

# Steps and Implications of Transitioning to IFRS: Raising Transparency of State Owned Enterprises

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*SOE Roundtable*


**CFRR** >>>

**Centre for Financial  
Reporting Reform**




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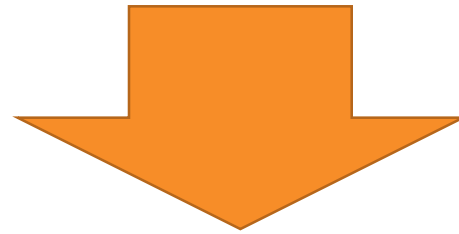


## Presentation Outline

- » Why state owned enterprises (SOEs)? Why now?
- » Role of SOEs in economies across ECA region
- » Quality and reliability of SOEs financial information
- » Accounting and Audit Reform in Georgia
- » Transition to IFRS: main challenges for SOEs
- » Resources

# Why state owned enterprises (SOEs)? Why now?

- » Ongoing financial and sovereign crisis around the world and in ECA
- » Reducing budget capabilities put pressure on governments to re-visit support of SOEs
- » Many SOEs do not operate on market terms requiring governments' assistance
- » Financing SOEs becoming scarce, capital costs rising, investors shying away from poor governed and poor performing companies
- » Still SOEs bear big potential to lead their domestic markets by building good corporate governance and leading the way



- » Many countries demonstrate that good governance of SOEs builds foundation for their positive contribution to economic efficiency and competitiveness
- » SOEs that are practicing good corporate governance are able to improve their performance
- » Experience shows that market-based model is the most effective way for efficient allocation of resources



## Why state owned enterprises (SOEs)? Why now?

In our region SOEs remain significant players in many areas:

- » providing sizable contributions to GDP
- » creating jobs
- » supplying essential services to citizens, such as light and power, healthcare, water, transportation and education
- » leading the markets in financial discipline and transparency

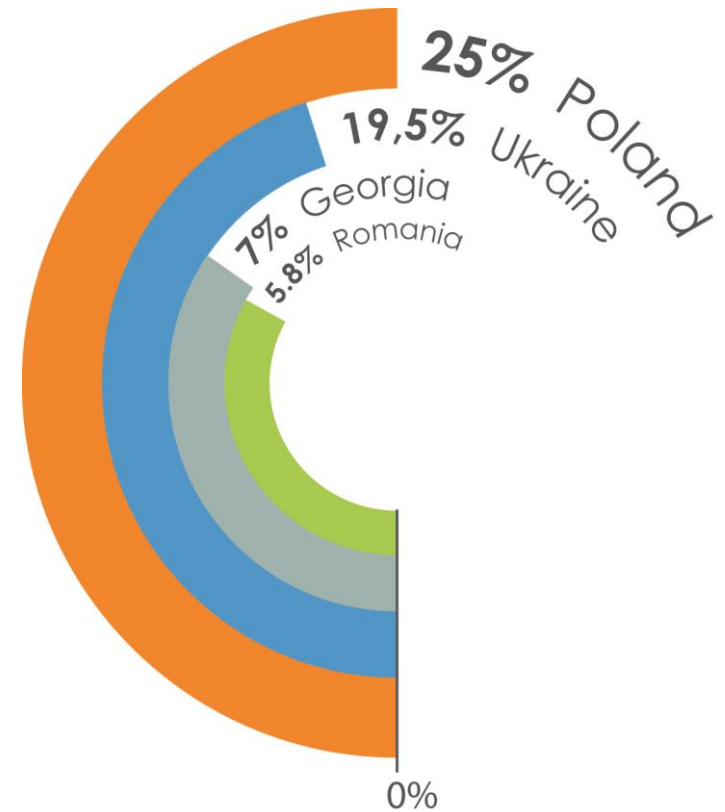
SOEs performance has a direct impact on social, political, and economic development of a country and on people's everyday lives.

# Role of SOEs in Europe and Central Asia region

SOEs are significant contributors to GDP:

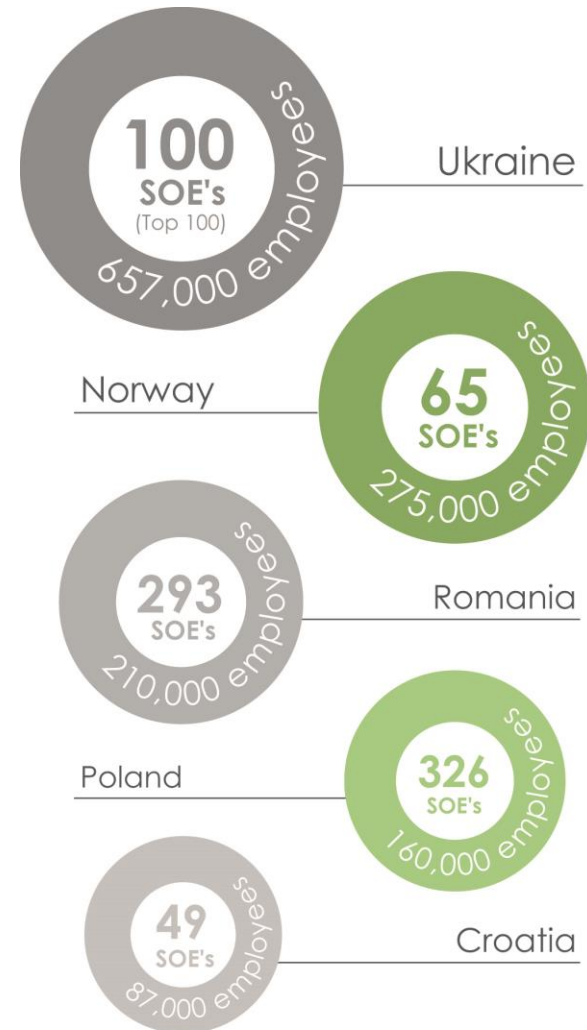
In the main sectors:

- Energy
- Transport
- Telecommunications
- Financial sector
- General manufacturing



# Role of SOEs in Europe and Central Asia region

SOEs are among largest employers:

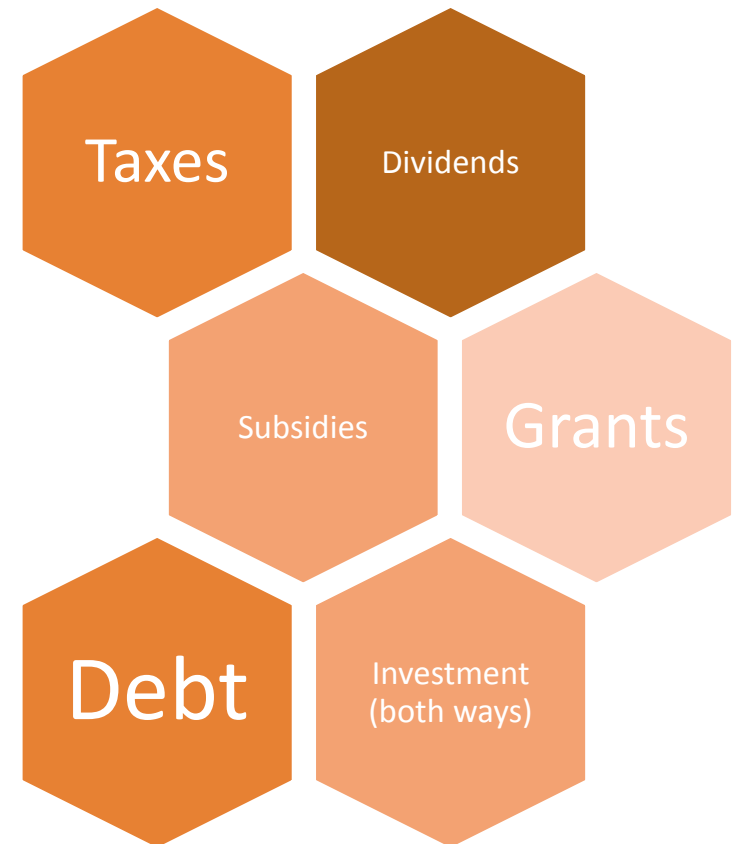


# Quality and reliability of SOEs financial information

Why is SOEs financial information so important???

- » SOEs are large tax payers
- » Dividend revenue for the budget
- » Subsidy | grants allocation from the budget
- » Investment by SOEs into public good
- » Investments attracted by SOEs from 3<sup>rd</sup> parties
- » Large issuers of debt

Serves as a basis for effective management and decision making



# Quality and reliability of SOEs financial information

- » **Defining an SOE:** An SOE is any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership\*.
- » **Commercial orientation:** SOEs are entities that pursue “economic activities”, which involves offering goods or services on a given market and which could, at least in principle, be carried out by a private operator to make profits.
- » **Reporting requirements:** All SOEs should disclose financial and non-financial information, and large and listed ones should do so according to high quality internationally recognized standards\*.
- » **Audit requirements:** SOEs’ annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit\*.

\* - as per OECD Guidelines 2015





# Quality and reliability of SOEs financial information

How to instill financial discipline and ensure SOEs report good quality numbers

- » SOEs = PIEs
- » Reporting under IFRS
- » Annual audits
- » Mandatory publication of audited financial statements
- » Corporate governance as at private sector peers, public companies
- » Functioning boards with proper expertise & independent directors

# Quality and reliability of SOEs financial information

- » Good practice in leading economies and OECD member countries to apply same rules to SOEs as to listed companies (and/ or PIEs)
- » In fact, in many countries, SOEs are indeed listed (to varying degree)



- » Sets the level playing field for private and state owned entities
- » Instills corporate governance requirements in SOEs = private

# Quality and reliability of SOEs financial information

- » Accounting and Audit frameworks should be aligned to reflect stronger requirements for SOEs = PIEs (*for large SOEs*)
- » Enforcement of requirements and monitoring should be embedded into the legislation
- » Achievable either by general accounting legislation OR by special dedicated decision of the Government:
  - » Belarus: IFRS required starting January 1 2017
  - » Ukraine: IFRS required for public stock companies (listed) + special list published by MOE
  - » Most EU countries: IFRS mandatory\*

\* based on size, listing status or specifically designated by the governments



# Accounting and Audit Reform in Georgia

- » New Law On Accounting, Reporting and Auditing signed into effectiveness in June 2016 aiming to:
  - » Improve the Accounting Systems, Reporting and Risk Management
  - » Improve the Corporate Governance
  - » Increase Transparency of the Businesses
  - » Facilitate the Capital Market Development Process
  - » Increase Efficiency of the Financial Sector and Tax Administration
  - » Improve the Investment Environment

## **Time for Implementation:**

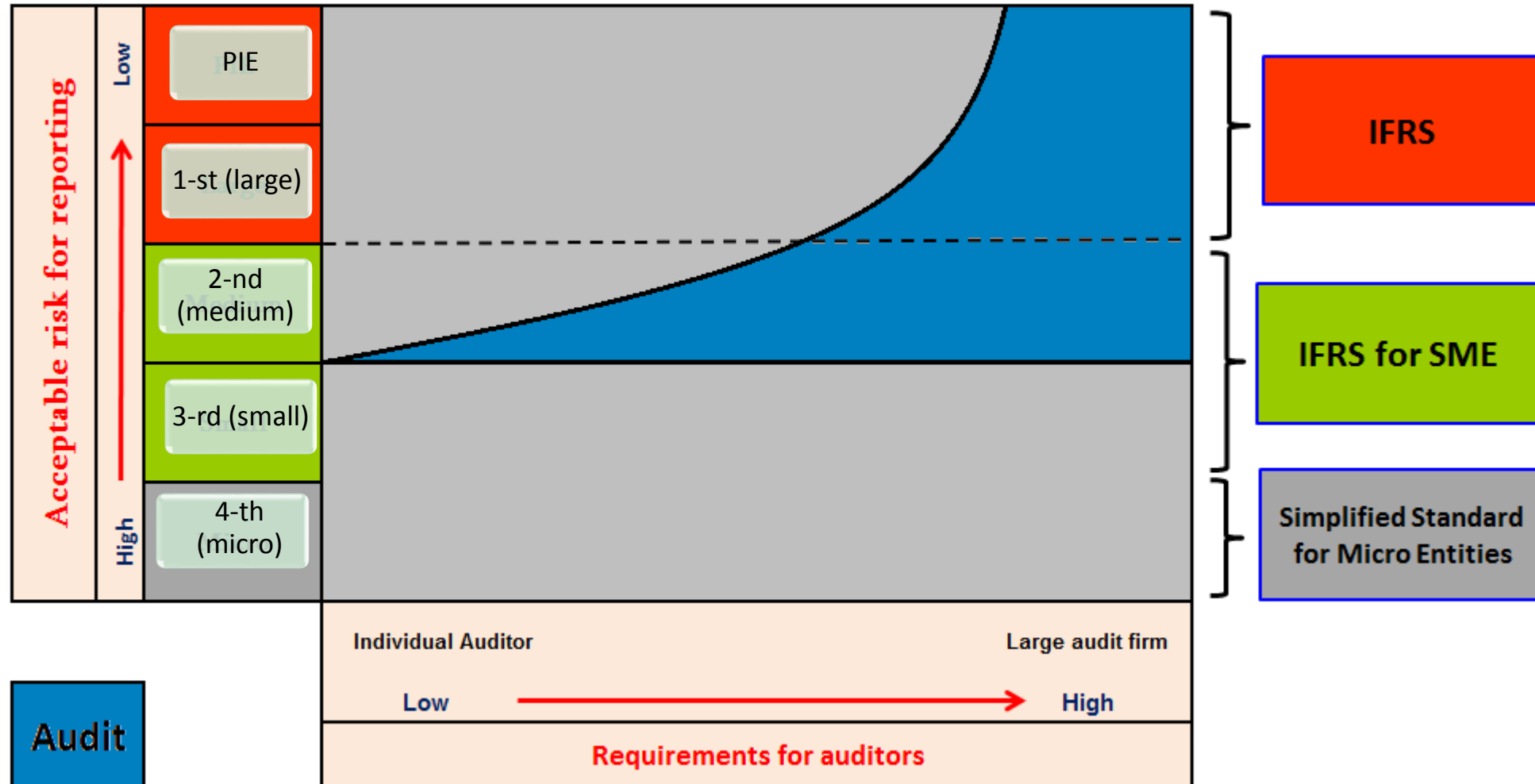
Deadline of approximation of Georgian accounting and auditing regulations to respective European Directives 2013/34/EU and 2006/43/EC is determined as September 2017 according to the Association Agreement



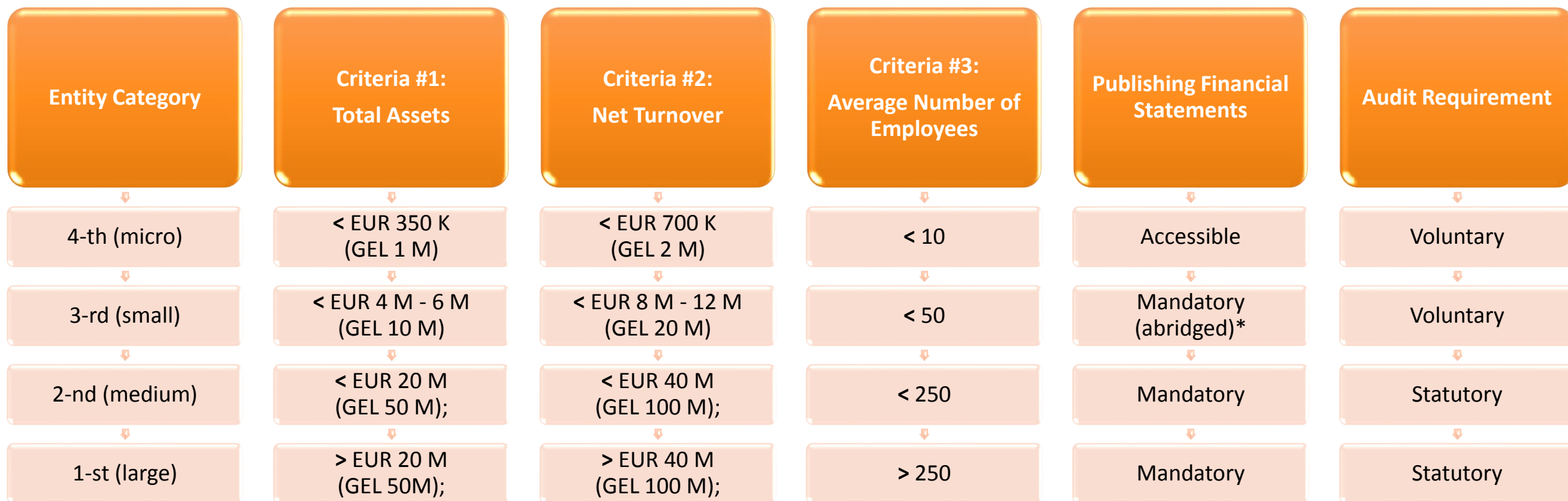
# Public Interest Entity (PIE) Definition

- » Listed entities
- » Commercial banks and qualified credit institutions
- » Micro-finance organizations
- » Insurance undertakings
- » Non-governmental pension schemes
- » Investment funds
- » **Entities designated as PIEs based on Governmental decision**

# Requirements on audit and reporting standards



# Entity Classification and Reporting Requirements



# Management and non-financial reporting

	<b>Accountability</b>	<b>Information to disclose</b>
<b>Review of undertaking</b>	PIEs, 1-st and 2-nd categories	Business development, financial position and performance, analysis of principal risks and uncertainties
<b>Corporate governance statement</b>	Listed entities	Corporate governance codes, systems of internal controls and risk managements, rights of shareholders, administrative, governance and oversight bodies, mandatory sales of shares
<b>Non-financial statement</b>	PIEs with number of employees exceeding 500	impact of its activity, relating to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters
<b>Report on payments to the State</b>	PIEs and 1-st categories	Concessions fees, dividends, lease, taxes, interests, royalty and other payments exceeding 100 th GEL

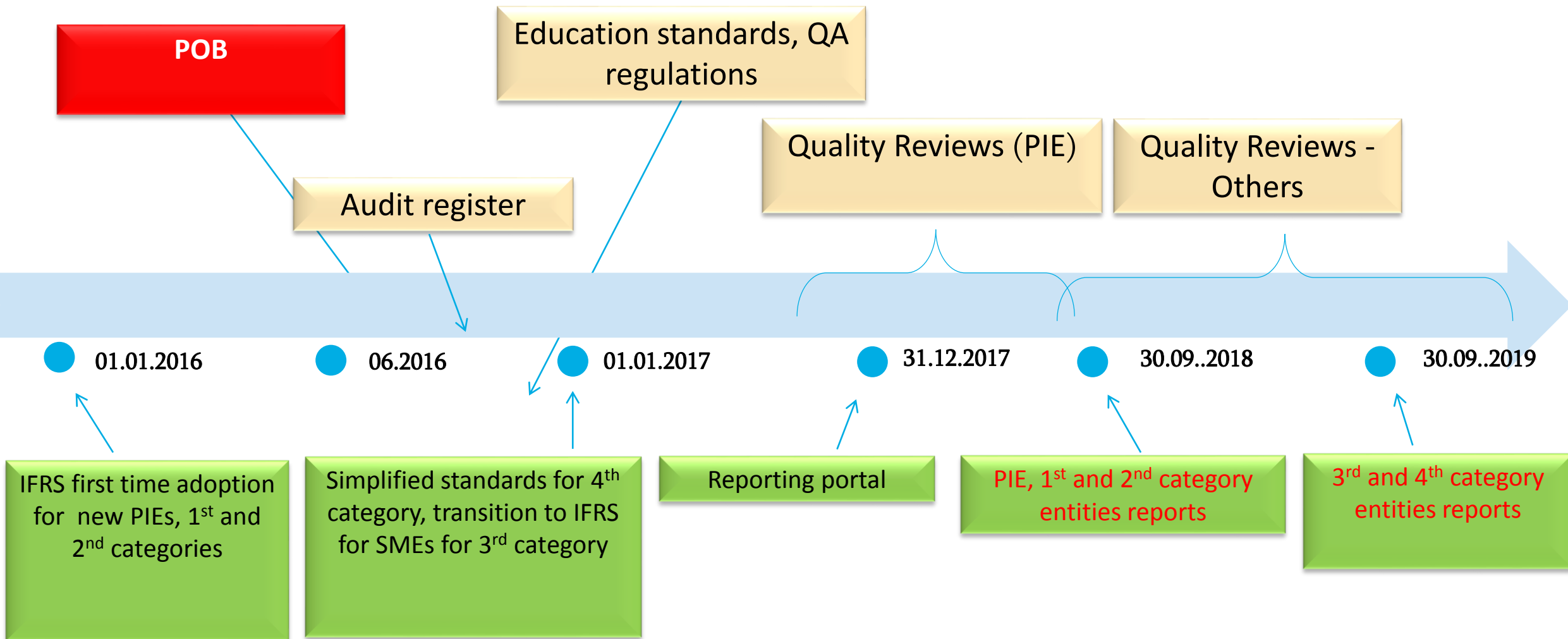




## Transition to IFRS

- » Transition to IFRS >>> complex process taking many years
- » Principles based vs. rules based
- » High capacity and professional judgement
- » Disclosure and publication
- » Law is only the beginning of a journey

# Timeline of the Reform



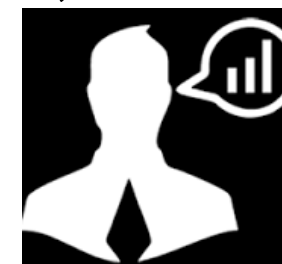
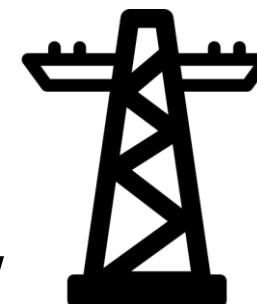
# Transition to IFRS

- » Main changes and typical challenges in transition:
  - » IAS 1 *Presentation of Financial Statements* – all main classes present, no off-sets, comparatives, 4 main financial statements + notes, significant accounting policies must be disclosed
  - » IAS 24 *Related Party Disclosures* – often missing or incomplete, this information is not a secret => should be disclosed. For SOEs – transactions with the State



# Transition to IFRS

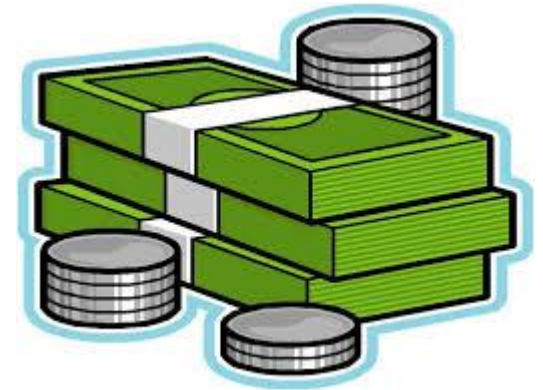
- » Main changes and typical challenges in transition:
  - » IAS 2 *Inventory* – valued at lower of cost or net realizable value @ reporting date
  - » IAS 16 *Property, Plant and Equipment* – recognition, completeness and valuation (cost vs. revaluation | FV). Impairment under =>
  - » IAS 36 *Impairment of Assets* – most asset classes, with few exceptions => assets carried at recoverable amount
  - » IAS 32 *Financial Instruments: Presentation*  
IAS 39 *Financial Instruments: Recognition and Measurement*, and  
IFRS 9 *Financial Instruments* (from 2018)



# Transition to IFRS

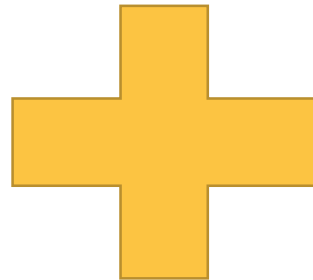
» Main changes and typical challenges in transition:

- » IAS 12 *Income Taxes* – deferred tax recognition, measurement and impairment assessment
- » IAS 19 *Employee Benefits* – example, vacation accruals
- » IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – provisions, accruals and contingent liabilities



# Audits and reliability of SOEs financial information

- » Regular audits (annual, quarterly or 6-M reviews)
- » ISA based
- » Quality assurance system
- » Public oversight



» Publication    Publication    Publication

# Audits and reliability of SOEs financial information

- » Audits to be performed by credible/ reputable audit firms (POB quality assurance, other ways to assure quality of audits if POB is not existent)
- » Selection and appointment of independent auditors: thought through, based on qualification and ability of an auditor to properly perform an audit. NOT lowest cost method\*\*
- » Communication between independent auditor and the board (via audit committee) is crucial for building credible and reliable financial statements
- » Publication of audit financial statements is a must for SOEs = PIEs

\*\* - price should be considered, but not become the only decision factor



## Good governance practices at SOEs

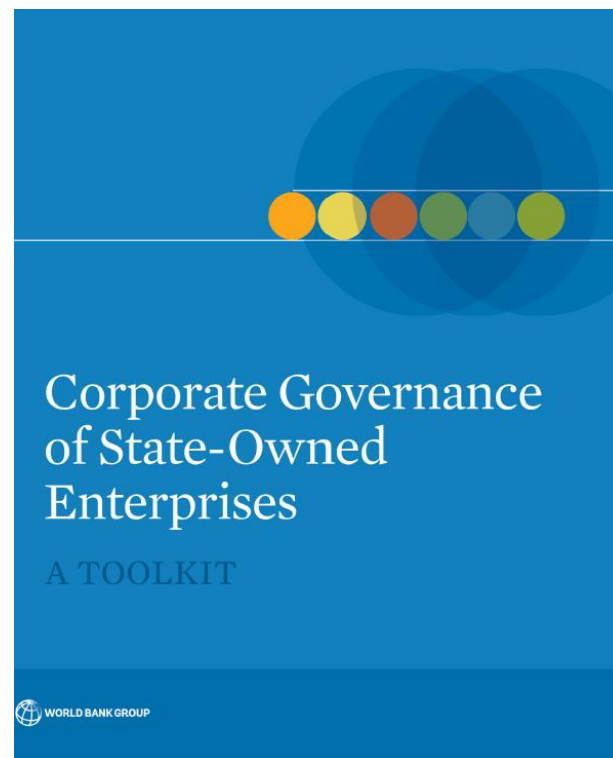
- » What is the standard setter for SOE accountability?
- » Where are the good practices?
- » Where to look for more answers



# Good governance practices at SOEs

» OECD: Guidelines on Corporate Governance of State-Owned Enterprises (2015)

» The World Bank: Corporate Governance of State-Owned Enterprises: Toolkit (2014)



OECD Guidelines on  
Corporate Governance of  
State-Owned Enterprises

2015 EDITION





## Where to find good practices?

- » OECD web-site: <http://www.oecd.org/>
- » OECD: Guidelines on Corporate Governance of SOEs (2015):  
RUS: <http://www.oecd-ilibrary.org/docserver/download/2615068e.pdf?expires=1475525236&id=id&accname=guest&checksum=F4EE436A996B1F23E1333D6F62770D8D>
- » ENG: [http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015\\_9789264244160-en](http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en)



# Where to find good practices?

» IFRS and related:

» Official web-site: [www.ifrs.org](http://www.ifrs.org)

» Resourceful page with explanations and latest news: [www.iasplus.com](http://www.iasplus.com)



## Where to find good practices?

- » Leading economies in Europe:
- » Sweden: <http://www.government.se/government-policy/state-owned-enterprises/>
- » Norway: <https://www.regjeringen.no/en/topics/business-and-industry/state-ownership/statens-eierberetning-2013/the-state-ownership-report/id2395364/>
- » Lithuania: <http://vkc.turtas.lt/en>



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Questions

Discussion



**Thank you.**