

# Conclusions and recommendations of the National Audit Office

## Limited company as an organization form of central government functions

The audit was targeted at the establishment of seven central government special assignment companies and the early stages of their operations. The companies were established during Prime Minister Sipilä's government term in 2017–2019, and the state made capital injections of a total of about EUR 490 million into them. The money for this purpose was raised from sales of shares, the budget, and the funds of Senate Properties.

Four of the limited companies were established to provide services for the future counties. These companies were Maakuntien tilakeskus Oy, SoteDigi Oy, Vimana Oy, and Hetli Oy. Hetli Oy operated for only slightly over four months. Vimana Oy's business was later merged with SoteDigi Oy.

In addition to the four county companies, the audit was targeted at the following three central government special assignment companies: Traffic Management Finland was established when the traffic control and management services of the Finnish Transport Agency were incorporated. Pohjolan Rautatiet Oy was established for the planning of new rail connections. Oppiva Invest Oy was established to support the development of learning environments and teaching tools for vocational education.

## Special assignment companies should be established only after careful consideration

When state funds or activities are transferred from on-budget entities to state-owned companies, Parliament's budgetary power is limited, and part of its control and oversight power is transferred to the Government and the companies' own bodies. Before limited companies where the state is a majority shareholder are established, it should therefore be considered whether the limited company form is a necessary or the best solution for the need concerned. In principle, the social benefits provided by the company should exceed the costs incurred by central government from capital injections into the companies.

As stated in the recommendation issued by the Ministry of Finance in 2018 concerning incorporation, the primary organization form of central government operations is central government agencies and institutions. A limited company, in turn, is an organization the primary purpose of which is to endeavour to make profit in competitive markets. Therefore, central government special assignment companies should remain exceptions both in central government operations and among state-owned companies. As special assignment companies usually do not operate in competitive markets, and they are hardly exposed to the risk of bankruptcy, they are not under a pressure to increase the efficiency of their operations in the same way as limited companies operating in fully competitive markets. Problems related to competition neutrality can usually also be avoided by establishing, instead of a special assignment company, a non-profit-making state-owned company operating in a competitive market.

Another reason for establishing special assignment companies only after careful consideration is that the Act on the Openness of Government Activities does not apply to limited companies where the state has a

controlling interest. As a rule, the Act on the Openness of Government Activities does not apply to limited companies unless they exercise public authority. It is often argued that operations organized in company form are more transparent as regards expenditure, for example. However, in the case of special assignment companies, only a very small group of actors is entitled to receive more detailed information on the company than its official final accounts.

Oppiva Invest Oy was established to grant subordinated loans to companies of a certain industry. It is not always necessary to establish a new special assignment company for a very narrow purpose. Instead, it should be considered whether an existing state-owned company could assume responsibility for the new function or whether the necessary service could be bought from private companies already operating in the market.

#### **Incorporation is not intended to serve as an alternative funding solution to appropriations granted under the budget**

Capital was injected into most of the state-owned companies at which the audit was targeted through shares in listed companies. However, the main reason for the use of company form should not be the opportunity to operate outside the spending limits or to inject capital quickly into the company by selling shares held by the state or another state-owned company.

It is problematic, although permitted, that the state injects capital into new state-owned companies by transferring shares directly to them instead of recording the sales proceeds in the budget and granting the necessary funds from the appropriations under the budget. What makes the transfer of shares an attractive option is that, in the central government spending limits rule, capital injections into a company through the budget are considered expenditure falling within the scope of the spending limits, whereas capital injections through the transfer of shares are considered expenditure falling outside the scope of the spending limits. This may encourage the Government to dispose of the state's shareholdings instead of covering the expenditure from the state budget within the scope of the spending limits rule. If the state transfers its shares in listed companies in order to inject capital into a new state-owned company, it suffers a permanent loss of the dividend income from them as well as the revenue from the increase in the value of the shares.

Earmarking shares and the proceeds from their sale – or funds transferred from companies as capital repayments – for a certain purpose does not comply with good budgeting practice even though it is not prohibited. Using proceeds from the sale of shares for earmarked additional expenditure is contradictory to one of the most important principles of the spending limits rule, i.e. breaking the link between expenditure and revenue.

The state has concentrated the management of its listed holdings in the hands of the Ownership Steering Department of the Prime Minister's Office and Solidium Oy. Therefore, it is problematic that the state has assigned Oppiva Invest Oy the management of its own portfolio of shares. The value of the shares and the amount of dividend income can vary considerably. Thus, the performance of Oppiva Invest Oy is not only dependent on its actual business operations but also on how well it succeeds in managing its portfolio.

### The state owner should have a clearer idea of the direction of the operations of state-owned companies

The management of several companies stated in interviews that they wish that the state would more clearly and rapidly disclose what it expects of the company and how it expects it to operate. When new state-owned companies are established and their operations are launched, it is important for the state owner to communicate clearly to the company's management what the company's business objectives are and in what direction the business should be developed. In addition, the state owner should disclose the business model and earnings logic it has planned for the company.

The state is responsible for appointing only independent persons to the management of state-owned companies. As a rule, the state should avoid appointing public officials who have prepared the establishment of a new company to its management, as this would cause a conflict of interest for the public official. The audit also identified situations where the board members of the group companies had connections with companies that supplied goods or provided services to the group. The state owner must contribute to ascertaining that the persons elected to positions of trust at the companies do not have conflicts of interest.

### Major reforms involve risks that are mainly beyond the control of the companies established in connection with the reforms

If a company is established as part of a more extensive social reform, the state owner and the company should, for reasons of risk management, strive to ensure that the company's services are not fully tied to the reform. The services will then remain relevant even if the actual reform is cancelled. Some of the companies whose operations were related to the cancelled regional government reform had also tried to provide structurally independent services, but in practice, many solutions and services were closely linked with the prepared reform model.

The implementation of the reform was started even though it had not yet been approved by Parliament. The companies were also established, capital was injected to them, and their start-up phase operations were launched. Eventually, the reform was cancelled before the companies had even started their income-generating business operations, and the benefits at which their establishment had aimed were not achieved.

From the companies' perspective, it would have been better if the implementation of the reform had not started until Parliament had approved it. This would have been possible if the legislative proposal had allowed a sufficiently long period for the implementation. However, this was beyond the companies' control.

### None of the incorporation cases examined in the audit can be considered to have violated the recommendation concerning incorporation

None of the incorporation cases examined in the audit can be considered to have been directly contrary to the recommendation issued by the Ministry of Finance on 15 October 2018 concerning incorporation. This is largely due to the fact that, instead of being strict, the recommendation mainly accords wide discretion to the implementation of incorporation in an individual case.

## Recommendations of the National Audit Office

The National Audit Office makes the following recommendations:

1. When new state-owned companies are established and when the state's ownership steering is performed, the government agency responsible for the ownership steering should form a clear picture of how it expects the company to operate and what it expects the company to achieve. The state owner should communicate these issues to the company's board of directors and management.
2. The Ministry of Finance should contribute to the amendment of the central government spending limits rule in such a manner that transfers of shares held by the state are included in spending limits expenditure.
3. The Ministry of Education and Culture or the Finnish National Agency for Education should have an unbiased assessment made within five years of the social benefits and costs of the operations of Oppiva Invest Oy.
4. The Ministry of Transport and Communications should have an unbiased assessment made within five years of the social benefits and costs of the operations of Traffic Management Finland.
5. When the establishment of a new state-owned company is planned, the ministry preparing the matter should also analyse and document an alternative solution where, instead of the establishment of a new company, the new function would be assigned to one of the existing state-owned companies or the necessary service would be bought from private companies already operating in the market.