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MINISTRY OF FINANCE, ECONOMIC STABILIZATION AND NATIONAL POLICIES

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Public Enterprises Circular No. 01/2021 (ii)

All Secretaries of the Ministries,
Chairmen of Commercial Corporations,
Statutory Boards (including Government Universities),
Government Owned Companies, State Banks and Subsidiary Companies of such entities.

<u>Guide for Preparation of Subsidiary Policy</u>

The General Treasury, by its circular No. 01/2021, issued the Guidelines on Corporate Governance for State-Owned Enterprises (SOEs) and Operational Manual for SOEs whereas the subsidiary companies were categorically excluded from the applicability of such guidelines with an aim to play vibrant business conduct provided that the parent entity will introduce a proper subsidiary policy in order to ensure Return on its Investment (ROI) while achieving the established objectives by the subsidiary companies.

2. As per section 2.2.5 of the Guidelines on Corporate Governance, the parent entity is mandatory to have a Board approved subsidiary policy that addresses dividends, changes in equity & shareholding, and major transactions while section 7.7 of the Operational Manual also requires the parent entity to establish a structure that facilitates oversight of the performance of subsidiaries coming under its purview in line with the provisions of Companies Act.

3. In this backdrop, this application guide provides high-level instructions for parent entities to compile an appropriate subsidiary policy framework that should essentially cover the following key areas.

3.1. Corporate Governance Practices

The Board of Directors (BoD) of the parent entity should identify and adopt policies related to the Corporate Governance practices of the subsidiaries to ensure that they are governed by the best practices either equivalent or superior to the practices stipulated in the "Guidelines on Corporate Governance for State-Owned Enterprises".

3.2. Strategic Involvement

Strategic direction should be articulated by the parent BoD in a manner that ensures an adequate ROI while assuring the independency of the subsidiary company.

3.3. Investment Policy

The BoD of the parent entity should decide and adopt the policy on making investments by its subsidiaries, having considered the risk and the return of the investment while considering the objectives and the financing methodology of the subsidiary. Here, the parent entity should ensure that major investments by its subsidiaries are not done without the concurrence of the parent BoD and no new sub-subsidiaries are created unless with the approval of the Secretary to the Treasury.

3.4. Dividend Policy

The BoD of the parent entity should determine and adopt the level of profit distribution from the subsidiaries, taking into consideration the factors such as financial resource requirements for future investments. The parent entity may use the distribution policy stipulated in section 5.3 of the Operational Manual for SOEs as a baseline.

3.5. Financing Policy

The BoD of the parent entity should decide a policy on how the investment of subsidiary companies is financed by either equity or debt and its proportion ensuring the sustainability of the entity. It may also be considered, corporate guarantees, or letters of comfort, for addressing the working capital requirements and the factors to be considered in such decisions, including the feasibility of the project, forecasted cash flow, assessment of the economic, social, and environmental impact, possible changes in ownership structure, etc.

3.6. Human Resource Policy

Under the Human Resource policy, the BoD of the parent entity should discuss the mechanism that is in place to ensure that the BoD of the subsidiaries formulates guidelines to recruit, train and develop, promote, and retain personnel with the necessary skills and competencies to achieve the set objectives of the subsidiaries. Here, performance contracting is highly recommended for high-level managerial positions while all the employees are to be given Key Performance Indicators (KPIs) derived from the Strategic Plan to achieve the set targets.

3.7. Appointment/Removal of Members of the BoD

The BoD of the parent entity shall formulate policies relating to appointing, and removing Board Directors of the subsidiaries, subject to the provisions in the Articles of Association and the Companies Act. Such policies may contain guidelines to appoint experienced high caliber individuals to the Boards of subsidiaries, including at least one member from the parent Board and another executive from the parent entity (such as Head of Finance), to coordinate the financial and non-financial activities of the subsidiary. The performances of the BoD of the subsidiary shall be evaluated through an independent Performance Evaluation Committee appointed at the parent level on annual basis.

3.8. Administrative, Finance, Operational Systems and Controls

The subsidiaries shall ensure that their business conduct creates Value for Money and as such, performance-oriented culture should be established to achieve the set targets of the entity. The CEO of the subsidiary is recommended to be appointed on a contract basis and the BoD shall have the authority to remove him/her if the performance is below the average and accordingly, required provisions should be included in the contract to do so.

Each subsidiary shall prepare its administrative and finance manual within the legislative framework and industry norms and shall be approved by the BoD of the parent entity with the concurrence of the Department of Public Enterprises.

3.9. Performance Monitoring

The BoD of the parent entity should properly review the progress of the subsidiaries coming under its control in line with the Strategic Plan, Action Plan, and Annual Budget while required corrective and preventive measures shall be recommended to the BoD of a subsidiary. This shall be done in the monthly board meeting as a mandatory agenda item.

4. Parent entity should focus on the areas stipulated in Guidelines on Corporate Governance and Operational Manual for SOEs when making the subsidiary policy and the subsidiary policy shall also be fair and equitable and should be in line with the industry norms in order for the subsidiaries to conduct their business in a competitive and dynamic environment.

5. The parent entities shall introduce the subsidiary policy before December 31, 2023 with the concurrence of the Director General, Department of Public Enterprises through the Secretary of the relevant Line Ministry. Unless the parent entity introduces a subsidiary policy before December 31, 2023, provisions of the Guidelines on Corporate Governance for SOEs and Operational Manual for SOEs and circulars should be followed by the subsidiary companies.

6. Nevertheless, the government circulars and directions that address the subsidiary companies, shall also be followed by such subsidiaries even though the subsidiary policy is in place.

7. Provisions of this circular shall be effective immediately; however, financial institutions and their subsidiaries, and listed companies are exempted from this circular provisions.

K. ~~M. Ma~~hinda Siriwardana
Secretary to the Treasury

Copies to:
1. Secretary to the President
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3. Secretary to the Cabinet of Ministers
4. Auditor General