a barrier to entry by new competitors into the market, with no positive purpose. At worst, a licensing requirement may become a revenue collection exercise.
- 89 A licensing requirement is often introduced to address safety and technical competence concerns. As discussed below, these issues are often now addressed by setting standards and penalising any firm or person for breaches, rather than creating a licence requirement.

### **Electricity**

- 90 The licensing regime for electricity generators appears particularly problematic, as the SIEA is given the role of issuing licences to potential competitors. This creates an obvious conflict of interest.
- 91 An applicant could seek a licence for one of three reasons. First, the aim may be to use the generator as back-up supply only. Subject to technical concerns, SIEA is unlikely to resist issuing a licence for back-up generation. Second, the purpose may be to self-generate as an alternative to SIEA’s service. Third, the purpose may be to generate electricity to sell to SIEA to provide across its network. Both of the last two activities present a competitive challenge to SIEA, and put it in a difficult position when considering an application.
- 92 These issues intersect with the Community Service Obligation issue discussed below. Utilities such as SIEA are expected to provide service in loss-making areas, cross-subsidising from the profitable Honiara market. Competitors will only enter in the profitable market, eroding the ability of SIEA to fund the CSO by cross-subsidy. Unravelling these issues involves introducing transparency into the CSO agreement with government and weighing up the benefit of SIEA facing competition. It is unrealistic and unfair to expect these issues to be resolved by SIEA when considering an application.

### **Telecommunications**

- 93 Telekom has recently been granted an exclusive licence to provide all forms of telecommunications in the Solomon Islands for the next 15 years. While this exclusivity is to be reviewed every 5 years, any change requires agreement of both parties. This absolute ruling out of competition in telecommunications is contrary to the international trend, which is to introduce and facilitate competition in telecommunications.
- 94 It may be that an assessment was made that competition was not possible in Solomon Islands telecommunications markets. We have not seen any such analysis. What can be said is that over the last 20 years improvements in technology have made competition possible in numerous aspects of telecommunications where it was previous thought impossible. It is difficult to see how competition in calling card sales, international calling and ISP services

is not possible, for instance. Further, advances in switching and mobile technology offer the real prospect of competition in pacific island markets, and could become a reality within the next 15 years.

- 95 Again, this issue is linked to CSO issues. Telekom has said that in return for its exclusive licence it feels a moral obligation to provide loss making rural services. However, what Telekom is to provide in return for its exclusivity is not well defined, nor is the cost transparent. The Telekom CSO is discussed further below.

### **Civil aviation**

- 96 The licensing of aviation markets is another area where we need to be careful the licensing regime does not prevent competition for no obvious gain to consumers. While competition in some areas is unlikely, competition in domestic air services, for example, has delivered significant benefits to consumers in other pacific countries.

### **Other reform initiatives**

- 97 We are aware these issues are being addressed in other projects looking at specific sectors – telecommunications and civil aviation in particular. This does not raise any consistency or sequencing issues. The specific reforms are guided by the same principles discussed in this paper, and should result in sound regulatory frameworks that give consumers confidence they will receive a reasonable deal. The idea of a Government Policy Statement on economic regulation, discussed in this paper, would give stakeholders confidence these reforms are proceeding from a common framework.

### **Potential for competition**

- 98 Consistent with the discussion at the start of this paper on the regulatory priorities of government, it will be important that any sector-specific regulation focus on the activities where competition is unlikely, and facilitates (or at least does not impede) the development of competition in other areas where competition may be more likely.
- 99 To a certain degree this overlaps with the discussion of licensing, above. Where licences are provided for, it has obviously been recognised that there is the potential for competing providers. As discussed above, it is important that any licensing does not become a barrier to this competition. Facilitating competition where realistically possible will deliver significant benefits to consumers in the long run.
- 100 It would be useful to review whether there are other areas where competition is possible. While licences may not be specifically provided for, the legislation may not prevent a competitor from engaging in the activity. If the legislation does not grant the incumbent a monopoly, then competition can occur.
- 101 While we have to be realistic about the degree and likelihood of competition in these sectors in the Solomon Islands, advances in technology mean competition is possible on a small scale where it could not have been imagined previously (e.g. ISPs and international calling). Further, the threat of “self provision” may be effective competition in areas such as electricity generation and water.

## **Safety and technical regulation**

- 102 As discussed above, there may be a role for safety and technical regulation on a sector-by-sector basis. Safety regulation will be appropriate where it is inappropriate to leave safety standards to market participants. Technical regulation will be appropriate where setting common technical standards facilitates competition and market transactions.
- 103 It is important that regulation introduced to pursue these valid objectives is focused, and does not become an unnecessary barrier to entry or an intrusion into normal commercial decision-making by firms.
- 104 A key challenge when regulating safety and technical standards is how to leverage of international expertise and international standards. Standard setting requires significant expertise, and there is a wealth of international material and expertise available. In some situations, the regulatory regimes in other jurisdictions can also be used.
- 105 An example is the licensing of electrical contractors and electricians, which leverages off the qualification regime in NSW, Australia. The regulation is currently administered by SIEA, and the appropriateness of SIEA having this regulatory function may be something that can be reviewed in future.

## **Information disclosure**

- 106 None of the current sector-specific legislation requires the various incumbents to disclose prices or performance measures in a systematic way. This is in contrast to regulation of utilities in other jurisdictions, where information disclosure requirements are common.
- 107 Information disclosure requirements need not be onerous. Firms should be producing performance information for management purposes. For example, membership of the Pacific Islands Telecommunications Association (PITA) requires Telekom to publish information on its service levels, but only on a members-only part of the PITA web page.
- 108 SIWA and SIEA are required by their legislation to provide an annual report of activities to the relevant Minister who then tables it in Parliament, but it is unlikely to contain specific service measures.
- 109 There is the potential for real gains to be made by requiring the various utilities to report their performance against international standards (which are readily available), in a way that is accessible to consumers. This would give consumers the information they need to put pressure on their provider to lift performance. This also empowers consumers to play a more active role in any price regulation process, and to facilitate competition where possible.

## **Price regulation**

- 110 The sector-specific regulation deals with price in the following ways:
- 110.1 the radio broadcasting and television legislation does not address price, leaving the utility free to set its prices;
  - 110.2 the postal legislation allows the utility to set its own prices;
  - 110.3 the water, electricity and ports legislation allows for the relevant Minister to regulate prices, on recommendation of the utility. The relative roles of the utility and officials in determining price are unclear from the legislation. In practice, the Minister does not have access to expert advice when considering a price proposal, and weighs political considerations;

- 110.4 the electricity legislation allows SIEA to licence other generators or operators, including setting price as a condition;
- 110.5 the telecommunications legislation does not address price, but the exclusive licence granted to Telekom requires it to get approval for all changes in telecommunications prices.
- 111 Some general comments can be made about these legal frameworks and institutional arrangements. Key issues are:
- 111.1 there are no transparency and accountability mechanisms in the various processes for regulating price. As discussed above, the legal framework should:
- (a) set tests and criteria against which the regulator's decision can be measured;
  - (b) require the regulator to consult the public before making a decision; and
  - (c) require the reasons for decisions to be published;
- 111.2 it is not clear whether the expertise exists to administer these various price control processes. As noted above, regulating price is difficult and requires significant information and expertise. If done badly, this can have a real impact on how much businesses invest, and therefore the Solomon Islands consumer.

### **Electricity**

- 112 In electricity, the price regulation was recently updated by an external expert as part of an aid project. The result is a relatively complex formula that SIEA administers by processing changes to inputs that can be externally verified, such as changes to the Retail Price Index calculated by the government statistician, and changes in the fuel price set up the Price Advisory Committee.
- 113 External expertise was needed to update the regulation. The reform has resulted in a credible pricing formula that has the confidence of the stakeholders, and is an example of successfully contracting in the right expertise at the right time. It is not clear what level of oversight officials are performing over SIEA's administration of the pricing formula. There is no public consultation.

### **Water**

- 114 Water tariffs are determined by SIWA. The legislation requires the consent of the Minister and the gazetting of any tariff change. In practice the Minister has no source of expert advice and weighs political considerations. Water tariffs are currently probably lower than they need to be for SIWA to sustain and improve its network. The most recent price increase was in 2003, and was the first for 5-6 years. This is the result of an assessment by management that consumers cannot afford higher prices (there are significant arrears and bad debt issues at current price levels) and political judgments by the board and the Minister. Again, there are obvious links to the issue of Community Service Obligations, discussed below.

### **Direct link with fuel price**

- 115 As with electricity, the price of fuel has a direct and significant impact on the economics of water. Half of SIEA's operating costs are the cost of electricity, which is driven by the fuel price.

- 116 This highlights the importance of the process used to set the fuel price. In particular, the regulatory process should allow an opportunity for SIWA, SIEA and other major users to scrutinise proposed price changes.

### **Telecommunications**

- 117 Telekom seeks regulatory approval for annual % changes in its telecommunications prices. The licence sets a maximum of 2/3 of the change in the Retail Price Index. It is unclear whether the regulator has the resources or expertise to second-guess Telekom's prices. The Telecommunications Authority currently relies on the Ministry of Finance and comparative statistics from around the Pacific. No price rises have been vetoed as yet, but the current price increase proposal is being debated. There is no test to measure the prices against, and there is no public consultation before approving price changes.

### **General**

- 118 These are serious issues. Any reform should provide for transparency and accountability in the price setting process, and address the current blurring of the roles of the utilities as service provider/competitor and price regulator. A longer term option may be a multi-sector regulator that sets all regulated prices. Such a regulator could take advantage of economies of scale and scope in running multiple processes, and build up a sustainable critical mass of institutional knowledge.

#### *Short term – Government Policy Statement?*

- 119 In the short term, a number of the significant issues may be addressed by the government issuing a Government Policy Statement setting out the government's expectations as to how officials will issue licences and set prices set under the various statutes.
- 120 In relation to issuing licences, this would include guidance that licensing is intended to address issues of safety and technical standards, but not act as a barrier to competition or a revenue collection mechanism.
- 121 In relation to price regulation, this could include requiring officials to conduct a process that includes public consultation and the publishing of a report, and contracting in specialist economic expertise to advise on the setting of prices or price formula (as has occurred in electricity).

### **Community Service Obligations**

- 122 As discussed above, the government will have important social goals in some markets. Principally, the government will be concerned to ensure essential services are widely provided and affordable.
- 123 There are obvious challenges in making utility services universally available in the Solomon Islands. Services are currently available in Honiara and the provincial capitals, and not in the wider rural areas. The costs of establishing and maintaining services are high in these areas, and the number and ability of consumers to pay for services is low. Service in the provincial capitals are near break-even at best, and in more rural areas clearly loss making.
- 124 There is a range of ways these objectives can be pursued. Increasingly, the focus internationally is on the government procuring social services in a transparent manner. This is so for four reasons:

- 124.1 First, if the utility is government owned, transparent procurement assists in keeping the objectives of the SOE clear (a point discussed further in our discussion document on the SOE governance framework).
  - 124.2 Second, the utility may be a private firm. This will be the case if the government decides the public interest is better served by purchasing social services from a private firm than by owning the utility directly.
  - 124.3 Third, ensuring that the social objectives are achieved at least cost to taxpayers.
  - 124.4 Fourth, ensuring that the cost of the social objective is clearly identified for the government, to enable informed choices to be made between competing social priorities, and competing demands on the budget.
- 125 Focusing on transparency requires us to consider the facts on what it costs to provide services in these areas (it may be surprisingly low or high), and what services are actually demanded by the local citizens. It also involves the government setting transparent objectives in each sector. This should involve public consultation. Examples of transparent procurement of Community Service Obligations include:
- 125.1 tendering for the supply of utility services in rural areas;
  - 125.2 negotiating and publishing a CSO arrangement with a particular utility, including specific service commitments and transparent costing.

### **Electricity**

- 126 The Honiara market is SIEA's only profitable market. All other areas are loss making. SIEA has no explicit agreement with the government to supply loss-making areas, and no payment has been made in recent times. The Electricity Act imposes an obligation on SIEA to supply all consumers, but also provides an ability for SIEA to recover the uneconomic portion from the consumer. Neither limb of this regulatory bargain is enforced.
- 127 One result is SIEA has few incentives to expand its network in these areas, and only makes one or two extensions per year. The government has not identified its objective for network coverage.
- 128 Another result is that SIEA has an incentive to prevent competing generators from supplying electricity, even where this would be good for the Solomon Islands consumer, because competition in profitable activities would erode the ability of SIEA to provide loss-making services.

### **Telecommunications**

- 129 As discussed above, in return for its exclusive licence Telekom has adopted a 'moral obligation' to provide some loss making services. The services Telekom is to provide in return for its exclusive licence are not defined.
- 130 Telekom estimates that it loses about \$10,000 p.a. per line in a rural area, and its current rate of investment in the rural area is \$6.5m - \$10m. This compares to annual turnover of \$24m and annual profit of \$13m in 2004. As part of its *Unity Blong Community 2004 & Beyond* proposal, Telekom proposes the payments it currently makes to the government as licence fees, taxes, etc be collected into a fund to pay for rural telecommunications.
- 131 Applying the principles of economic regulation, any such fund would be part of a package that included public consultation on the required services, a competitive tender to provide those services, specific performance targets and monitoring, and the introduction of a competitive framework.

## **Links to other areas of government policy**

- 132 These issues of economic regulation relate to other areas of government policy and reform, and it is important to consider economic regulation as part of this wider context.

### **State-Owned Enterprises performance improvement**

- 133 The government is currently considering policy reforms to:
- 133.1 improve the governance and performance of SOEs; and
  - 133.2 increase private sector participation in markets where SOEs currently operate, where appropriate.
- 134 Economic regulation applies to SOEs and private sector firms. This is fundamental. Important points are:
- 134.1 that SOEs face the same disciplines as the private sector;
  - 134.2 there is a need to be clear about the difference between the commercial and regulatory functions of government. Longer term, this may include separation of commercial and regulatory functions currently performed by SOEs;
  - 134.3 the government's objective of a reasonable deal (reasonable prices, quality services and consumer protection) does not require government to own the business.
- 135 The SOE framework should provide a transparent process for the government to procure Community Service Obligations.

### **Sector reforms**

- 136 There are projects looking at specific sectors – telecommunications and civil aviation in particular. The specific reforms are guided by the same principles discussed in this paper, and should result in sound regulatory frameworks that give consumers confidence they will receive a reasonable deal. The idea of a Government Policy Statement on economic regulation, discussed in this paper, would give stakeholders confidence these reforms are proceeding from a common framework.

## **Annex 9: Stocktake of SI SOE Finances**

# **Solomon Islands State Owned Enterprises Finances Stocktake**

Work-in-Progress  
12 March 2007

*Prepared as part of ADB-TA No. 4482-SOL:  
SOE Reforms and PSP*

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## 1. Introduction

### 1.1 Purpose and Structure of Report

This report provides an overview of the SOE sector. It essentially comprises a set of working papers intended primarily as a **work-in-progress resource** for use by those who are responsible for *monitoring* SOEs performance, and *assessing* from a shareholder perspective what if any action may be appropriate for SIG to take. Such action may include decisions about the future of individual SOEs.

**Section 2** summarises development of the SOE sector and includes a box on hidden advantages for SOEs. **Section 3** provides a note of caution relating to the lack of availability and low reliability of accurate financial data.

**Section 4** discusses the overall financial position of the SOE sector in the Solomon Islands, and provides some summary tables. *Table 4.1* sets out the government's financial interest in SOEs for the past three years. *Table 4.2* sets out approximate profits and losses for the past three years and *Table 4.3* is the government's share of these profits and losses. *Table 4.4* contains indicators of the size of the SOEs. *Table 4.5* provides estimates of the total numbers of staff employed by each SOE.

**Section 5** comments on each individual SOE. **Section 6** provides explanatory notes to the overview tables in Section 4. For example, these notes set out the sources of data and indicate whether the numbers have been based upon estimates or more reliable data, such as audited financial statements.

### 1.2 Caveat About Financial Information in this Working Paper

The overview financial tables in Section 4 need to be interpreted with considerable CAUTION!. This is because the data varies from *reliable* "audited financial statements", to *less reliable* unaudited financial statements to *even less certain* management accounts, to *indicative only* best guesstimates derived from whatever information was available at the time of their preparation.

## 2. Overview of SOE Sector

### 2.1 Historical Perspective

The SOEs that currently exist are the result of historical developments. As might be expected, they are the typical mix of infrastructure providers (electricity, water, ports, airline, post, broadcasting, printing, shipyard and formerly telecommunications), finance (development bank and home finance) and development ventures (commodities export, livestock, plantations, fishing and canning, forestry). Many of the development ventures have been unsuccessful and commercial trading operations have ceased.

Where operations have ceased, the legal entity may still exist, but have not been “tidied” up. For example, Solomon Taiyo Limited has not been liquidated, though the assets were used to form Soltai.

The SOEs were often established by transfer of assets, either from government or donors. Rarely was adequate working capital provided so the SOEs always struggled to fund capital projects.

An investment holding company structure (ICSI) was established after independence with the concept of investing in a portfolio of development activities with the successful ones funding new ventures. This never worked as not enough of the ventures were successful.

Loans were often used to fund capital expenditure, frequently from the owner (SIG or ICSI) or the NPF. The NPF loans were usually guaranteed by government. Few loans were properly serviced but little was done to take enforcement action or to seek remedy of the defaults. Repayment of guaranteed loans frequently fell back to government. As is normal practice, loans from international institutions were typically made to SIG and on-lent to the SOEs. Where the SOE has failed to service the on-lent loan, government has remained liable for interest, repayments and exchange rate losses.

Few SOEs have been financially successful. The reasons for this are a combination of poor commercial decisions and inadequate prices charged for goods and services. These both stem from either inadequate management skills or political interference. With pricing, either prices have been deliberately kept low as a matter of policy or through inadequate costing.

Cash flow has been significantly affected by poor debt collection. This was exacerbated by the tensions, but existed before that time. Sales were made and revenue recorded, but the cash was often not collected. Provisions for doubtful debts have often been inadequate until there has been a crisis.

With cash flow problems, SOEs have responded by withholding payments of their own debts – both long term debts as well as payments to suppliers, PAYE and NPF contributions. Consequently there is a complicated web of unpaid debts and arrears which is still being unwound.

The lack of capital from the owner combined with low profitability (or losses) and poor debt collection has meant that few SOEs have been able to replace or adequately maintain capital assets. As a result, operating capacity has generally declined and many SOEs have very old, obsolete assets and are barely able to function. What asset replacement has occurred has tended to be funded by donors.

In terms of governance, there has been no cohesive structure within government to provide overall guidance on policy or strategy. The only co-ordination has been through ICSI as a holding company, but ICSI has been more like a portfolio investor rather than a manager of a group of companies.

Boards of directors have tended to be representative rather than professional directors and typically an MP has been appointed chair, as a patronage position.

There has been little forward planning. Few SOEs have any form of strategic or business plan though they may have one year budgets. Some have prepared proposals for future development (based upon seeking substantial capital injections) but these are

often overly optimistic so that it is unlikely that they would have been successful, even if they had been funded.

Financial management and reporting, and performance reporting has been non-existent or very poor and many Boards have operated without current financial information. As a result, there has been little management for results and the current poor financial positions reflect the drift of events rather than purposeful active management.

Overall, few SOEs have preformed at an acceptable level – in spite of many hidden advantages – see box on the hidden advantages. There is considerable potential for improving the performance of Solomon Islands SOEs.

## **2.2 Priorities for Improving SOE Performance**

The following are suggested as priorities for improvement of SOE performance:

- a. Bring financial management reporting up-to-date so that management and Boards have realistic data upon which to base decisions.
- b. Identify the debt issues – both receivables and payables – and make plans for action to improve the situation. Where there is inter-entity cross debt (e.g. between an SOE and SIG) then seek to negotiate set off.
- c. Adequately provide for doubtful debts and write off debts where there is low likelihood of recovery, e.g. the debtor no longer exists.
- d. Prepare annual financial statements and have them audited.
- e. Commence preparation of business planning, starting with identifying purpose and objectives, a SWOT analysis and identify the most likely areas for improvement, e.g. water losses, customer billing, debt collection, pricing.
- f. Consider changes to the business model to require pre-payment by customers (who are likely to be poor payers) so as to reduce future debt collection issues, e.g. use of pre-paid power meters, payment before delivery of goods or service.
- g. Update asset registers, taking care to identify assets that were destroyed or damaged during the tensions and any items that are no longer operational or are obsolete. Write off assets that are no longer of value. Consider revaluation of significant assets, especially land and buildings.
- h. Prepare an updated budget for the current year, with projection for the following two financial years. This should have an emphasis on realism.

The items in the priority list are aimed at getting each SOE ready for the governance framework that is likely to be implemented. The sequence of the items is a suggested order for action. All these actions would be necessary whether or not the SOE is to remain in government ownership or be considered for privatisation, as they are all aimed at building up the basic information needed for business improvement. The same steps are needed whether ongoing government ownership and management or preparation for sale is the target.

### 3. Data on SOEs

**Table 1** sets out the government’s financial interest in SOEs for the past three years. **Table 2** sets out approximate profits and losses for the past three years and **Table 3** is the government’s share of these profits and losses. **Table 4** is estimated measures of size – total assets and revenue. **Table 5** is estimated staff numbers employed by SOEs.

As explained in the **notes** to the Table in Section 4, little data has been able to be drawn from audited financial statements (only 3 of 16 entities) so data is indicative rather than reliable, and considerable caution is required when drawing conclusions, especially as financial results after audit are often markedly worse than un-audited or management results. In addition, in the absence of access to current financial data, estimated figures have had to be included – adopting the philosophy of it being better to be approximately right rather than precisely wrong.

Another aspect for caution is that it has not been possible to form a view on the current value of assets and liabilities and the data reported has just been taken from SOE records. In many cases SOEs financial statements include as an asset, accounts receivable that are probably unable to be recovered. There may also be fixed assets that are overvalued due to wear and tear or obsolescence. On the other hand, land values have risen sharply and many SOEs have not revalued their land to current values.

#### 3.1 Solomon Island State Owned Enterprises Hidden Advantages

The box below outlines the various sorts of hidden advantages enjoyed by SOEs in the Solomon Islands, compared with typical privately-owned businesses.

#### **Solomon Island State Owned Enterprises Hidden Advantages**

##### **1. Capital**

###### **1.1 Equity**

At the time they were established, many SOEs were provided with assets that were treated as the owner’s contribution to equity. In many cases this meant that funding was largely equity as there has not been any policy on capital structure and appropriate debt/equity ratios. Similarly, there has not been policy on target rates of return on equity and, in practice even where SOEs have made profits, the return on equity has been very low, effectively giving them an advantage (e.g. Housing Finance Ltd, 85% equity funded).

###### **1.2 Debt on favourable terms**

SOEs have often received loans at lower than market terms. Interest rates have been low, or even zero. Repayment periods have been long, relative to the life cycle of assets. Many of these loans have been from government itself or its investment holding company. (e.g. fishing, forestry, airline, housing finance, printing)

Where the government as owner has provided a loan, many SOEs have not been able to service their loan. Some have never made any interest or principal repayments. In these circumstances, the government has typically not taken action

## **Solomon Island State Owned Enterprises Hidden Advantages** (continued)

to recover the overdue debt and there may be no penalty applied. (e.g. housing finance, printer, airline) In some cases, debt has been converted to equity – effectively forgiveness of the debt. (e.g. forestry, and proposed for utilities)

Some loans have been sourced from international financial institutions such as the ADB, which charges 1% interest and typically have 30 year terms with no repayments in the early years of the loan. These loans are denominated in hard currency, so there is currency risk. In some instances, the SOE has been sheltered from exchange rate risk which has been left with government. In other cases, the exchange rate risk has been shared (e.g. development bank).

### **1.3 Debt guaranteed**

In many cases, even where the SOE has borrowed from commercial lenders, this has been with a guarantee from government or its investment holding company. This has probably resulted in the SOE receiving more favourable terms for the loan (e.g. a lower interest rate) or receiving a loan when the capital structure or risk would normally deter a lender. Overdrafts and loans from the NPF have often been guaranteed (e.g. airline, development bank).

## **2. Donated Assets**

Many SOEs have received assets from donors. Often, the donated assets have been the core of the assets at the time the SOE was established.

Standard accounting practice has been to treat the value of donated assets as “Deferred Income” that is amortised over the economic life of the asset. The effect of this has been to offset depreciation on these assets. This practice should have enabled SOEs to generate cash flow from operations so as to be able to replace the assets at the end of their lives. In practice, this has rarely happened so that the benefit of donated assets has probably been transferred to customers in the form of lower prices. Typically, when donated assets have needed to be replaced, a donor is approached to fund replacement (e.g. utilities).

## **3. Exemption from Taxes**

### **3.1 Income tax**

Some SOEs have been given exemption from income tax for significant periods, perhaps 20 years (e.g. forestry).

### **3.2 Import Duty**

Many SOEs have received exemption from payment of import duty on capital items. This is a normal requirement of donors for donated assets (e.g. utilities).

## **4. Overall Financial Results**

Obviously, Solomons Islands SOEs were considerably affected by the period of ethnic tensions that caused financial difficulty for all entities. During the tensions, some SOEs

had assets destroyed or stolen (e.g. Solomon Islands Plantations Limited) and all suffered cash flow difficulties as customers were unable to pay accounts receivable. Many SOEs are still in a “recovery” phase and still have substantial outstanding accounts receivable.

With cash flow difficulties, SOEs themselves were unable to pay their bills and incurred arrears for PAYE, NPF employer contributions, electricity and water and even staff salaries. Some of this arrears has still not been cleared. SOEs were also unable to pay interest on their debt, and often chose not to pay interest to SIG and ICSI, nor to make principal repayments in accord with the loan agreements. In most cases, SOEs have not resumed loan servicing for SIG/ICSI debt. Exceptions are the Ports Authority and Kolombangara Forest Products. Solomons Air has also begun paying some interest to ICSI.

The data provided is for the past three financial years 2003 – 2005, starting with the period in which RAMSI arrived and the initial recovery phase.

**Table 1** shows the government’s net financial investment in SOEs for the past three years. Excluding the Development Bank of Solomon Islands which has negative equity<sup>1</sup> and is to be liquidated, the Governments net investment in SOEs totals around \$345 million and has been increasing. [To be updated as additional data is obtained.] However, over \$200 million of this is loans and around 80% of this is on-lent ADB loans.

The growth in net investment is rather deceptive as much of the growth relates to revaluation of assets<sup>2</sup> or SIG grants to SIWA, rather than improved operations and increases in interest on debt owed by SOEs to ICSI or SIG, which has been recorded as a liability but not paid.

Solomons Air and Solomon Islands Printers report negative net equity. However, they both have loans from ICSI which are greater than the negative equity. Both also probably have undervalued assets (aeroplanes and land). So, the government has a potential positive financial interest in these two entities.

As set out in **Table 3**, a significant proportion of SOEs have been making losses. Soltai Fishing and Processing Limited has been making substantial operating losses, but has positive net equity only from a substantial revaluation of assets. Solomon Airlines and the Ports Authority have achieved profitability after the arrival of RAMSI in 2003 provided stability and increased business volumes. Kolombangara Forest Products results mostly reflect changes in the valuation of forests rather than trading.

**Table 4** aims to give overall measures of the size and importance of the SOEs. Total assets are estimated to be over \$700 million and annual revenue \$433 million. The annual revenue figure is more reliable than the assets figure. Note that Telekom is excluded from these figures as the ICSI shareholding in it is very small.

The asset figure should be regarded as approximate as it includes some broad estimates and many SOEs have not revalued assets to current values. Revaluation would involve upwards revaluations for some assets – especially land and SolAir planes – but many

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<sup>1</sup> As mentioned later, there is a European Investment Bank on-lent loan to DBSI. This has been excluded from the table as it is expected to be forgiven by EIB, provided DBSI is liquidated.

<sup>2</sup> ICSI’s share of Soltai’s revaluation of assets is \$34.5 million and accounts for most of the growth in the net financial interest in SOEs.

tangible assets would probably need to be written off as obsolete, destroyed or diminished in value through lack of maintenance.

The fact that assets exceed annual revenue reflects the dominance of capital intensive utilities (electricity, ports, water) and the Soltai cannery. Another factor is that some capital investments have low rates of return.

Comments on individual SOEs are in section 5, following the tables.

**Table 1**

Solomon Islands Government financial interest in SOEs							
	Year End	Percentage Owned	Type of Holding	Notes	2003 \$ million	2004 \$ million	2005 \$ million
Investment Corporation of Solomon Islands	Dec	100%	Net assets	1	1.30	1.91	2.49
<b>Wholly owned by ICSI</b>							
Development Bank of Solomon Islands	Dec	100%	Equity	2	(23.29)	(14.94)	(13.63)
Sasape Marina Limited	Mar	100%	Equity	3	4.92	3.42	2.00
Loan from ICSI			Debt	4	0.31	0.31	0.30
Solomon Airlines Limited	Dec	100%	Equity	5	(17.56)	(12.80)	(5.80)
Loan from ICSI			Debt	6	17.95	20.73	22.00
Solomon Islands Printers Limited	Dec	100%	Equity	7	(2.16)	(2.50)	(3.00)
Loan from ICSI			Debt	8	3.46	3.46	3.46
<b>Majority owned by ICSI</b>							
Solomon Islands Plantations Limited	Dec	97.7%	Equity	9	3.00	3.00	3.00
Soltai Fishing and Processing Limited	Dec	51%	Equity	10	16.23	15.94	39.63
<b>Minority shareholding by ICSI</b>							
Kolombangara Forest Products Limited	Dec	19.70%	Equity	11	13.23	10.69	12.59
Loan from ICSI			Debt	12	16.70	16.62	16.00
Solomon Telekom Company Limited	Mar	2.7%	Equity	13	4.94	4.39	4.23
<b>Corporations or direct SIG ownership</b>							
Commodities Export and Marketing Authority	Dec	100%	Equity	14	0.59	0.64	1.00
Solomon Islands Broadcasting Corporation	Dec	100%	Equity	15	0.53	0.76	1.38
Solomon Islands Electricity Authority	Dec	100%	Equity	16	15.00	11.82	10.00
Loans from SIG			Debt	17	150.00	153.16	155.00
Solomon Islands Home Finance limited	Dec	100%	Equity	18	14.07	14.12	14.21
Loans from SIG			Debt	19	2.02	2.14	2.23
Solomon Islands Ports Authority	Sep	100%	Equity	20	39.00	40.06	38.01
Loans from SIG			Debt	21	18.09	17.87	17.72
Solomon Islands Postal Corporation	Dec	100%	Equity	22	0.00	0.00	0.00
Solomon Islands Water Authority	Dec	100%	Equity	23	(2.22)	4.72	10.00
<b>Approximate net SIG interest in SOE sector</b>					<b>276.12</b>	<b>295.51</b>	<b>332.83</b>
SOE with negative net interest - DBSI					(23.29)	(14.94)	(13.63)
<b>Approximate positive net interest, excluding DBSI</b>					<b>299.41</b>	<b>310.45</b>	<b>346.46</b>
<b>Composition:</b>							
Equity - where positive					110.58	111.46	138.55
Negative equity					(21.93)	(10.58)	1.20
Loans owed to SIG/ICSI					208.54	214.29	216.71

See notes in section 6 setting out the basis for the data in the tables.

**Table 2**

<b>Net Profit/(Losses) of SOEs and companies with SIG shareholding</b>					
	<b>Year End</b>	<b>Notes</b>	<b>2003 \$ million</b>	<b>2004 \$ million</b>	<b>2005 \$ million</b>
Investment Corporation of Solomon Islands	Dec	1	(0.67)	0.61	0.59
<b>Wholly owned by ICSI</b>					
Development Bank of Solomon Islands	Dec	2	(9.37)	(2.63)	1.20
Sasape Marina Limited	Mar	3	(0.23)	(1.51)	(1.50)
Solomon Airlines Limited	Dec	5	(0.76)	4.76	7.00
Solomon Islands Printers Limited	Dec	6	(0.84)	(0.34)	(0.50)
<b>Majority owned by ICSI</b>					
Solomon Islands Plantations Limited (97.7%)	Dec	9	(0.49)	0.29	0.05
Soltai Fishing and Processing Limited (51%)	Dec		(13.86)	(5.23)	(26.83)
<b>Minority shareholding by ICSI</b>					
Kolombangara Forest Products Limited (19.7%)	Dec	11	(3.17)	(12.89)	9.66
Solomon Telekom Company Limited (2.7%)	Mar	13	10.62	12.98	26.70
<b>Corporations or direct SIG ownership</b>					
Commodities Export and Marketing Authority	Dec	14	0.05	0.05	0.36
Solomon Islands Broadcasting Corporation	Dec	15	(0.34)	0.21	0.56
Solomon Islands Electricity Authority	Dec	16	(3.18)	5.37	(1.80)
Solomon Islands Home Finance limited	Dec	18	0.04	0.04	0.09
Solomon Islands Ports Authority	Sep	20	(10.36)	1.06	(2.05)
Solomon Islands Postal Corporation	Dec	22	0.00	0.00	0.60
Solomon Islands Water Authority	Dec	23	9.10	5.14	(3.57)

Note: It is not meaningful to total this data as some entities are only partly owned by government or ICSI. Extraordinary items such as revaluations or write-offs have been excluded.

**Table 3**

<b>Solomon Islands Government share of Net Profit/(Losses) of SOEs and investments</b>					
	<b>Year End</b>	<b>Notes</b>	<b>2003 \$ million</b>	<b>2004 \$ million</b>	<b>2005 \$ million</b>
Investment Corporation of Solomon Islands	Dec	1	(0.67)	0.61	0.59
<b>Wholly owned by ICSI</b>					
Development Bank of Solomon Islands	Dec	2	(9.37)	(2.63)	1.20
Sasape Marina Limited	Mar	3	(0.23)	(1.51)	(1.50)
Solomon Airlines Limited	Dec	5	(0.76)	4.76	7.00
Solomon Islands Printers Limited	Dec	6	(0.84)	(0.30)	(1.00)
<b>Majority owned by ICSI</b>					
Solomon Islands Plantations Limited (97.7%)	Dec	9	(0.48)	0.28	0.05
Soltai Fishing and Processing Limited (51%)	Dec		(13.86)	(5.23)	(26.83)
<b>Minority shareholding by ICSI</b>					
Kolombangara Forest Products Limited (19.7%)	Dec	11	(0.62)	(2.54)	1.90
Solomon Telekom Company Limited (2.7%)	Mar	13	0.41	0.51	1.04
<b>Corporations or direct SIG ownership</b>					
Commodities Export and Marketing Authority	Dec	14	0.05	0.05	0.36
Solomon Islands Broadcasting Corporation	Dec	15	(0.34)	0.21	0.56
Solomon Islands Electricity Authority	Dec	16	(3.18)	5.37	(1.80)
Solomon Islands Home Finance limited	Dec	18	0.04	0.04	0.09
Solomon Islands Ports Authority	Sep	20	(10.36)	1.06	(2.05)
Solomon Islands Postal Corporation	Dec	22	0.00	0.00	0.60
Solomon Islands Water Authority	Dec	23	9.10	5.14	(3.57)
<b>Totals</b>			<b>(31.11)</b>	<b>5.82</b>	<b>(23.36)</b>

Note: This is the government share of the profits/(losses) of each entity, rather than the total net profit/(loss).

**Table 4**

<b>Solomon Islands SOE - estimated size measures - Assets and Revenue</b>					
	<b>Year End</b>	<b>Percentage Owned</b>	<b>Notes</b>	<b>Assets \$ million</b>	<b>Revenue \$ million</b>
Investment Corporation of Solomon Islands (Excluding investments in subsidiaries, including Telekom shares)	Dec	100%	1	28.0	1.3
<b>Wholly owned by ICSI</b>					
Development Bank of Solomon Islands	Dec	100%	2	17.9	4.1
Sasape Marina Limited	Mar	100%	3	5.0	3.5
Solomon Airlines Limited	Dec	100%	5	36.0	119.0
Solomon Islands Printers Limited	Dec	100%	7	2.0	1.0
<b>Majority owned by ICSI</b>					
Solomon Islands Plantations Limited	Dec	97.7%	9	5.4	0.3
Soltai Fishing and Processing Limited	Dec	51%	10	150.9	134.5
<b>Minority shareholding by ICSI</b>					
Kolombangara Forest Products Limited	Dec	19.70%	11	118.7	22.1
<b>Corporations or direct SIG ownership</b>					
Commodities Export and Marketing Authority	Dec	100%	14	6.0	1.9
Solomon Islands Broadcasting Corporation	Dec	100%	15	3.4	2.7
Solomon Islands Electricity Authority	Dec	100%	16	218.0	88.0
Solomon Islands Home Finance limited	Dec	100%	18	17.1	2.0
Solomon Islands Ports Authority	Sep	100%	20	71.3	22.8
Solomon Islands Postal Corporation	Dec	100%	22	0.0	7.4
Solomon Islands Water Authority	Dec	100%	23	46.0	21.1
<b>Approximate total SOE sector assets</b>				<b>725.7</b>	<b>431.7</b>

Note: Deliberately excludes Telekom which is no longer an SOE since NPF is the majority shareholder. The asset figures include many estimates so are approximate.

**Table 5**

<b>Approximate SOE staff numbers</b>	
<b>Enterprise</b>	
Investment Corporation of Solomon Islands	3
<b>Wholly owned</b>	
Development Bank of Solomon Islands	14
Sasape Marina Limited	50
Solomon Airlines Limited	150
Solomon Islands Printers Limited	30
<b>Majority owned by ICSI</b>	
Solomon Islands Plantations Limited (97.7%)	-
Soltai Fishing and Processing Limited (51%)	1,000
<b>Minority shareholding by ICSI</b>	
Kolombangara Forest Products Limited (19.7%)	500
<b>Corporations or direct SIG ownership</b>	
Commodities Export and Marketing Authority	14
Solomon Islands Broadcasting Corporation	51
Solomon Islands Electricity Authority	
Solomon Islands Home Finance Limited	15
Solomon Islands Ports Authority	
Solomon Islands Postal Corporation	85
Solomon Islands Water Authority	75
<b>Total</b>	<b>1,987</b>

Note: More data to be collected.

## **5. Comments on Individual SOEs**

### **5.1 Investment Corporation of Solomon Islands (ICSI)**

ICSI is a holding company for SIG investments in SOEs that are companies<sup>3</sup>. The original concept was that it would be a development investment vehicle with a variety of commercial ventures. The mature investments would generate profits sufficient to allow ICSI to support new ventures through their start-up phase. The early history, the first decade after independence, shows that this ideal was never achieved. While some ventures were profitable, many were not. Also, the portfolio of investments did not seem to be supporting broader economic aims of promoting employment as most employment growth was from the private sector.

During the 1990s, financial performance of SOEs appears to have deteriorated – though the TA team has little data to support this impression. By the late 1990s, SIG was in financial difficulty and the TAs of the time concerned with SOEs were targeted at privatisation, with the primary aim of generating funds to support SIG. They did not seem to have the aim of providing an overall framework for managing SOEs that remained in government ownership, nor of considering the overall legal and economic regulatory framework for SOEs or network utilities.

With the ethnic tensions, financial performance of SOEs owned by ICSI deteriorated even further (as the economy declined) and some lost many assets through theft and deliberate destruction. This flowed through to ICIS as interest on loans was not paid, principal repayments were missed and SIG initiated transactions to support failing SOEs using ICSI (e.g. Solomons Air).

As a result, ICSI now has cash flow issues and is reliant upon income from rents and Telekom dividends from their very small remaining shareholding. They have been cash flow positive since 2004, as they have constrained expenditure. In 2006, they began receiving some interest on loans to SolAir.

The most recent audited financial statements for ICSI are for the year ended December 2001, but the backlog is under action. Completion of up-to-date consolidated financial statements requires that the subsidiary companies complete their statements first so ICSI can consolidate or equity account for their results as well as adjust for inter-company debt.

### **5.2 Wholly-Owned Subsidiaries of ICSI**

#### **Development Bank of Solomon Islands**

DBSI is insolvent and has been under a Court-appointed statutory manager since 2004. The statutory manager has reported that a situation has now been reached that his Court-appointed role can cease, since the purpose of this appointment – to protect depositors and ensure they are repaid – has been achieved, and since sufficient cash is held to repay the remaining deposits.

At June 2006, DBSI had a deficit in shareholders funds of \$13 million. The major remaining liability is \$21 million owed to the European Investment Bank. EIB will not write off this debt unless DBSI is liquidated and liquidation was agreed to by the then Minister of Finance in October 2005, as part of the “Honiara Club” discussions.

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<sup>3</sup> Home Finance is not a subsidiary of ICSI as it was initially a corporation that was converted to a company in the expectation of privatisation.

The statutory manager has recommended that the next step should be liquidation using the Conversion of Statutory Bodies to Companies Act. This is the same legislation used for the Livestock Development Authority and would transfer the assets and liabilities to the Government. The main asset is outstanding loans. It is proposed to sell the loan portfolio to the ANZ Bank.

Though the statutory manager's proposal was made in July 2006, Government has not yet made a decision.

### **Sasape Marina Limited**

Sasape operates a slipway and ship repair facility in Tulagi. It has very old assets, many of which are technically obsolete and overdue for replacement. It operates with difficulty and has been making operating losses. It has valuable land and provides facilities that are used by Solomons shipping and fishing. Government wants infrastructure with a new slipway able to handle ships of up to 1,000 tons, compared with the present 300 ton capacity.

Officials and ERU have been unsuccessful with past attempts to clarify the potential financial and commercial viability of Sasape under robust and realistic assumptions. Sasape is an example of a loss-making SOE which is delivering a service which potentially could be provided by the private sector and/or within neighbouring countries. Sasape has lost significant sums of money while following non-commercial political directives, and generally appears to have been weakened rather than strengthened by the government's involvement as an owner. However, it is seen as providing services which are essential to Solomon Islands inter-island shipping, and also providing employment and income to people outside of Honiara.

The Economic Reform Unit proposed that Sasape should be privatised with the aim of a new owner able to finance much needed capital expenditure. The proposed privatisation was to be managed by the ERU itself, but has not progressed the sale. The TA provided the ERU with general guidelines on good practice for privatisation and in November 2005, specific guidance on the issues that should be addressed for privatisation of Sasape.

### **Solomon Airlines Limited**

Solomons Air is the national airline providing both international and domestic services. The company has been the subject of other TAs and work by the ERU and has specifically been excluded from this TA. The other work was aimed at possible privatisation as well as business improvement. The proposed sale has not progressed and there is no clear government policy on this issue.

SolAir made losses during the period of tensions, but its financial results have subsequently improved once business volumes improved. Financial reports showed a loss in 2003 but a profit in 2004. It is said to have made a profit in 2005 and also expects 2006 to also be profitable.

The last available un-audited financial statements, for 2004, showed negative net equity of \$13 million. This will have been reduced by subsequent profits. In addition, it has been stated that its aircraft were undervalued. ICSI has a substantial loan to SolAir, almost \$21 million in 2004. This was over 40% of reported liabilities. A debt to equity conversion could provide SolAir with positive net equity and there is a proposal to convert around \$10 million of the debt to equity.

### **Solomon Islands Printer Limited**

The Solomon Islands Printer Limited (SIPL) has its origins under the British colonial period as a regional printer. After independence it continued as the government's printer though in recent years government agencies have tended to use other printers as well as SIPL. Financially, it has not been successful and has negative net equity. The main cause of the operating losses seems to have been poor management and theft. There have not been adequate job costing systems to ensure that prices quoted for work were adequate to cover costs.

The ADB TA provided assistance earlier in 2006 to help ICSI, the shareholder on behalf of SIG to determine whether this business was potentially financially viable under changed practices, using prudent and realistic assumptions. That work was interrupted by the April 2006 civil unrest, before results were available. The TA local accounting team have subsequently completed work on costing for SIPL.

While SIPL has negative net equity, it also has a substantial loan from ICSI, its parent. This loan could be converted to equity to provide positive net equity. Alternatively, if the business or assets were to be sold and the company liquidated, ICSI would receive around 70% of net proceeds as the major creditor.

There is no clear decision on the future for SIPL. While the ERU has been advocating sale of the company, the current Government's policy is unclear in terms of privatisation in general, and the future of SIPL in particular. The comment has been made that if SIPL is to be retained, it needs additional funds to boost operations. ICSI would like SIPL to become profitable before a decision is taken on its future.

### **5.3 Partly-Owned by ICSI**

#### **Solomon Islands Plantations Limited**

Solomon Islands Plantations was a financially successful operation but was virtually put out of business during the tensions. Assets were destroyed or stolen. What remained of the business in terms of usable assets was sold by government to new investors.

The company itself remains in existence but is to be liquidated. What remains is some machinery and parts plus about \$3 million in cash. In early 2005, ICSI borrowed \$1.5 million from SIG to buy out shares from CDC – making ICSI the owner of 97.7% of the company. The loan was supposed to have been repaid, but hasn't been as the liquidation has not been completed.

There has been no recent progress with the liquidation.

#### **Soltai Fishing and Processing Limited**

Fishing and tuna canning operations were managed through a joint venture company called Solomon Taiyo Limited formed in 1973, with the Japanese partner Taiyo Fisheries Company, later renamed Maruha Corporation Limited, of Japan was the original partner. With the collapse of tuna prices in 1999, Solomon Taiyo was in financial difficulties by 2000 and the shareholder agreement with Maruha was due to expire in February 2001. Maruha did not intend to enter a new agreement and Solomon Taiyo went into voluntary liquidation in February 2001.

In 2001, Soltai Fishing & Processing Limited was formed as a successor company with only \$100 of paid up capital, 51% held by ICSI and 49% held by the government of Western Province.

Financial statements show a pattern of operating losses since Soltai has been formed. Losses over the period 2003 to March 2006 total \$28.7 million, after taking account of a benefit of \$21.3 million of donated assets. The raw operating losses totalled \$50 million. During 2005, the assets were revalued by \$67.7 million. This boosted shareholders funds but because of the losses, they were \$77.7 million at December 2005, compared to \$31.2 million prior to the revaluation.

Soltai has loans from NPF. These were in default in 2005. In March 2006, the Solomon Islands Government assumed responsibility for the NPF loan, effectively forgiving a liability of around \$20 million<sup>4</sup>. (ICSI as a 51% shareholder will receive its share of this forgiven debt as an increase in equity.)

As a condition of this bail out, there was a memorandum of understanding that required that Soltai agree not to borrow. However, an ANZ Pacific Regional manager visited and proposed a \$35 million loan at 14%, secured over assets. The board went ahead with this loan, in spite of the agreement not to borrow. Subsequently, they gave a presentation to the PM on the company and its prospects. In this presentation they sought his support for validation of the borrowing in breach of the MOU. The loan is to be used for a new fish meal plant, cold storage and to provide \$7 million in working capital.

Soltai has an agreement with a firm called TriMarine to process tuna loins on their behalf. TriMarine has purse seine trawlers and owns the fish as well as the finished product so Soltai just receives a processing fee. There is a proposal for TriMarine to provide a further loan for a new processing line at a cost of around \$7.5 million (\$US 1 million). This would be used for catering packs of canned tuna. The by-product red meat has potential to double output of Solomon Blue cans.

Japan has donated two new fishing boats (about 200 tons each). These still use pole fishing rather than trawling. These boats are owned by SIG but leased to Soltai without charge.

### **Kolombangara Forest Products Limited**

KFPF is a joint venture between ICSI and CDC Group – formerly called the Commonwealth Development Group, a company owned by the UK Department for International Development (DFID). There is a complicated capital structure with classes of shares and debt from the shareholders with conversion of debt into shares as the forest is milled. The company also benefits from agreements for income tax holidays.

The company operates plantation forestry on a sustainable basis with international certification of sustainability.

In late 2005, there was a proposed capital reconstruction of KFPL (with a debt to equity conversions that would have simplified the capital structure and given ICSI a 40% shareholding). The ICSI Board did not sign the formal agreement and it has not been implemented. In the meantime, CDC (the majority owner) has a potential buyer for its

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<sup>4</sup> We were advised that SIG negotiated a settlement with NPF for a lower sum, around \$16 million, and has issued a “note” for this amount.

shares and has said it would not implement the capital reconstruction before the new investor takes over. The potential buyer is a US investor said to be called “New Forest” and the shares would be part of a Tropical Timber Fund (probably a mutual fund). Various issues raised by the new investor as conditions of their purchase are near resolution and the deal is expected to be concluded, including the capital reconstruction.

In 2005, there was also major new strategy involving EU funding. The EU project is a mixture of grant and soft loan, aimed at funding harvesting uneconomic trees (resulting from a poor variety being planted) that are nearing maturity as well as covering the cost of replanting with improved variety trees. The EU project has been approved and is nearly finalised and implemented. The Stabex grant will be given to ICSI and used to fund increased equity investment.

Audited financial statements are up-to-date. For the December 2005 year these show a \$6.1 million loss on operations for the year, offset by a \$15.8 million revaluation of the forest, giving a \$9.7 million net result. However, the company is barely getting by in terms of cash flow. Most of the equipment is worn out and needs replacement. It was stated that KFPL has so little cash that it is in arrears with PAYE.

The successful completion of the deal with the EU and the sale of CDC shares to the new investor are regarded as essential for the company to progress and have a sound future.

### **Solomon Telekom Company Limited**

Telekom was originally a joint venture between ICSI and Cable and Wireless with ICSI initially having a majority holding. Most of ICSI's shares were sold to NPF as a swap deal for SolAir debt to NPF which was in default. This reduced the ICSI shareholding to around 10%. While ICSI holds the same number of shares, subsequent new shares issued to NPF and Cable and Wireless, including a debt to equity swap (Cable and Wireless debt swapped for shares), have diluted the ICSI shareholding to 2.7%.

Telekom is very profitable with an average after tax return on equity over the past 5 years of 18%.

## **5.4 Wholly-Owned by SIG**

### **Commodities Export and Marketing Authority**

CEMA is a statutory corporation, formed in 1984 replacing the Copra Board. Other marketing activities were added over the years including cocoa, palm oil, spices, coffee, and ngali nuts. In the tensions period, CEMA experienced financial difficulties since crop production fell, especially as it had leased a ship for inter-island transport. A decision was taken to cease trading, although it has unpaid liabilities from this time. These are being repaid from the sale of assets. At the end of 2002, its debts were \$10 million, but are currently about \$4.5 million. CEMA expects to have repaid all old debts by the end of 2007.

Currently CEMA is an industry regulatory body setting quality standards, inspection and grading and issuing licenses to export agents. It also seeks project funding from government or donors for activities that seek to stimulate crop production or raise standards. A current example is an EU-funded project to train agricultural extension officers of the Department of Agriculture and Livestock.

Limited financial information is available as the financial ledger in and old DOS-based computer system has not had its balances transferred to the new system. Estimated net equity is around \$1 million. Since ceasing trading, CEMA has been managing expenditure so it operates at a small profit and uses the proceeds from the sale of assets to repay debt and buy new capital items.

### **Solomon Islands Broadcasting Corporation**

SIBC operates a radio network in competition with private sector broadcasters. Competitors include three commercial entities (one partly owned by Fiji Broadcasting) and a religious broadcasting station. Since 1997 it has operated a “user pays” policy for broadcasts of government information messages and political campaigning.

Privatisation of SIBC was considered by government around 1999, but not proceeded with as the potential purchaser turned out to have no commercial standing. SIBC used to receive annual grants for public policy services such as news, but these ceased during the tensions and were only reinstated at a reduced level in 2004. SIBC is coming out of survival mode after the destruction of assets and loss of cash revenue during the tensions.

SIBC has provided internal management financial reports, though there are no audited financial statements since 1998. These show profits in 2004 and 2005 and some rebuilding of assets, though some of the assets are understood to have come from donors.

### **Solomon Islands Electricity Authority**

The Solomon Islands Electricity Authority (SIEA) has been the subject of a study by a World Bank/PWC TA and under action by the ERU, so has been excluded from detailed work by this ADB TA. The World Bank TA provided an updated financial position as at December 2004, has recommended that SIEA contract out management and that there be a SIG debt to equity conversion to recapitalise SIEA, after offsetting arrears owned by SIG to SIEA for power.

The World Bank report on SIEA’s financial position at December 2004 involved major adjustments totalling \$188 million for issues such as exchange rate losses on ADB on-lent loans, write downs for fuel and inventories where the record keeping had not charged consumption to appropriate financial years, provision for doubtful debts and revaluation of assets. The result was to reduce SIEA net equity to \$12 million or 5% of assets, clearly too low.

At December 2004, SIEA had loans to SIG and NPF totalling \$177 million. Of this, \$24 million was to NPF but other than around \$3 million of this was guaranteed by SIG so effectively almost all debt was SIG responsibility. As well, SIG owed SIEA \$10 million for electricity purchases. Clearly, a capital reconstruction would be needed and this would probably require SIG converting debt to equity.

NPF has obtained Court judgments for its debts. SIG debt advisors have advised us that the judgment incorrectly treats all loans as having provisions that charge compound interest on overdue interest, while the loan documents for most loans only allow simple interest. It is unclear whether there is any ability to appeal on the basis of error of fact. The difference between the two calculations is some \$10 million.

As recapitalisation was under consideration, a discussion paper was prepared by this ADB TA. This paper provides information on the purpose of equity, typical equity ratios for other electricity companies and discusses some of the issues that might be relevant in determining an appropriate capital structure for SIEA and considerations to take into account in deciding the best way to implement such a recapitalisation.

Work continues within the ERU towards a management contract for SIEA. The recapitalisation has not occurred, but should be completed before the terms of any management contract are determined.

### **Solomon Islands Home Finance Limited**

Solomon Islands Home Finance was a statutory corporation that was established to develop land and provide housing loans, especially to civil servants. It mainly operates in Honiara.

The corporation was converted to a company, Solomon Islands Home Finance Limited (HFL), in May 2000 in anticipation of privatisation at that time. Privatisation did not occur and HFL has continued to operate. Its financial situation throughout the tensions was difficult, especially as government ceased paying mortgage deductions from public servant's pay, which was HFL's main source of loan repayments.

Currently, HFL is the subject of detailed work by the ADB TA, covered elsewhere in this report.

### **Solomon Islands Ports Authority**

SIPA operates the main ports in Honiara and Gizo. SIPA provides comprehensive services covering wharfage, stevedoring and warehousing. Other ports are run by provincial governments, but generally do not charge ferry companies (which causes SIPA difficulties as the ferry companies are reluctant to pay SIPA charges). Often these provincial jetties have been financed as aid projects, but are not maintained. SIPA considers there is a need for a coordinated infrastructure strategy for ports.

SIPA is self-financing. During the tensions, export volumes dropped significantly as gold production ceased and the main plantations also stopped production. Import volumes also fell so SIPA made losses. With limited cash flow, SIPA was not able to buy new equipment so much is overdue for replacement.

SIPA has ABD on-lent loans. While these loans were at concessional rates to government, SIPA has been charged 7.36% interest. More significantly, as the loans are denominated in SDRs, the fall of the Solomon Islands dollar has resulted in exchange rate losses. These losses were a net \$11 million over the period 1998-2003 on loans that had balances outstanding of around \$14 million at the commencement of this period. In spite of this, SIPC has maintained loan servicing.

After the arrival of RAMSI, inbound freight volumes have increased substantially and SIPC's financial results have improved. However, export volumes have been slow to recover, as the gold mine has not recommenced operations and plantation volumes are still low. For example, data from CEMA is that copra production is still less than half the peak volumes in the 1990s.

### **Solomon Islands Postal Corporation**

Solomons Post was formed into a statutory corporation in 1997. There were issues relating to formal transfer of title to ownership of assets at this time, and these remain unresolved.

In its first few years, the corporation received government grants but has become self financing. After many operational and financial difficulties during the tensions, the corporation has commenced a strategic review, with assistance from TA members. Guidance has been provided on strategic planning and financial analysis. There are many issues, such as run down premises as little maintenance was able to be funded in the past.

Financial management is hindered by having lost the general ledger computer files for 2001-2004. While data is being re-entered, at present the Post management and the TA does not have access to full financial data. Operating data is available for 2005 and 2006, but there are no opening balances so financial position cannot be determined. The data is being re-entered so financial records will be available.

In terms of operations, the Postal Corporation has been diversifying and seems to be profitable, though without the opening ledger balances this cannot be stated categorically. Ventures include bulk re-mailing, foreign currency services at the airport, expanded philatelic operations, a joint venture with ANZ involving ATMs and agency operations, and an internet café. Work is under way to identify additional services that can profitably be provided in provincial areas.

### **Solomon Islands Water Authority**

As SIWA has been the subject of a study by a World Bank/PwC TA and under action by the ERU, it has largely been excluded from detailed work by this ADB TA. The World Bank/PwC study recommended that SIWA be subject to a financial reconstruction, and be merged with Solomon Islands Electricity Authority under a single management contract. There was also a Japanese-funded study of SIWA involving asset replacements and moving to gravity-fed water distribution to improve viability by reducing the need for pumping and use of electricity.

[Further update required. The proposed merger with SIEA is unlikely and there seems little potential for synergy if SIWA reduces power use. The fact that SIWA was the largest power user was a major factor in the merger concept.]

### **Livestock Development Authority**

The Livestock Development Authority (LDA) ceased operation in the late 1990s. A decision was taken to wind up LDA using the Conversion of Statutory Bodies to Companies Act. This Act, despite the name, covers winding up of a corporation as well as conversion to a company in anticipation of privatisation.

A winding up order was signed by the Minister of Finance in March 2000. There was confusion at that time about the legal effect of the order. People operated on the (incorrect) assumption that LDA had become a company and was being liquidated as if a company. A liquidator was appointed and proceeded to act as if a liquidator under the Companies Act. There was also a second order to transfer some of LDA's assets and functions to the Ministry of Agriculture. This order had no legal basis under the Conversion Act. Also, government has used some LDA property rent free and there are

issues with title to some LDA land being held in the name of the Commissioner of Lands rather than LDA.

The liquidator received claims from creditors and started to identify and sell assets. The tensions made his work difficult, especially as during this time, most of LDA's records were destroyed and other assets, such as livestock stolen. As a result, little progress was made other than receiving claims. In October 2004, the liquidator was murdered and activity ceased.

The TA investigated the situation and received advice from its legal expert on the Conversion of Statutory Bodies to Companies Act. This advice was that the winding up order transferred the LDA's assets and liabilities to the Permanent Secretary, Finance on behalf of government. As a result, the TA was able to advise that:

- a. Payment of liabilities need not be directly linked to realisation of assets.
- b. Actions by various government agencies that have taken ownership or used LDA assets without payment do not need remedial action, as the assets have remained in government ownership.
  - a. Land where titles were held in the name of the Commissioner of Lands rather than LDA need not have titles changed.

The TA provided advice on a suggested action plan and had discussions with Ministry of Finance staff responsible for debt arrears aimed at early initiation of payments to claimants, especially former LDA staff who had not been paid redundancy entitlements due over 5 years ago.

Essentially the TA was able to clarify the legal position and enable the stalled winding up to be recommenced.

## **5.5 Other Entities that Are Not SOEs**

### **Central Bank of Solomon Islands**

CBSI is not an SOE but holds \$10m (9.7%) of the shares in ICSI and 8% of the Development Bank of Solomon Islands (DBSI). It has fully provided for loss of the DBSI investment and for all but \$673,000 of the ICSI investment. CBSI does not have any loans to SOEs, though it does hold loans to SIG.

### **Solomon Islands National Provident Fund**

SINPF is a public authority with board members appointed by the Minister of Finance, but is not a SOE. Rather it is a financial mutual operating under its own statute for the benefit of Solomon Islands employees. Employers are required to contribute 10% of staff pay to NPF, the funds are recorded in the name of each individual employee as member's contributions, investment income is added to each member's account and the employee is entitled to receive the balance of their account when they retire.

There are important implications for governance of NPF that arise from its status as a mutual. As a mutual, the members are entitled to share the net equity of the organisation. Government and the Board need to be aware that they have trustee obligations to the members and should not do anything that benefits Government to the detriment of the NPF members.

However, there are important relationships between NPF and SOEs, as well as SIG. This is especially important for NPF's investment policies. Such investments need to

be made on a commercial basis as if NPF were to make a loan to a SOE at a low rate of interest or terms that are less than commercial, then this would be detrimental to the interests of NPF members. Such an action would be a breach of trust by directors whose obligation is to the members.

Historically, NPF has been a major lender to SOEs, usually with a SIG guarantee. When SOEs have defaulted, SIG has been required to take over responsibility for the loans. NPF is now the majority shareholder in Telekom, having acquired its shares from ICSI when Solomons Air was unable to meet its obligations under a loan. So, ICSI acquired the loan in return for passing shares in Telekom to NPF.

### **Solomon Islands Visitors Bureau**

The Solomon Islands Visitors Bureau (SIVB) is a separate entity with a board with 10 members. SIVB provides marketing on behalf of the tourism sector rather than trading on its own behalf. Its funds largely come from a 10% tax on hotel accommodation (86% of revenue in 2004), SIG grants (13% of revenue in 2004) with the balance from other levies and license fees. So, it is effectively funded from taxes rather than trading. Rather, its role is tourism promotion and licensing of tourism operators. It also acts as the consolidator for tours, linking flights with accommodation and trips, such as diving. This is done for free, and they do not receive commission for this work.

The conclusion is that the Solomon Islands Visitors Bureau (SIVB) is not a commercial venture and should not be considered as a State-owned Enterprise.

## **6. Basis for Estimated Financial Interest of Solomon Islands Government in SOEs**

This section describes the basis for the financial data provided in the SOE sector financial overview tables in Section 4 above.

As note in the introduction to this working paper, considerable caution is required in using the data as few figures are from audited financial statements. Accordingly, the data should be used as indicative rather than definitive.

### **6.1 General Points about the Estimated Figures**

The majority of Solomon Islands SOEs do not have up-to-date audited financial statements. The only SOEs with current audited data are:

- a. Development Bank of Solomon Islands
- b. Kolombangara Forest Products Limited (minority shareholding)
- c. Solomon Telekom Limited (strictly not a SOE with a very small minority shareholding)

As a result, the best available data has been used. This includes un-audited financial statements, data from management reports, data from general ledger trial balances and in some cases, educated guesses, especially for recent years. The basis for data is set out in the numbered cross reference notes for each SOE.

## **6.2 Approach Taken to Gathering Data for the Tables**

The equity investment data in the table is the Government's share of the net equity where there is less than 100% ownership. While most SOEs that are companies are subsidiaries of ICSI, the table reports the Government's indirect financial interest in the subsidiaries. This means that the data for ICSI itself is net assets excluding the subsidiary companies separately reported in the table.

## **6.3 Notes on Individual SOEs**

### **1. Investment Corporation of Solomon Islands**

ICSI is the holding company for most SIG investments in SOEs that are companies. The best measure of the SIG interest in ICSI's subsidiary companies is its share of the net assets of each subsidiary plus the amount due to ICSI for loans it has made. ICSI's financial statements have been drawn up on a conservative basis with provisions for losses on loans to subsidiary companies. The subsidiary companies have included the full liability for loans, including interest, even though in most cases interest has not been paid to ICSI nor accrued by ICSI as income.

Accordingly, the data for ICSI is for estimated net assets excluding the equity and debt in subsidiaries. The financial interest in subsidiaries is stated separately for each entity. This means the modest sums reported as net equity for ICSI is fixed assets, cash and deposits and accounts receivable other than from subsidiaries, less debt.

### **2. Development Bank of Solomon Islands**

DBSI is insolvent and has been under statutory management since 2004. The data up to December 2005 is audited. At June 2006, DBSI management accounts showed a deficit in shareholders funds of \$13 million. The major remaining liability is \$21 million owed to the European Investment Bank. EIB will not write off this debt unless DBSI is liquidated and liquidation was agreed to by the then Minister of Finance in October 2005, as part of the "Honiara Club" discussions.

### **3. Sasape Marina Limited: Equity**

The data for 2003 is audited, for 2004 is un-audited and the 2005 data is a projection and assumes a loss in 2005 similar to the loss of \$1.5 million in 2004.

### **4. Sasape Marina Limited: Loan**

The loan from ICSI was originally for \$250,000. It is in default and its growth reflects the addition of unpaid interest.

### **5. Solomons Airlines Limited: Equity**

The data for 2003 is audited, for 2004 is un-audited and the 2005 data is a projection and assumes a profit in 2005 of \$7 million.

### **6. Solomons Airlines Limited: Loan**

The loan from ICSI is in default and its growth reflects the addition of unpaid interest. A debt to equity conversion of around \$10 million is under consideration.

### **7. Solomon Islands Printer Limited: Equity**

The data for 2003 is un-audited. The 2005 data is based upon work by Pricewaterhouse in mid 2005. The 2004 data is an interpolation between the two sets of data. Losses for 2004 and 2005 are estimated.

#### **8. Solomon Islands Printer Limited: Loan**

The loan from ICSI is in default but is interest free so has remained at the same level. If the company was liquidated, the loan would represent around two-thirds of creditors, so the net worth may be some \$1.5 million rather than the net \$0.66 million of the net equity offset against the loan. (This would be the effective result if there was a debt to equity conversion.

#### **9. Solomon Islands Plantations Limited**

This is the remaining assets after sale of the plantation business to international investors. The data is an estimate using management accounts at June 2004, and assuming that there is no saleable value for “Plantation establishment” and other tangible assets sell at a discount.

#### **10. Soltai Fishing and Processing Limited: Equity**

The equity is 51% of the net equity reported in the financial statements. The statements have been prepared by the auditor but the audit reports have not been finalised. In 2006, equity will be boosted by the forgiven NPF debt taken over by SIG.

#### **11. Kolombangara Forest Products Limited: Equity**

This is 19.7% of the equity in the audited financial statements. There is a proposed capital reconstruction that would involved debt to equity conversion giving ICSI a 40% overall share of equity. This may be consummated in late 2006 or early 2007 along with EU funding and loan for development.

#### **12. Kolombangara Forest Products Limited: Loan**

The loan is part of a complicated arrangement with conversion to preference shares as the forest is milled. The amount included is the sum in the audited KPFL financial statements, though ICSI has provided for potential loss of the loan.

#### **13. Solomon Telekom Company Limited**

Strictly, Solomon Telekom is no longer an SOE as the majority of shares are now held by NPF. ICSI still holds some shares, though has not had cash to take up new share issues so the ICSI shareholding has diminished. The data included is the ICSI share of net equity which has decreased from 6.7% in 2003, to 3.9% in 2004 reaching 2.7% in 2005. The cost price of the shares in ICSI’s records exceeds the net equity though a market value of the shares would be higher than the share of book value as Telekom has a high rate of return on equity.

#### **14. Commodities Export and Marketing Authority**

There is limited current data as the general ledger was lost through computer failure. A new general ledger system was in operation for 2005, so data from income and expenditure is available but there are no opening balances for assets and liabilities. Net equity is estimated as around \$1 million as equity was lost around 2001-2002 through commercial losses on shipping.

#### **15. Solomon Islands Broadcasting Corporation**

The data is from the general ledger.

### **16. Solomon Islands Electricity Authority: Equity**

The Pricewaterhouse/World Bank TA provided an estimate of net assets for SIEA as at December 2004, including revaluing assets and also adjusting for foreign exchange losses on the ADB loan to SIEA. The previous audited financial statements were for 1996. The data for 2003 and 2005 are estimates using 2004 as a start point.

A capital reconstruction is required which would involve a debt to equity conversion and also take account of SIG arrears for electricity, which were \$10 million in 2004.

### **17. Solomon Islands Electricity Authority: Loans**

The loans from SIG to SIEA were valued as at December 2004 by the Pricewaterhouse/World Bank TA. At that stage \$136 million related to ADB loans on-lent to SIEA and \$17 million to SIG domestic loans. The ADB loans are in SDRs so have incurred exchange losses. In addition, there are NPF loans that are subject to SIG guarantee which may add another \$9-16 million to SIG debt.

### **18. Solomon Islands Home Finance Limited: Equity**

The financial statements have been prepared by the auditor but the audit for 2005 has not been completed. Detailed work by the TA on reviewing the HFL assets suggests that the loan portfolio is overvalued but the land is undervalued.

### **19. Solomon Islands Home Finance Limited: Loan**

This loan from SIG has not been properly documented and does not seem to have been recorded as an asset in SIG records. HFL has never made interest repayments so the sum owed has been growing by the amount of interest.

### **20. Solomon Islands Ports Authority: Equity**

The data is un-audited.

### **21. Solomon Islands Ports Authority: Loans**

These are ADB loans, on-lent from SIG. SIPA has been revaluing the ADB loans and reporting the exchange rate losses. The data for is un-audited.

### **22. Solomon Islands Postal Corporation**

The SIPC has lost the data for its general ledger. They are re-inputting the data since 2000 but until they do that, there are no opening balances to give a meaningful Balance Sheet. [Progress on this is slow and will probably not be completed until 2007.]

### **23. Solomon Islands Water Authority**

The Japanese study report included estimates of SIWA revenue and expenditure for 2003 – 2005 and this data has been used as the basis for the estimated profits/(losses). The most recent audited financial statements are for 1998 and un-audited drafts are held for 1999. SIWA has had problems with its computer system so no current data on assets and net equity is available. Some very rough estimates of net equity have been included. SIWA's improved financial position is largely from SIG grants in 2004 and 2005 of \$1.8 million and \$8.9 million respectively.