

Financial and aggregate reporting of State-owned enterprises (SOE)

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The main purpose – providing a fuller and more accurate picture of the public sector net assets, debt and its performance



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- There is increasing demand for governments to monitor the performance of state-owned enterprises (SOEs) more closely and to improve public reporting on SOEs
- The preparation of annual aggregate reports has emerged as a leading practice for governments to account for the use of public money in the SOE sector, manage fiscal risk, and effectively exercise their role as owner – accountability of the ownership function of the state to Parliament and citizens
- SOEs are increasingly being integrated into public sector financial statements
- SOE aggregate reporting and public sector consolidated financial statements serve distinct purposes, but the two can complement each other to improve public reporting on SOEs

Key topics



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- Financial reporting requirements for SOEs
- Aggregate reporting

Financial reporting standards applicable to SOEs



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- **SOE** - enterprise, the state exercises ownership or control, their purpose and activities are of economic nature (offering goods or services in a given market).
- General purpose financial statements - intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs (IASB)
- Therefore: Financial reporting standards designed for entities with economic activities
- For external users - shareholders, lenders, regulators, and investors

Economic substance and business models are critical in determining applicable financial reporting frameworks

Good practices in Financial reporting and auditing standards for SOEs



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Topic	International standard	Standard-setter
Financial reporting	International Financial Reporting Standards (IFRS) and IFRS for Small and Medium-sized Enterprises (SMEs)	International Accounting Standards Board
Internal audit	International Standards for the Professional Practice of Internal Auditing	Institute of Internal Auditors
Internal control and risk management	COSO Internal Control-Integrated Framework	Committee of Sponsoring Organizations of the Treadway Commission
External audit	International Standards on Auditing (ISA) ----- International Standards for Supreme Audit Institutions (INTOSAI)	International Auditing and Assurance Standards Board ----- International Organization of Supreme Audit Institutions
Corporate governance	Principles of Corporate Governance SOE Corporate Governance Guidelines	OECD

Source: World Bank, 2014, op. cit.

Transparency & Accountability of SOEs



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- SOEs are expected to be “more public than public (listed) companies” - wider public is ultimate owner
- Transparency is not only release of information, but rather the quality, timeliness and reliability of the information being made public. This can be facilitated by accurate and timely reporting, either at entity level (individual SOEs) or for the country’s SOEs as a whole (aggregate annual reporting on all SOEs)
- Accountability -internal and external:
 - internal accountability - strong control environment, compliance of internal controls over financial reporting and effective internal audit overseen by effective audit committees;
 - External Accountability - effective and independent external audit practices, audit by SAIs and follow-up of audit findings, effective role of regulators and Parliament’s public accounts committees

Quality of financial reporting information by SOEs



- The quality of an entity's financial reporting is measured across different dimensions, including completeness, accuracy, timeliness, and relevance
- As evidenced by in-country work by World Bank teams, SOEs have difficulties with producing IFRS-based financial reports
- SOE reports are often incomplete, lacking key statements or notes that would normally be an integral part of the financial reporting package; or they may be inaccurate in the treatment of technical or sensitive areas; or they may be so delayed that they lose their timeliness and relevance

Financial reporting standards



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IFRS – for economically significant SOEs

- Complex set of standards
- Recognition and measurement requires significant cost and effort (fair value)
- Demanding disclosure requirements

IFRS for SMEs or NAS

- For smaller SOEs
- Less demanding in recognition and measurement (concept of undue cost and effort), often historic cost is allowed
- Less demanding disclosures
- NAS or other reporting frameworks (i.e. compliant with EU accounting directive) – policy choice in some countries for non-PIEs – usually less demanding

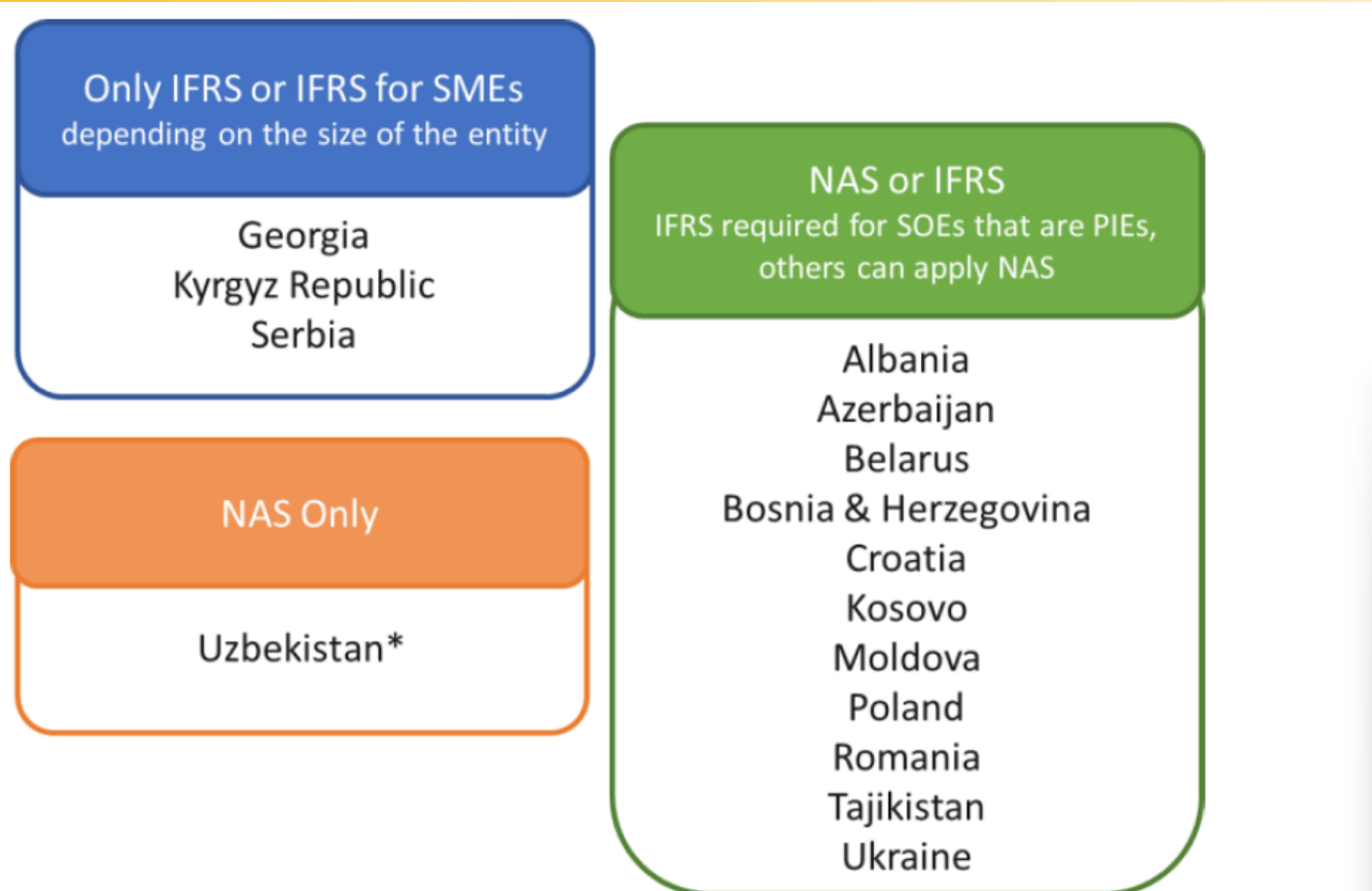
Consolidated financial statements! – for SOEs with subsidiaries/groups

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Applicable of Financial Reporting Standards in selected countries in the region



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* Uzbekistan is in the process of adopting the IFRS at the time of this Survey.

Source. *Corporate Governance of SOEs in ECA, survey, WB 2020*

Appropriate accountability mechanisms - Auditing & Controls



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Standards

- International Standards of Auditing
- Independent auditors
- Supreme Audit Institutions – avoid duplication of financial audits; define the scope

Controls and accountability mechanisms

- Audit committee – proper scrutinizing internal and external audits & demand follow up actions
- Internal audit
- System of internal controls
- Systems for auditors' appointment – avoid significant decision-making role by management
- Corporate governance statement – “comply or explain” principle for CG code

Public availability of full sets of audited financial statements and annual reports 10

Aggregate reports



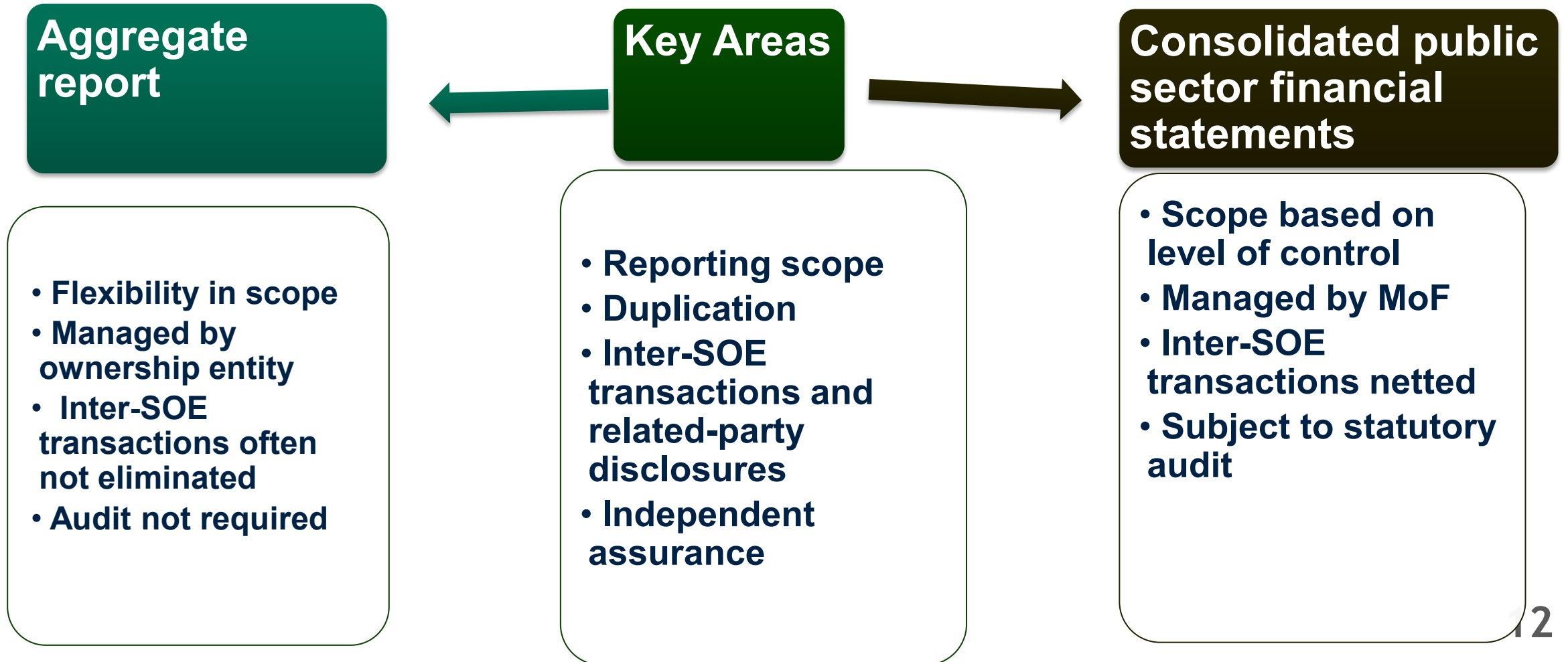
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- The objective of aggregate reports - improve transparency and accountability in government reporting on the composition and performance of the SOE portfolio
- Aggregate reports - an account on the economic performance and financial situation of SOEs and the use of public money in the sector
- The term “SOE aggregate report” is distinct in meaning from aggregation of financial statements
- SOE aggregate reports are often publicly disclosed
- International governance frameworks also call for governments to report on the main fiscal flows from the national budget to SOEs, particularly with respect to public service obligations
- SOE aggregate reports are increasingly seen as an accessible means for any government to account for the way they exercise their ownership role and to manage the fiscal risks associated with SOEs

Key Issues: Aggregate Reporting and Public Sector CFS



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Aggregate SOE Reporting in selected countries



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- Croatia
- Kosovo
- Moldova
- Romania
- Ukraine (top 100 SOEs only)

Yes



- Albania
- Azerbaijan
- Belarus
- Bosnia & Herzegovina
- Georgia
- Kyrgyz Republic
- Poland
- Serbia
- Tajikistan
- Uzbekistan

No





Benefits

- Relatively accessible in low-capacity environments; draws on existing data
- Enhances transparency on individual SOE performance and the overall portfolio (one-stop shop for SOEs)
- Facilitates management of fiscal risks
- Encourages consideration of non-financial indicators (e.g., environmental, social or sustainability metrics)
- Promotes governments taking an active ownership role



Potential Limitations

- Challenging to implement when ownership functions are fragmented
- Related party transactions with other SOEs - may not be reflected appropriately
- May require investment in staff training or information systems for efficiency

Content of aggregate reports – good practice (1)



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Reporting on material issues, including information related to sustainability, governance aspects, as well as on the achievement of public policy objectives. The information should give a full, clear and reliable picture of the SOE portfolio and be of high quality, comparable, concise and accessible publicly, including through digital communications.

- covers all economically significant SOEs and make it a key disclosure tool directed to the general public, the legislature and the media
- annual narrative report with information regarding the performance of the SOE portfolio
- overall accountability framework of an ownership entity - a mechanism to report back to the legislature or other representative bodies

Content of aggregate reports – good practice (2)



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Full picture of the SOE portfolio's size and sectoral distribution when appropriate and the portfolio's and individual SOEs' performance for the reporting period

- “forward looking” elements that support value creation
- financial performance and the value of individual SOEs, performance related to key relevant non-financial indicators
- indication of the total value of the state's portfolio, general statement on the state's ownership policy and how the state has implemented it
- organisation of the ownership function, nomination and appointment, composition, qualifications and remuneration of state-owned governing bodies, overview of the evolution of SOEs, aggregate financial information and reporting on changes in SOEs' boards
- key financial indicators: turnover, profit, cash flow from operating activities, gross investment, return on equity, equity/asset ratio and dividends, share of employment and other information bearing on environmental, social and governance practices
- individual reporting on the most significant SOEs
- the applied reporting standards applicable to individual SOEs and by the ownership entity when presenting aggregate information by the portfolio

Key conclusions



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- Financial reporting of individual SOEs and groups of SOEs (consolidated) – critical source of information
- Information should be credible and available – audits and public availability
- Aggregate reporting – tool for aggregate data and sound accountability mechanism
- Financial statements of SOEs (and groups), and aggregate reporting should be a good source of information for consolidation into Public Sector financial reporting

Reform options for sound quality of financial information by SOEs



- Sound financial reporting standards
- Audit requirements
- Public availability requirements
- Sound governance arrangements for financial reporting and auditing, including audit committees and sound internal controls and audit
- Aggregate reporting requirements