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Corporate governance and non-financial statements in central and local government companies 1/48/21

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Latvia saw a productive autumn in terms of changes to corporate governance rules. On 11 November 2021, Parliament passed amendments to the Public Person’s Shares and Companies Governance Act, effective from 8 December 2021, requiring large central and local government companies to apply corporate governance principles and prepare various statements in this area.

The amendments provide that a public person’s companies and publicly private companies (“companies”) with net revenue exceeding EUR 21 million and balance-sheet total exceeding EUR 4 million for the previous financial year will be required to prepare a corporate governance statement. The first statement must be prepared for the financial year 2021 (the financial year that began on 1 January 2021 or during the calendar year 2021).

The amendments state that the Cabinet of Ministers has yet to issue corporate governance recommendations, but those are likely to follow the Corporate Governance Code drawn up by the Ministry of Justice’s Corporate Governance Advisory Council. The principles included in the Code summarise best international practice in corporate governance and may be applied to any company. The Ministry of Justice has already drafted Cabinet regulations stating that the Corporate Governance Code should be applied.

A company’s corporate governance statement will have to include the following information:

1. A reference to the corporate governance recommendations the company applies
2. Information on whether and how the company applies particular principles included in those recommendations
3. If the company does not apply any of the principles included in the corporate governance recommendations, the company will have to indicate which principles it does not apply and what the rationale is behind that by detailing:
    - the reasons for not applying each particular principle and the possible consequences, as well as the way in which the company decided not to apply that principle;
    - the date the company plans to begin applying that principle if, for instance, the decision relates to a limited period; and
    - how any measure the company has taken instead of applying that principle achieves the goal of the principle, or of the recommendations, or promotes good corporate governance in the company.

The corporate governance statement may be included in the company’s management report or prepared as a distinct part of its financial statements. If the company also prepares consolidated financial statements, it will be allowed to prepare only one corporate governance statement included in either set of financials. Also, the corporate governance statement will have to be posted on the company’s website at least once a year.

A company will have to prepare non-financial statements if for two consecutive years its average headcount exceeds 250 and it meets one of the following criteria:

- Balance sheet total exceeds EUR 20 million
- Net revenue exceeds EUR 40 million

It is important to note that the amendments prescribe different time limits for preparing the first non-financial statement. For example, a company with more than 250 employees that is large according to the criteria of the Company and Consolidated Accounts Act is liable to prepare its first non-financial statement in 2026 for the financial year 2025 (the financial year beginning on 1 January 2025 or during the calendar year 2025) but a large company with more than 500 employees must do so in 2022 for the financial year 2021 (the financial year that began on 1 January 2021 or during the calendar year 2021).

A non-financial statement should give at least the following information:

1. Details of the company’s development, performance, and financial position, as well as information on its business impact on environmental, social and worker-related aspects, human rights compliance, anti-corruption and anti-bribery measures – corporate social responsibility (CSR) areas;
2. A description of how the company implements its policies on CSR areas and a description of procedures the company has put in place to pay proper attention to how those policies are implemented;
3. Information on key CSR-related risks that are characteristic of the company’s transactions, and if this is essential and reasonable, also risks arising from legal transactions the company has concluded in the course of business or risks associated with its goods or services that may have adverse CSR consequences, as well as information on how the company manages those risks;
4. Key CSR-related non-financial indicators that are characteristic of the company and the industry it operates in; and
5. A reference to the amounts appearing in its financials, with explanations if any of those amounts is related to the company’s CSR areas.

To provide information on CSR areas, the company can use the guidelines or recommendations contained in Latvian or EU legislation or in documents issued by the UN, the OECD, the ILO, the ISO, or another international organisation. The non-financial statement should state which guidelines or recommendations the company uses.

If the company fails to implement a policy on any CSR area, the non-financial statement must explain the rationale behind that failure.

The non-financial statement may be included in the management report or prepared as a separate document to be published together with the management report as part of the financials. Non-financials prepared for the last five years will have to be posted on the company’s website.

Since some companies have to prepare their first corporate governance statements and non-financials for 2021, they should get to work on this today. They should read the Corporate Governance Code and the good corporate governance principles it includes and assess any necessary changes to their internal processes and procedures to ensure those principles are properly applied. If an in-depth analysis returns a finding that one of the principles cannot be applied yet for objective reasons, this will need to be explained in the corporate governance statement. Preparing it will be the last stage of this process to be completed after several purposeful steps, revising the corporate strategy, assessing the internal culture, risk management, internal control systems, the process of electing council members, how the council's work and decision-making is organised, the council and board pay-setting principles, stakeholder involvement in the company's business, and ensuring transparency. All of these are important aspects and it takes time and knowledge to evaluate them properly.

When it comes to non-financial statements, companies need to answer questions about what ESG goals they want to achieve in order to become more competitive in the long term and to better adapt to today's challenges. It is important to be aware that before the non-financial statement is published, the company needs to make thorough preparations, setting the goals to be achieved and identifying the required data to measure the progress towards achieving those goals. Also, appropriate guidelines or standards should be chosen for presenting the disclosures in the non-financial statement. When it comes to choosing standards, bear in mind that the EU has started work on drawing up a single non-financial statement standard that will soon be binding on a wide range of companies in Latvia. The standard aims to ensure that comparable and reliable information on ESG and corporate sustainability is available to investors and the general public.

These new requirements for central and local government companies are a great example of promoting the availability of corporate governance and sustainability information at national level, which is a precondition for companies moving towards new business models that are aligned with environmental and societal needs.