



Emerging Markets  
Investors Alliance  
Actionable Intelligence for Responsible Investing



# Benefits of Financial Statements for Investors and Credit Rating Agencies

Fergus McCormick

Emerging Markets Investors Alliance

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# Financial Market Objectives

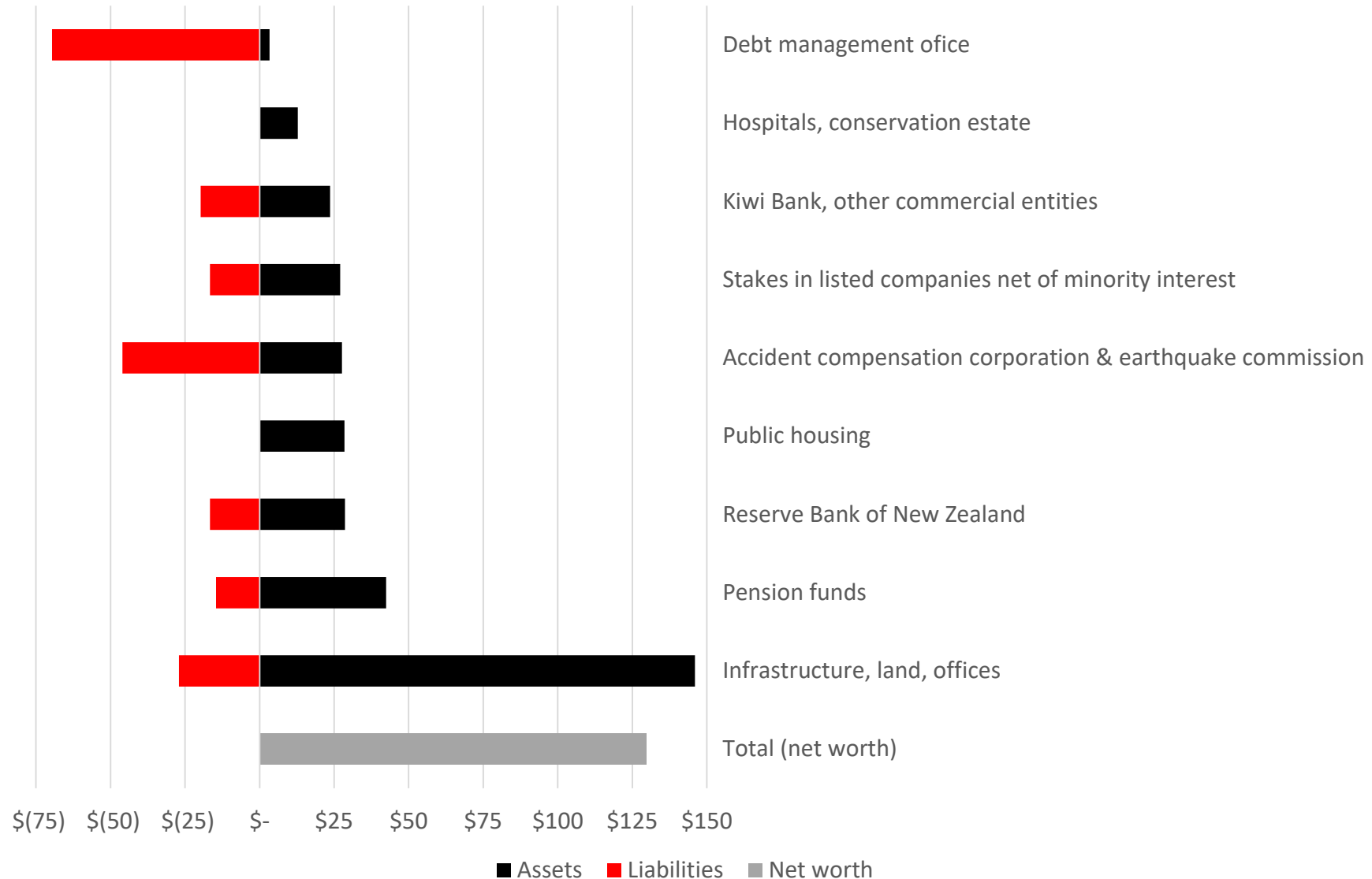
- Investors aim to increase real adjusted returns
  - Take strategic or tactical positions based on price discovery or value discovery
- Credit rating analysts assess credit risk
  - Assess probability of default of a central or general government on its bonded debt held by the private sector
  - Moody's also assesses expected loss-given-default

# Relevance of Balance Sheet to Financial Markets

- IPSAS-based financial statements produce a balance sheet - complements traditional statistical reporting.
- A balance sheet is critical to understanding:
  - A government's strengths, weaknesses and effectiveness
  - How transparent and accountable it is
  - What its priorities are, how well it is governed, how it makes decisions
  - How much value public officials are creating
- How? A balance sheet informs:
  - Financial position, fiscal position and fiscal stance
  - Debt strategy and asset-liability management
  - Coordination and funding of public sector entities
  - Profits/losses of government-controlled entities
- A balance sheet produces indispensable fundamental indicators:
  - Operating balance before gains & losses after expenses are deducted from revenue
  - Net debt
  - Net worth

# Example of Full Disclosure: New Zealand Balance Sheet

(Fiscal year ending 30 June 2019, NZD billions)



# Positive Relation between Transparency & Market Performance

- For a sovereign, IPSAS and GFS provide a standard reporting framework. But few governments adhere to this standard. Even fewer use financial statements for budgeting.
- Why?
  - They do not have the capacity
  - They do not appreciate the value
  - They fear the consequences of disclosing this information
  - They have something to hide
  - They are focused on the near term

# Positive Relation between Transparency & Market Performance

- From an investor's perspective, inadequate data and poor fiscal transparency create misperceptions of sovereign risk and value. This leads to a mispricing of risk.
- From a rating analyst's perspective, inadequate data and poor fiscal transparency tend to result in a lower sovereign credit rating.
- A lack of information creates uncertainty, distorts credit assessments, and leads analysts to assume the worst.
- By contrast, the more information disclosed, the higher the credit rating and the narrower the bond spreads.

# Incremental Fiscal Transparency is a Structural Reform

- Improving disclosure is a structural fiscal reform.
- Investors and rating analysts look benignly on reforms. Improving disclosure is considered positively by rating analysts and investors. (However, this is only the case if an increase in transparency is communicated clearly to the market.)
- Except for countries approaching default, this means that incremental improvements in disclosure also improve a country's risk perception and its creditworthiness, even if the information increases liabilities and exposes poor management.
- This is the case for both economic statistics (GFS) and financial statements (IPSAS).

# Market Skeptics

- Investors and rating analysts who fail to recognize the value of financial statements or a balance sheet.
- Investors whose only objective is to boost real-adjusted returns.
- Rating analysts who view risk in a pro-cyclical manner or whose ratings track those of other rating agencies.
- Investors or analysts who are held back by regulatory, methodological and internal capacity constraints.



# Market Enthusiasts

- Investors or analysts who
  - Take a holistic, longer-term view of the consolidated public sector.
  - View the balance sheet as a risk-management tool.
  - Track and appreciate the value of marginal increases in fiscal transparency.
  - Monitor the Governance component in Environmental, Social & Governance (ESG) for integration or engagement purposes.

# Increasing Fiscal Transparency Can Improve Creditworthiness

- Increasing fiscal transparency is the easiest and quickest way to improve credit quality: provide a balance sheet with existing data, explain data gaps, improve budgeting.
- Consistently improve data disclosure within the context of a public financial management system.
- Produce simplified presentations of the data in addition to full presentations.
- Communicate regularly with investors, rating analysts.

# Thank you

Fergus J. McCormick

Director of Sovereign Research

Emerging Markets Investors Alliance

New York, New York

+1 (917) 660 4731

[fmccormick@eminvestorsalliance.org](mailto:fmccormick@eminvestorsalliance.org)