Diagnostic Assessment of Public Investment Management for State Owned Enterprises and Non-Profit Government Entities

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Diagnostic Assessment of Public Investment Management for State Owned Enterprises and Non-Profit Government Entities

1. Introduction and background

A framework for the design and diagnosis of the functions and institutional arrangements for public investment management (PIM) has been evolving over recent decades. PIM has been characterized as being composed of eight essential functions that need to occur in the public sector, but may be organized or arranged somewhat differently in different governments. See Box 1 and further elaborated in Box 2 below. In its initial elaborations, this diagnostic framework was applied with a focus on the investment programs of governments that were composed of the investments that are government owned and operated (GOO) through the government budget. Further elaboration of the PIM diagnostic framework, including country studies, was presented in a major study, The Power of Public Investment Management: Transforming Resources into Assets for Growth. While this diagnostic framework was initially applied to central government GOO investment projects, it was recognized that it also covered PIM at all levels of government (central, state, provincial, district, local, etc) and through all investment vehicles used by the government in the broader public sector, including public private partnerships, state owned enterprises and other public authorities and corporate entities of various kinds. This study focuses on the specific institutional arrangements needed for effective and efficient PIM for non-financial SOEs and other government corporate entities.

The extension of the application of PIM to non-financial SOEs is important in that despite significant privatization of SOEs over recent decades, SOEs remain an important component of many economies such that underperformance of investments as well as potential fiscal risks on the government budget can undermine economic growth and performance of an economy. For example, the IMF in its recent report on Managing Public Wealth found that a sample of 14 countries (including some emerging economies) in its Public Sector Balance Sheet (PSBS) database only had an average rate of return on assets of 1.9% over 2010-16. Moreover, SOEs can form a significant share of economies. The Independent Evaluation Group (IEG) in an Approach Paper reports that in OECD countries, SOEs account for 15% of GDP and in transition economies, 20-30% of GDP. World Bank estimates that SOEs account globally for 20% of investment and 5% of employment. In terms of investment, which is pertinent to this

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4 IMF, Managing Public Wealth, IMF Fiscal Monitor, October 2018

paper, the IMF PSBS database (2018) shows fixed assets of non-financial SOEs averaging about 18% of GDP for 15 advance economies, 24% for BRICS (excl. China), 17% for 10 emerging and 12% for 9 developing economies. Aside from these indicators of the aggregate and average importance of SOEs, there is a high variation in the use and types of SOEs across countries, as discussed further below. This affects the varying importance and range of challenges that countries face in integrating SOE investment into the broader government management of public sector investment.

Another group of government entities that poses some similar challenges to SOEs in terms of integration into the government investment management framework are the not-for-profit government quasi-independent entities, often established as corporations as well. These include a range of entities often established as corporate entities such as revenue, research, development and statistical services. These are included here in how to assess the PIM of projects in both SOEs and other non-profit government entities.

### Box 1. Essential PIM functions

<table>
<thead>
<tr>
<th>Project preparation</th>
<th></th>
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<tbody>
<tr>
<td>1. Investment guidance &amp; preliminary screening</td>
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<td>2. Formal project appraisal</td>
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<td>3. Independent review of appraisal</td>
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<td>4. Project selection and budgeting</td>
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<table>
<thead>
<tr>
<th>Project Implementation</th>
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<tbody>
<tr>
<td>5. Project implementation</td>
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<tr>
<td>6. Project adjustment</td>
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<td>7. Facility operation</td>
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<td>8. Project evaluation</td>
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</tbody>
</table>

Annex 1 provides the general definition of SOEs in the public sector.

The remainder of this report looks at the basic challenges that SOEs and other government entities cause for the broader PIM. It reviews the range of types of SOEs across countries and the key types of legislation that affect PIM for their projects. It summaries the range of challenges in the relationship between government and SOEs projects in public investment management. It goes on to present a framework for considering how PIM for SOE and other entity projects can be diagnosed. Importantly, this framework focuses on the special features arising from PIM arrangements with quasi-independent companies, but it should be considered in conjunction with the basic PIM diagnostic framework as laid out in the PEFA-style
PIM diagnostic. SOE and other government entity projects need to be managed using the core PIM functions. What needs to be added is a diagnostic that checks that these functions are adequately serviced by a combination of efforts by the government and the public entity.

2. Basic challenges in integrating SOE projects into PIM

The decentralization of responsibility to a public entity is both a strength and a challenge. Public corporations generally operate quasi independently under board of directors and management team. Potentially, this is a benefit in achieving performance efficiency and accountability, but also poses challenge of coordination and consistency with broader public policy. Box 2 elaborates on the eight essential or core functions as listed in Box 1 that should exist in all PIM systems for traditional government owned and operated projects funded out of the general revenues. In the context of the PIM framework, questions arise of how the various core functions are organized, monitored and overseen so that the quasi-independent public entity behaves in line with the public interest. Which functions can an SOE conduct independently? Which functions need external monitoring, review or direction? How does an SOE choose its methods for appraising, selecting and implementing projects? In general, how does SOE PIM systems relate and integrate to broader government PIM system? This generally requires (a) laws and regulations as well as active oversight and management of public entities of various kinds by central authorities, and (b) transparency and accountability by the entities to ensure that they operate in line with a desired PIM framework.

In seeking coordination and consistency of SOE investments with broader public policy, the most basic concerns focus on the appraisal methodology and the decision-making criteria used to appraise and accept investment projects. What types of appraisal are conducted in evaluating the feasibility of projects by SOEs and by the government? Do the criteria include their external impacts on the public or on the government budget? How are these appraisals mandated, conducted and reviewed? For SOEs that are normally expected to be financially self-sustaining entities, how are their potential and actual financial failures assessed and managed,

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7 The exploration of the application of the PIM framework to SOEs in this paper here can be seen as an extension of The World Bank, Corporate Governance of State-Owned Enterprises: A Toolkit, 2014, which reviewed and made recommendations for reforms of SOE corporate governance along a number of dimensions as laid out in Annex 2. The PIM diagnostic framework, however, recognizes more of the differences arising across types of SOE and other government entities based on the types of products and their related economic externalities, and the regulatory and financial support relationships between the government and the SOE. These affect how the government needs to intervene or supervise this governance relationship to ensure that its economic interests are being pursued and efficiently and effectively achieved as well as their financial viability sustained when SOEs prepare and implement projects. PIM is essentially concerned with how projects arise and flow through the PIM system functions from the time of their conception through to their operational life and ultimate termination or repurposing. SOE governance concerns efficiency and effectiveness of the structure and operations SOE as a corporate entity at a point in time.
particularly where these entities become heavily indebted and a fiscal risk to the government? These questions can be answered using an integrated project appraisal framework.

**Integrated project appraisal framework**

An integrated project appraisal or cost-benefit analysis (CBA) is required to get a complete and coordinated consideration of investment projects of SOEs and other government entities. As discussed more comprehensively in Annex 3, a full CBA provides the analysis of the project impacts on the economy as a whole as well as on the key stakeholders involved in or affected by the project. To achieve this, CBA of an investment is conducted from three key perspectives:

i. **Financiers perspective**

Financial analysis (including the internalized risks of the equity and debt holders and internalized environmental costs) is key to assessing the financial viability of the project for the equity holders and the default risks of debt holders and, in the case of government projects, the demands of the project on current and future government budget revenues to sustain project operations.

ii. **Economic perspective**

Economic analysis (including the external risks and environmental costs) determines the aggregate net benefits generated by the project to all stakeholders and other affected persons in the economy. It is the key decision-making perspective for any government for any decision that affects the use of resources either by the government itself or by any public or private entity (where the project depends on government approval, such as by means of tax expenditure policy, direct funding, regulation or some other contractual arrangement.)

iii. **Distributional or stakeholder perspective**

Distributional analysis disaggregates the aggregate net economic benefit to reveal the net benefits or costs (including their riskiness) expected by all key stakeholders. These include service beneficiaries, government and other project financiers or sponsors, competing businesses, suppliers of inputs, and workers and populations displaced or otherwise affected by the project. This analysis reveals any excessive profits or losses to specific groups, and hence, is key to the political viability of the project. It is also important in the context of SOEs to reveal the potential impacts of the project on the government finances through dividend, royalty and tax receipts and any or direct or indirect support provided by the government, including loan guarantees.

The integrated appraisal framework reveals the basic challenge in PIM for SOE projects. The SOE or other government entity as a corporation is concerned with its financial viability,

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8 The fiscal risks faced by a government by an SOE arise out of its roles as owner and as revenue collector of taxes and social contributions from its operations, possible debt or loan guarantee provider, possible provider of subsidies, and protector of public adversely affected by its operations.
Box 2. Essential PIM functions in the context of traditional government investment

Project preparation functions

1. **Project identification, guidance and screening.** The projects identified should be consistent with the strategic national and sector priorities and plans of a government as well as with the expected resource envelope of the sector and overall government. Sector priorities should be consistent with the identification of supply gaps in sector services and the results of ex ante project appraisals and ex post evaluations. Project documents should be screened for alignment with sector priorities before detailed design and appraisal is undertaken.

2. **Formal project appraisal.** The formal conduct of cost-benefit or cost-effectiveness analysis of a project or program produces feasibility studies as the basis for project approval, budget selection and implementation. For new, large and complex projects both prefeasibility and feasibility studies including financial, economic, risk and distributional analysis would be conducted. The level of effort in the conduct of the appraisal would be proportional to the size, complexity and risks involved in a project. Appraised projects go through one or more approval steps and selection criteria depending on the type and size of project.

3. **Independent review.** An independent technical peer review process is used to assure the appropriateness of appraisal assumptions and methods and to avoid biases in estimates.

4. **Project selection and budgeting:** Central ministries and government executive select projects from the pipeline of approved projects in line with sector priorities and consistent with available general revenues, loan financing and project grants for capital expenditures and in line with expectations of future recurrent revenues available to sustain added operating and maintenance expenses. Selected projects need to be subjected to legislative scrutiny in the process of authorization of the projects and appropriation of the funds. In addition, the scrutiny, approval and budgeting for the contingent liabilities arising from loan guarantees to SOEs and PPPs and other financial failures by SOEs has to be institutionalized.

Project implementation functions

5. **Project implementation.** This involves the procurement of design, building and operating services to implement the project as well as the management of the implementation process including the control of expenditure commitments, the release of funds and the monitoring of implementation against cost and timing milestones that arise from the project design and implementation plan. Upon completion, the project needs to be tested, reviewed, and handed over to operators. Newly created assets are registered.

6. **Adjustment.** During the pre-completion period formal arrangements are required to make technical and/or financial adjustments to a project based on significant changes in the timing or economic environment affecting the project. Where the required project adjustments are large, the revised project may need re-evaluation, approval and budgeting.

7. **Service delivery.** Once the project is operational, it delivers services supported by recurrent funding and subject to performance monitoring. Project service delivery can be subjected to impact analysis relative the expected base line of services otherwise provided.

8. **Ex post program or project evaluation.** An independent external reviewer evaluates the project while still operating or as part of a decision to continue, terminate or restructure the project. Annual external audits would be conducted of financial operations and possibly also service delivery performance and presented to the legislature for scrutiny.
whereas as a public entity its projects should promote the public interest or the aggregate economic net benefits captured by the economic analysis. In other words, the SOE can be expected to ignore the external costs and benefits arising from the operation of its projects. These externalities could include financial costs (or benefits) in the government budget aside conducted, at least of all large and complex projects, to reveal the financial viability, economic allowed to operate at more arm’s length on pure a financial attractiveness basis like pure private businesses.

The integrated approach can handle both the cases of commercial or for-profit SOEs where the issue of the financial viability of the project (with and without government support) is a crucial question) and the cases of not-for-profit government entities that largely depend on allocations from the government budget to cover their costs of operations and maintenance.

In summary, in principle, all public entities should follow the same generic comprehensive integrated approach to project appraisal or CBA while recognizing the changing role of the financial analysis in the case of self-financing or commercial projects versus budget dependent projects and the accounting for the different types of external benefits and costs generated by projects in different sectors. The basic issue becomes legal and institutional arrangements to achieve this uniform approach in the case of the various types of SOE and non-commercial government corporate entities.

3. Types and diversity of SOEs and non-profit government entities

Laying out the dimensions to characterize the different types of SOE and non-profit government entity, helps direct the need for different types of institutional arrangement to direct the PIM systems required for these different types of entity.

Dimensions of public legal entities:
1. Type of legal entity: corporation or other government legal entity (authority, board, commission, etc) established with powers to conduct financial operations.
2. Legal basis: incorporated under general corporate law or under special legislation.
3. Purpose: commercial or non-commercial activity (market production for profit or non-market production and/or non-profit activity.)
4. Market status of equity: listed or non-listed; tradable or not; government control or not controlled.
5. Regulatory control: price regulated natural monopoly or natural resource exploitation or competitive bidding for provision of regulated product or not regulated
6. Significance of externalities: major environmental or other externality or insignificant externalities
7. Public financial support: general financial support for sector or entity-specific support through budget, targeted tax expenditures or loan guarantees or procurement preferences, or no support.
While the seven dimensions identified above could result in a large number of different classes of enterprise, in practice only a limited number of forms of entity are of interest. First, all SOEs have a commercial or market production for profit activity, while all government entities have non-market production and are non-profit operating to support public policy or administrative functions. As shown in Table 1, SOEs can be incorporated under general corporate law of a country and could either be listed corporates open to public trade in their equity shares or be “privately” owned by the government or can be established under some special statute. Second, within any of these forms of incorporation, the enterprises could be subject to regulatory controls concerning prices, natural resource exploitation and/or because they cause major environmental or other externalities and could receive significant specific financial support through direct assistance or tax expenditures. These characteristics are important indicators of the possible need for PIM oversight and the leverage mechanisms for the government to direct their investment decisions in line with government strategies and plans.

OECD has collected information on the distribution of sectors and corporate forms of SOEs in 40 countries (32 OECD member states and 8 other countries, including China, India and Brazil.) OECD classifies SOEs as majority-owned listed corporations, majority-owned non-listed corporations and statutory and quasi-corporations. Statutory corporations are those established by specific legislation rather than being fully incorporated under the general company law of a country.

Table 1 gives the frequencies of different forms of SOE based on an OECD survey of SOEs in 32 OECD and 7 other countries (including Brazil, China and India) for 2015. First, these results show China to be an outlier with 157,926 non-financial SOEs, vastly more than the 38 other countries in the survey combined which only have 2,153 non-financial SOEs. Only five countries have over a hundred non-financial SOEs, namely, Brazil, Czech Republic, Hungary, India and Lithuania. A further five countries have less than ten non-financial SOEs, namely, Australia, Austria, Japan, Switzerland and the United States. Despite this major variation in the numbers of non-financial SOEs across these countries, one common pattern is that outside of India and Italy, less than 5% of non-financial SOEs are listed corporations. It is important to recognize, however, that companies listed on a stock exchange are usually the larger companies in an economy. OECD reports that when equity values and employment are considered, listed SOEs form 45% of equity value and 25% of employment of all SOEs (including financial SOEs, but excluding China.) The importance of large listed SOEs can also be seen from their significant and growing presence amongst the Fortune Global 500 companies. In 2005, China SOEs were 3% of the Global 500 companies, rising to 15% by 2015, and the SOEs in the rest of the world rose from 6% to 8% of the Global 500 companies over the same period. The remaining non-listed SOEs show significant variation in their corporate form across countries. While the majority of SOEs, about 77% on average, are majority owned non-

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11 PWC, State-owned enterprises: Catalysts for public value creation? April 2015, Figure 1.
Table 1. Frequency of non-financial State Owned Enterprises (SOEs) by corporate form for OECD and selected other countries in 2015

<table>
<thead>
<tr>
<th>OECD countries</th>
<th>Minority-owned listed entities</th>
<th>Majority-owned listed entities</th>
<th>Majority owned non-listed enterprises</th>
<th>Statutory corporations and quasi corporations</th>
<th>All non-financial SOEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>37</td>
<td>133</td>
</tr>
<tr>
<td>Austria</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>6</td>
<td>6</td>
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<tr>
<td>Canada</td>
<td>37</td>
<td>37</td>
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<tr>
<td>Chile</td>
<td>23</td>
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<td>Czech Republic</td>
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<td>Denmark</td>
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<td>38</td>
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<td>France</td>
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<td>Germany</td>
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<td>Greece</td>
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<td>Hungary</td>
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<tr>
<td>Iceland</td>
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<td>Italy</td>
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<td>Japan</td>
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<td>Latvia</td>
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<td>Mexico</td>
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<tr>
<td>Netherlands</td>
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<tr>
<td>New Zealand</td>
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<tr>
<td>Norway</td>
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<td>Poland</td>
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<td>Sweden</td>
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<td>Switzerland</td>
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<td>Turkey</td>
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<tr>
<td>United Kingdom</td>
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<tr>
<td>United States</td>
<td>6</td>
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<tr>
<td><strong>Sub-total</strong></td>
<td><strong>67</strong></td>
<td><strong>55</strong></td>
<td><strong>1,276</strong></td>
<td><strong>276</strong></td>
<td><strong>1,607</strong></td>
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<tr>
<td><strong>Other countries</strong></td>
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<tr>
<td>Argentina</td>
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<td></td>
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<tr>
<td>Brazil</td>
<td>106</td>
<td></td>
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<td>Columbia</td>
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<td>Costa Rica</td>
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<tr>
<td>India</td>
<td>227</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Lithuania</td>
<td>123</td>
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<tr>
<td><strong>Sub-total</strong></td>
<td><strong>31</strong></td>
<td><strong>53</strong></td>
<td><strong>307</strong></td>
<td><strong>96</strong></td>
<td><strong>546</strong></td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>98</strong></td>
<td><strong>108</strong></td>
<td><strong>1,673</strong></td>
<td><strong>372</strong></td>
<td><strong>2,153</strong></td>
</tr>
</tbody>
</table>

- Excluding following OECD countries: Belgium, Luxembourg and Portugal
- Majority owned includes corporations with over 50% government equity holding or government control

listed corporations, there are eleven countries (Brazil, Germany, Greece, Hungary, Ireland, Israel, Italy, Japan, Korea, Netherlands, Slovenia and Spain) that only use this type of corporate form. By contrast, nine countries (Australia, Canada, Costa Rica, Estonia, Lithuania, New Zealand, Norway, Switzerland and United States) have 50% or more statutory corporations amongst their SOEs and in the extreme Canada has all its SOEs formed as statutory corporations.

Table 2 shows the distribution of SOEs in 2015 by sector for all the countries surveyed by the OECD. Excluding the financial SOEs, most of the majority-owned listed corporations are in the primary, manufacturing, electricity and gas sectors. Generally, the other types of non-financial SOEs are more concentrated in the regulated sectors, namely, primary sectors, telecommunications, transportation, electricity and gas and other utilities as well as “other activities.” These sector distributions are suggestive that most of the SOEs are in regulated sectors. This raises questions about how an SOE is directed and controlled through the various forms of legislation governing its incorporation, its sector activities and its regulated activities. These issues are addressed in the next section that covers institutional arrangements.

It is also important to recognize that in some countries SOEs may be operating as purely commercial entities producing private goods and services in direct competition domestically and/or internationally with other privately owned and operated entities. Where private companies operating in competitive markets pay regular taxes, do not generate major externalities, and do not receive significant financial support directly or indirectly through tax expenditures or trade protection, then private investments are expected to be economically

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Table 2. State-owned enterprises by sector and corporate form: Sample area excluding China (end-2015)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total (excluding state minority-owned enterprises)</th>
<th>Majority-owned listed enterprises</th>
<th>Majority owned non-listed enterprises</th>
<th>Statutory and quasi-corporations</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>N of enterprises</td>
<td>N of employees</td>
<td>Value of enterprises (USD millions)</td>
<td>N of enterprises</td>
</tr>
<tr>
<td>Primary sectors</td>
<td>2,467</td>
<td>9,238,528</td>
<td>2,407,825</td>
<td>154</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>225</td>
<td>842,654</td>
<td>143,036</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>215</td>
<td>507,170</td>
<td>263,397</td>
<td>16</td>
</tr>
<tr>
<td>Finance</td>
<td>251</td>
<td>796,215</td>
<td>353,940</td>
<td>39</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>64</td>
<td>961,521</td>
<td>110,447</td>
<td>7</td>
</tr>
<tr>
<td>Electricity and gas</td>
<td>220</td>
<td>816,142</td>
<td>502,299</td>
<td>24</td>
</tr>
<tr>
<td>Transportation</td>
<td>313</td>
<td>1,782,644</td>
<td>473,496</td>
<td>9</td>
</tr>
<tr>
<td>Other utilities</td>
<td>231</td>
<td>3,536,149</td>
<td>164,185</td>
<td>6</td>
</tr>
<tr>
<td>Real estate</td>
<td>106</td>
<td>32,115</td>
<td>84,670</td>
<td>5</td>
</tr>
<tr>
<td>Other activities</td>
<td>822</td>
<td>602,477</td>
<td>82,191</td>
<td>8</td>
</tr>
</tbody>
</table>

Note: The reported value of listed entities is based on market value at end-2015, unless otherwise specified in the country tables presented in the Annex. Negative equity values in individual sectors have been treated as zero. Sectoral value figures for majority-owned non-listed enterprises incorporate OECD Secretariat estimates for Spain, since national reporting did not disaggregate this information by sector.

Source: OECD Secretariat calculations based on questionnaire responses submitted by the national authorities of contributing countries or institutions and FactSet.
attractive and not require direct public oversight. This raises the issue of how to manage SOEs that are operating under similar circumstances as private companies, except that they are government owned. This is especially the case where the SOE producing private goods is a listed and traded company.

4. **Government-SOE relationship: structures and challenges**

   To help determine how the government should establish desirable institutional arrangements to ensure that all the core PIM functions are adequately and efficiently conducted, it is useful to review the relationships between government and SOEs and other government entities. These can cover the formal legal arrangements controlling the entities and the relationship to government, the financial relationships with government and mechanisms to limit potential collusion and corruption in the relationship. The diagnostic framework also needs to be able to target the different types of entity (as noted above) and their relationship with the government to check whether the PIM functions have institutional arrangements to ensure their conduct and oversee their quality.

4.1 **Legal and regulatory frameworks**

   The legal and regulatory frameworks are key both in determining SOE strategies and goals and in determining the internal operational parameters and procedures of the public company. As is noted below, however, the actual behavior of corporations may ultimately depend heavily on the nature and comprehensiveness of the transparency and accountability of the company to its various stakeholders ranging across its parent ministry, central ministries, government executives, legislators, civil society, taxpayers and the general public. What information is available to whom can clearly affect the behavior of the company. The legislative framework may well be an important and necessary agent to achieve a sufficiently high level of transparency to influence the corporate behavior that the government as controlling owner may not otherwise require. For example, the company have well prepared investment plans and statements of account, but these may not be available for public scrutiny.

   The legislative framework enabling and directing SOEs can be broken into legislation affecting (i) the corporate form and internal operations, (ii) specific SOE issues, (iii) general public financial and debt management, (iv) regulated sectors, and (v) all business and corporate entities.

   **Legislation concerning corporate form and internal operations**

   As noted above, the most common form of incorporation among the countries surveyed by the OECD (see Table 1) was under the company legislation of the country. Company law

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typically deals with ownership and equity shares, boards of directors, mandates or purposes of the company, appointment of company executives, maintenance of accounts and external auditing, etc. Any company would also be affected by accounting standards and auditing requirements of a country. For an SOE, it may also be subject to procurement and public service employment conditions of the wider government. Where SOE-specific legislation is used to create the corporate entity, then such legislation typically cross references the companies act of the country, but clarifies the mandates and functions of the company, its relationship to parent ministries, appointment of board members and their powers, and whether public procurement and employment conditions apply or not. Where a company is a listed company, then legislation and regulations relating to companies listed on a stock market as well as the requirements of a particular stock market. Importantly, stock markets typically require high levels of transparency and disclosure about corporate plans and performance and regular publication of audited accounts. This clearly solves much of the transparency issue that often relates to SOEs. Where companies are owned and controlled by governments, like private closely-held companies, the full financial performance and accounts may not be publically available. This is a clear limitation on the transparency of a non-listed SOE and the potential for effective review and oversight. While the government may have regular internal access to the plans, performance record and accounts of an SOE, and these may eventually be disclosed through an audit committee of the legislature on a delayed basis, it limits the ability of legislators, civil society and the general public to monitor and review the performance of such SOEs owned by the government on behalf of the public in a complete and timely manner.

**SOE specific legislation**

The need to ensure the public transparency and accountability of SOEs raises the issue of whether there is any need for SOE-specific legislation. There are possibly at least seven areas where SOE legislation is appropriate.

The first relates to the **regular reporting** (at least annually) so that all SOEs (and, in fact, all government entities that are outside the government direct expenditures) report their plans, achievements and full financial statements (assets and liabilities, profits and losses, and cash flows) to the parent ministry and ministry of finance in a complete and timely fashion. These documents would also identify the source of all debt and any loan guarantees provided to the entity. These documents should be public documents provided to both the legislature and public. The simplest approach in current times would be to post them as electronic documents. This would also assist the government to set up consolidated public sector accounts covering all public entities including the government itself. This, in turn, would form the basis the ability to conduct public sector wide risk sustainability analysis. Note that debt management and loan guarantees should be covered under separate legislation as these pertain more broadly to loans and guarantees to private entities (including PPP corporations) as well as the loans raised by the government or its entities. Where listed SOEs already make adequate public disclosure of their

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13 Note that some government establish specific units and funds to manage the awarding of loan guarantees specifically to PPPs. For example, Indonesia has the Indonesia Infrastructure Guarantee Fund, Brazil has the
plans, performance and accounts, the legislation could indicate such, but, nevertheless, require the documents to be forwarded to the government and published.

The second area would cover dividend policy, which is a basic source of conflict of interest between the government and the SOE. SOE dividends can be a significant source of general government revenues, but excessive dividend distributions can undermine the sustainability of the SOE. Retained earnings play a key role in providing equity to support the maintenance and expansion of productive capital assets and to allowing loan acquisitions without raising the debt-to-equity ratio. Objective rules should provide limits based on shares of profits and assets and equity requirements to sustain approved planned investments. Where listed companies are exposed to significant market competition, such competitive forces may be deemed adequate to allow such SOEs more independence in their dividend policy.

The third area would cover investment policy and practice. This would require SOEs to conduct full-integrated investment analysis of all projects requiring such analysis in the PIM guidelines of the government (such as all large and complex projects.) It may provide exceptions for fully taxable commercial SOEs (especially listed SOEs) which do not receive any significant government support (directly or through target tax expenditures or loan guarantees) and do not cause any major environmental or social externalities. It should also specify which SOE projects needed to be reviewed and approved by the government. Review of project appraisals could also be required by an independent expert third party. Such requirements for PIM of SOE projects could well be specified in public financial management (PFM) legislation and regulations. In such cases, any specific SOE legislation should cross reference the PFM legislation.

The fourth area concerns the costing and compensation for social activities undertaken by a commercial SOE. The published accounts of SOEs should include cost estimates of identifiable social activities undertaken by the SOE under instruction of the government and should also include any compensation received from the government directly or indirectly for undertaking the social activities. Again, this requirement could be part of PFM legislation.

The fifth area concerns the procurement of goods or services from SOEs by the government or another public entity. SOEs should not be given any preferential treatment or hidden subsidy in supplying government. It should be a general requirement that SOEs compete on a level playing field with alternative private supplies for any contract to supply goods or services to ensure efficiency of government operations. Again, this requirement could be part of PFM legislation.

The sixth area relates to the trading in SOE equity shares. The legislation should specify which unit within the ministry of finance (possibly a privatization or divestiture unit) is responsible for monitoring and evaluating the performance of SOEs with tradable shares, recommending any sales or acquisitions of shares, and conducting the trades. Transparent and competitive trading procedures should be specified.

Federal Guarantee Fund and Companhia Paulista de Parcerias – CPP (Paulista Partnership Company), and Mexico has FONADIN and Partial Credit Guarantee arrangements.
The seventh area relates to **indirect government ownership** of an SOE. While generally it is expected that government owns equity shares in an SOE directly, cases occur where a government controlled pension or social security fund holds the controlling share of the equity of a company. All PIM related legislation, regulations and rules should apply to that company as if it was owned directly.

**Legislation concerning public financial and debt management**

Given SOEs and other public entities are part of the financial operations of the public sector and have impacts the budget through (i) general revenues through dividend, royalty and tax payments, (ii) debt on lending, loan guarantees and default and loss coverage, and (iii) may conduct social activities and policy on behalf of the government. In addition, special areas such as debt management and procurement may be covered with the general legislation on public finances or under separate special legislation. The general legislation overseeing the financial operations of the government may not elaborate on the PIM requirements for screening, appraising, financing, approving or managing public investments. These details may only be contained in guidelines or manuals published under the general legislation and related regulations. Two important manuals or guidelines should be required and sanctioned by the public financial management legislation and regulations, namely, (i) a PIM manual that lays out how all the core PIM functions are carried out the various units of government and over the budget cycle and (ii) a project appraisal manual that specifies the methods to conduct integrated project appraisal. Importantly, the PIM manual should specify how comprehensive the project appraisal needs to be depending on the nature of the project and which agency or entity is designing and implementing the project. Other general legislation concerning accounting and auditing also has impacts on SOE financial operations.

The public financial management legislation and regulation could cover some of the SOE specific issues noted above, namely, the financial reporting requirements, the investment policy and practice, and the costing and compensation for social or policy activities required by an SOE. Any SOE-specific legislation would then cross-reference the public financial management legislation.

**Legislation for regulated sectors**

Important groups of SOEs are in the natural resource exploitation sectors (oil and gas, mining, forestry, fishing, etc) and the natural monopoly network sectors (electricity, gas, water, communication, transportation, etc.) Sector legislation and related ministries typically oversee these sectors and may establish SOEs involved in specific aspects of the development or operation of these sectors. In addition, specialized boards, commissions or authorities may be established to oversee licensing (exploration and exploitation of mineral reserves, rights to generate power or operate telecommunication systems, etc) and to set prices for electricity, water, transport systems, etc. Ideally, the sector legislation and/or SOE legislation and/or public financial management legislation should specify how PIM functions should be conducted, the transparency and review of operations, and where central government ministries should be involved in review and approval of investments.
Legislation affecting all business and corporate entities.

SOEs and other public entities typically have to comply with general legislation affecting health and safety, labor work conditions, land rights and use, environmental quality standards, etc. In some cases, compliance with environmental and land use legislation raises major economic issues that need to enter the project screening and appraisal and may require review by sector and central government ministries.

In summary, it is clear that investment management by SOEs can range from being highly decentralized to the board or directors and management of an SOE to being highly integrated in the government PIM system. Given the range of legislation affecting the operations and investment behavior of an SOE, the investment management procedures and requirement may or may not be explicit. In many governments, the PIM system and related guidelines and appraisal manuals may not be well developed or appropriately used. In such cases PIM reform of the general government is essential to lead PIM reform of the SOE sector.

4.2. Financial relationship and fiscal risks

SOEs have been a long-running source of concern of creating fiscal risks for governments. These can arise from SOEs not being subject to hard budget constraints because of the implicit financial backing by the government. This so-called “soft budget constraint” (SBC) problem can be exacerbated or exploited by weak or corrupt SOE management causing fiscal problems through poor revenue performance, over spending or excessive borrowing. SOEs that receive on-lent loans from the government may fail to repay the government, which is left with the obligation to repay the loan out of general revenues. The finances of SOEs can also be weakened where governments extract excessive revenues from SOE surpluses, particularly in the natural resource extraction sectors, leaving them unable to sustain their operations or undertake new investments. Alternatively, in situations where SOEs are mandated to take on policy roles (such as supplying product at below market prices to low income households), but do not receive financial compensation for the public services, then these “quasi fiscal roles” weaken their financial positions and raise the risks of defaulting on their creditors.14

SOEs established as corporate entities can acquire (and must account for) assets and liabilities. Given public entities ultimately are owned by the government, any failure to meet the repayment of liabilities, including loan repayments, typically falls explicitly or implicitly on the government budget. This government backing of borrowings by SOEs, other government entities and PPPs typically allows the entity to borrow on more favorable terms than it would be able to on the strength of its own balance sheet or expected future profitability. This has a positive economic outcome where it allows the entity to be financially viable, but can lead to major financial stress to the government and economy where it leads to the wasteful use of debt.

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In addition, if the entity takes poor investment decisions or otherwise underperforms and defaults on its debt obligations, then this can have possible serious budgetary and possibly macro-management consequences. Debt management of SOEs is a key component of SOE risk management. Consequently, it needs to be reflected in the risk management arrangements of both the government as owner and internally in the SOE.  

Given the serious nature of the need to manage the debts of SOEs and other government entities, a number of approaches are typically followed:

First, the debt sustainability of the government is taken beyond analysis of the core central and general government to the wider consolidated government so that all the net revenues and debt obligations of the consolidated government are accounted for and managed. See for example, the IMF study on Managing Public Wealth, which builds a Public Sector Balance Sheet (PSBS) Database for 31 countries (15 for single years and the remaining 16 for multiple years). This expands the role of the central agencies of government to establish consolidated public sector accounts that allow for better management of the overall public portfolio of assets and liabilities. This should allow better assessment of the incremental risks on the government and the economy arising from major SOE investments and financing.

Second, the government budgets for the contingent liabilities, especially where explicit guarantees have been awarded, which may be called in cases of debt defaults and other financial failures by SOEs and other government entities.

Third, the government establishes a special unit within the ministry of finance, or as a separate entity, to manage government guarantees by making explicit financial analyses of the risks arising from each new guarantee and advising on the approval of such new guarantees.

Fourth, the government requires full-integrated project appraisal including risk analysis to be conducted for all new, complex and large projects undertaken by most, if not all types of SOEs and other government entities, and requires review of such appraisals by central ministries and possibly external agencies. This last approach clearly becomes part of the imposition of a more integrated approach to PIM across the public sector. As already noted above in section 2 and Annex 2, an integrated approach to project appraisal and public sector management is critical to recognize the impacts of SOE projects on the government fiscal positions as well as on other affected parties.

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16 IMF, Managing Public Wealth, IMF Fiscal Monitor, October 2018
17 The government may get exposed to SOE risks indirectly where a government pension plan invests in an SOE and where the pension plan returns are underwritten by the government.
Annex 4 presents a fiscal risk matrix for the government that arise from SOE financial operations.

4.3 Controlling performance, costs, collusion and corruption

All public sector entities should be operating with performance targets (short-term objectives and long-term goals) that are consistent with generating economic net benefits while remaining financially within their expenditure budgets arising out of their sales revenue and/or share of government revenues. Within the core government such performance targets should exist for the costs centers within all ministries, departments and other agencies and be overseen by parent sector and central government ministries and the legislature. Within SOEs and other government non-profit entities such targets may or may not be clearly articulated in the articles or statutes of incorporation or other regulatory legislation affecting the performance and related investment decisions and the direction and oversight given to the entity. Section 4.1 above discusses the nature of such legislative frameworks. The degree of clarity of performance targets, procedures and accountability affects (a) the roles of the management and boards of directors (as would exist in most corporate entities) and (b) how the board and management may positively or negatively affect the performance of the entity.

One of the crucial elements in SOE investment and performance management is how the selection, qualifications and composition of board members as well their role in the appointment and supervision of the senior management. The board of directors are key in overseeing and the management are key in developing and implementing the investment project design, appraisal and financing to ensure that projects are in line with the economic, financial and risk management goals of the government. Given the controlling position of government ownership, these board and management positions have often been the target of political patronage rather than based on professional capacity. Even where strong professional capacity is put in place, this needs to be backed by transparent review and accountability mechanisms to encourage good investment management at all stages.

Critically, the history of performance of SOEs is replete with cases of poor performance: cost overruns and/or failure to supply and poor investment management. For example, the IMF found in a sample of 14 countries (including some emerging economies) from its Public Sector Balance Sheet database that the average rate of return on assets was only 1.9% over 2010-16.\(^\text{18}\)

In many cases, this poor performance is related to corrupt activities causing failures to perform or cost overruns in performance. These performance failures also often result in debt default problems that are transferred onto the government to settle.

Clearly, a government can promote a culture of performance and professionalism, and sound PIM-related legislation, regulations, manuals etc. should lead to efficient performance, but without sufficient active review, oversight and public objections and protests, the outcome can...

\(^{18}\) IMF, *Managing Public Wealth*, IMF Fiscal Monitor, October 2018, Box 1.1
be poor. Hence, a keen focus has to be put on the various forms of external review and oversight, and the transparency of plans and performance to the government, legislature and public in the PIM functions to ensure accountability of corporate boards and management.

5. Diagnostic Framework and Assessment Indicators for PIM for SOEs

5.1 Introduction to diagnostic framework: key types of entity and relationships to government

The basic PIM framework as shown in Box 2 has already been used in reviewing and diagnosing PIM systems for government and PPP investments in many countries. The findings are elaborated in *The Power of Public Investment Management*. In addition, a diagnostic framework based on PEFA (Public Expenditure and Financial Accountability) diagnostic tool has been developed to focus on the PIM eight core functions. The PEFA PFM Performance Measurement Framework was first issued in 2005 and has been used as a performance rating and diagnostic tool to assist many countries to enhance the performance of their PFM systems.

The PEFA-style PIM diagnostic tool has been used in a number of regions and countries to undertake a more detailed diagnosis of the structure and performance of the government PIM system. This diagnostic framework also built on studies of PIM processes, issues and performance indicators.

Before presenting the diagnostic framework and assessment indicators for PIM for SOEs and other government entities, a framework is developed based on the discussion above of types of public entity and their relationships to help categorize where differences in investment management can be considered. While like any corporate entity, SOEs in of themselves should have PIM systems internally that mirror those that should be laid out in the PIM and project appraisal manuals or guidelines of the government. The issue addressed here is how these SOE PIM operations should be integrated into the broader government PIM system so that coherent and coordinated sector policies can be achieved within the overall public sector. This requires additional desirable institutional arrangements for government to manage SOEs and other entities as part of the overall public sector.

First, a “crude” categorization is developed in Table 3 and then a more detailed elaboration is presented in Table 4.

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21 Graham Glenday and G.P. Shukla, “Proposals to strengthen the PIM component of the PEFA framework and indicators,” Report prepared for Public Sector & Governance, PREM, World Bank, October 2014

Table 3 focuses on the importance of the two major types of externality generated by public entities that demand external involvement in their operations to ensure that their investment designs and decisions are consistent with the broader public interest. The core issue behind the need for an integrated approach to investment appraisal and decision-making is the existence of major externalities from a project. For SOEs these externalities are generally either captured in the government budget (arising from government support for the project through direct budget support, on-lending, guarantees, targeted tax expenditures, or procurement preferences) or revenues from the project (such as royalties or resources rents received over and above regular corporate taxes) or evidenced as environmental and social\textsuperscript{23} externalities affecting other persons. Where these externalities are significant, then the government (over and above the company board and regulators) should also be involved ex ante in project review and selection and ex post in project adjustment and evaluation. Table 3 groups the company types into three major types: (i) for-profit companies producing private goods and services, (ii) regulated for-profit companies in natural resource or natural monopoly network sectors, and (iii) not-for-profit government entities. Among the for-profit SOEs, where the externalities are significant then there is a need for government involvement at all stages of investment decision making. In addition, in the case of all mega “private sector” projects and large regulated sector projects by SOEs, government should be involved. In the case of all not-for-profit government entities, which all depend upon government budget support, government should be involved in investment decision-making, at least for all large projects.

\textsuperscript{23} Social externalities can include displacement of communities by projects.
Table 3. Impact of basic entity types and major externalities on allocation of PIM functions

<table>
<thead>
<tr>
<th>SOE or other entity type</th>
<th>Externalities</th>
<th>Review, selection, adjustment &amp; evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>For-profit companies producing private goods and services</td>
<td>No significant targeted financial support or revenue and No significant environmental or social externalities</td>
<td>Board, except also government for mega projects</td>
</tr>
<tr>
<td></td>
<td>Significant targeted financial support or revenue or Significant environmental or social externalities</td>
<td>Board and government</td>
</tr>
<tr>
<td>Regulated for-profit companies in natural resource or natural monopoly network sectors</td>
<td>No significant targeted financial support or revenue and No significant environmental or social externalities</td>
<td>Board, regulator, except also government for large projects</td>
</tr>
<tr>
<td></td>
<td>Significant targeted financial support or revenue or Significant environmental or social externalities</td>
<td>Board, regulator and government</td>
</tr>
<tr>
<td>Not-for-profit government entity</td>
<td></td>
<td>Board and government</td>
</tr>
</tbody>
</table>

Note: Targeted final support includes direct budget support, on-lending, guarantees, tax expenditures, and procurement preferences

Table 4 expands upon the crude version in Table 3 in that (i) it breaks the for-profit SOEs into two types, listed or traded and not listed or traded and (ii) it considers the added arrangements required for each of the eight core functions. Unregulated SOEs that are listed and traded on public stock markets are widely held and can be treated more like a similar private company except that it needs to report in a transparent and comprehensive way to the government, legislature and public. SOEs that are closely held by government and not traded typically require greater public transparency, oversight by government and integrated appraisal
Table 4. Deviations from and additions to government PIM framework indicators for PIM diagnostic framework for SOEs and other government entities

<table>
<thead>
<tr>
<th>Core PIM function</th>
<th>Type of company or entity</th>
<th>Not-for-profit entity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For profit listed or traded</td>
<td>For- profit not listed or traded</td>
</tr>
<tr>
<td></td>
<td>No budget support, targeted TE or explicit guarantees</td>
<td>With budget support, targeted TE or explicit guarantees</td>
</tr>
<tr>
<td>Project preparation phase</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Strategic Guidance &amp; Preliminary Screening</td>
<td>Treated as part of government private sector economic strategy; SOE develops own strategy and guidance</td>
<td>Treated as part of sector or social strategy depending on economic externality justifying government subsidy or support</td>
</tr>
<tr>
<td></td>
<td>Government provides reasons and targets for social activities required to be undertaken by entity</td>
<td>Government provides reasons and targets for social activities required to be undertaken by entity</td>
</tr>
<tr>
<td>2. Formal Project Appraisal</td>
<td>Focus on financial and risk analysis except where major environmental or social externality or mega project</td>
<td>Full integrated analysis for all large projects</td>
</tr>
<tr>
<td></td>
<td>Required to use standard project appraisal manual and apply appraisal method as appropriate to project size and types as specified in PIM guidelines or manual</td>
<td>Apply supplemental to project appraisal manual that covers debt sustainability of project, SOE and government, default risks and fiscal risks faced by central and sub-national governments and other external guarantee agencies</td>
</tr>
<tr>
<td>3. Independent Review of Appraisal</td>
<td>Compliance with public reporting requirements for company plans, performance and financial statements as required by regulatory body of stock market</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Require all appraisals of mega and large projects to be reviewed jointly by ministries responsible for finance, planning and sector. Where feasible have mega and large projects reviewed by agency with independent experts.</td>
<td></td>
</tr>
<tr>
<td>4. Project Budgeting and Selection</td>
<td>Board decision except where major externalities</td>
<td>Board plus government approval</td>
</tr>
<tr>
<td></td>
<td>Where SOE and private companies engage in competitive bidding for supply of regulated product, ensure unbiased selection process</td>
<td></td>
</tr>
</tbody>
</table>

a. TE means tax expenditure
b. Mega projects could have investment of about 1% of GDP or more.
c. PIM guidelines manual should be in the form of regulations or otherwise sanctioned by legislation and regulations regarding public finance management and/or public investment management
<table>
<thead>
<tr>
<th>Core PIM function</th>
<th>Type of company or entity</th>
<th>Project implementation phase</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For-profit listed or traded</td>
<td>For-profit not listed or traded</td>
</tr>
<tr>
<td></td>
<td>No budget support, targeted TE or explicit guarantees</td>
<td>With budget support, targeted TE or explicit guarantees</td>
</tr>
<tr>
<td>Project implementation phase</td>
<td>Adoption of government or alternative competitive procurement rules</td>
<td></td>
</tr>
<tr>
<td>5. Project Implementation</td>
<td>Listed SOEs should provide copies of all interim reports or statements required by the relevant stock market. In addition, it should provide copies of all project completion reports.</td>
<td>All entities should conduct active project management and monitoring and also provide project progress and completion reports of all large projects.</td>
</tr>
<tr>
<td>6. Project Adjustment</td>
<td>Board decision except where major externalities</td>
<td>Board plus government approval where large adjustment</td>
</tr>
<tr>
<td>7. Facility Operation</td>
<td>Listed SOEs should provide copies of all interim reports and annual financial statements required by the relevant stock market.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Performance contract exists for social or policy activities</td>
<td>Performance contract exists for social or policy activities</td>
</tr>
<tr>
<td></td>
<td>Report periodically on performance of the production of social or policy activities, the quantities achieved and cost incurred and government support received</td>
<td>Report periodically on performance of the production of social or policy activities, the quantities achieved and cost incurred and government support received</td>
</tr>
<tr>
<td>8. Project Evaluation</td>
<td>Focus on financial and risk analysis except where major environmental or social externalities or mega project</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Full integrated analysis for all large projects</td>
<td>Full integrated analysis for all large projects</td>
</tr>
</tbody>
</table>

Timely completion, publication and review (by government ministries responsible and legislature) of all external audit reports.

a. TE means tax expenditure
b. Mega projects could have investment of about 1% of GDP or more.
approaches, especially for any large projects and where the significant externalities arise from the projects or operations of the SOE. By contrast, the not-for-profit entity largely conducts social or policy activities funded by the government general revenues. Such an entity is essentially a government agent providing social or policy related services that are part of the government operations, and hence, its PIM system needs to be well integrated into the government planning and investment system.

Generally, where for-profit SOEs (i) generate major externalities (changes in greenhouse gas emissions, air or water pollution, deforestation, community resettlement, etc.) and/or (ii) receive significant government support\(^\text{24}\) (through budget support\(^\text{25}\), loan guarantees, targeted tax expenditures, etc.), then the government needs to be involved in the project design and appraisal from an economic, distributional and financial perspectives, project and budget approval as well as ensuring the efficient and effective construction and operation of the project. Where the SOE is providing social or policy related services on behalf of the government, then explicit performance agreements, financial compensation and performance monitoring and evaluation should be in place to integrate the SOE into government operations. Wherever government on-lending or loan guarantees are provided, the government needs to be actively involved in assessing and managing the fiscal risks arising at the project, corporate, government and aggregate public sector levels.

\section*{5.2 Institutional arrangements and indicators important for SOE and other entity relationship to government}

Based on Table 3 and 4, which lay out the important types of entity and relationships of SOEs and other government entities to government for the core PIM functions, Table 5 presents develops 1, 2 or 3 desirable institutional arrangements for each core PIM function that integrate the entity PIMs into the government PIM system so that the SOE and other government investment plans are better aligned with the overall government sector and national plans and policies. They also ensure that the SOE and other public entity investments are economically beneficial and have the desired distributional impacts while also promoting the fiscal stability of the public sector.

These arrangements target the key investments that are likely to have major economic externalities and could generate significant fiscal risks. In general, they promote the comprehensive transparency to the government, legislature and public of the plans and financial statements of SOEs and other entities, which should not only promote accountability and better performance, but also allow for consolidated public sector accounts to be established and used in fiscal risk management.

The desirable institutional arrangements in Table 5 are then elaborated on in Table 6, which also provides indicators that can be checked in the diagnosis of how well the PIM system handles the projects of SOEs and other government entities. Section 5.3 then provides detailed

\(^{24}\) What is significant government support needs to be specified, but it could be if a project receives support valued at more than 5\%, say, of its gross revenue or total costs.

\(^{25}\) Budget support could be in the form of a subsidy or as compensation for social or policy related services.
descriptions and rationales for each of the desirable institutions and indicators in Table 6.

Two further issues are important to note before proceeding into the detailed descriptions and rationales of the desirable institutional arrangements and indicators. First, all these institutional arrangements should be supported by a legal and regulatory framework for the overall PIM system that has become to be recognized as consisting of three tiers:26

Tier 1: The legal authority for the PIM system, which ideally would be contained in **PFM and related legislation and regulations.**

Tier 2: More detailed procedural guidelines, high-level decision criteria, and designation of analytical tools. A **PIM manual** should play a key role to specify how all the core PIM functions are to be carried out for different types, complexities and size of projects, new and replacement projects, and for projects of different public sector entities (including SOEs and other government entities.

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Table 6. Additional desirable institutional arrangements and indicators for integration of SOEs and other government entities into PIM system

<table>
<thead>
<tr>
<th>Core PIM function</th>
<th>Desirable institutional arrangements</th>
<th>Indicators</th>
<th>Related PEFA-PIM indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Strategic Guidance &amp; Preliminary Screening</td>
<td>1.1 Mechanisms to coordinate sector market analysis between government sector planners and controlled SOEs in regulated sectors and SOEs receiving significant government support</td>
<td>1.1. SOE planned output performance and investments integrated into government published sector strategic plans</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>1.2. Performance contracts or explicit targets are provided for social or policy activities required of SOE or other public entity</td>
<td>1.2. Documented performance contracts or explicit targets for social or policy activities of entity</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>2.1. Existence of project appraisal manual covering integrated approach and related capacity and training</td>
<td>2.1. Existence and requirement to use a project appraisal manual along with training arrangements and funding to sustain capacity</td>
<td>3 &amp; 4</td>
</tr>
<tr>
<td></td>
<td>2.2. Existence of PIM manual* that lays out channels for screening and appraising projects based on size, complexity and prior experience, also specifies application to SOEs and other entities.</td>
<td>2.2. PIM manual* specifying appraisal channels and application of integrated appraisal to SOEs and other government entities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2.3. Unit(s) in government to analyze and screen government on lending and guarantees and more broadly the public sector financial and fiscal risks and sustainability.</td>
<td>2.3. a. Public sector debt management, loan guarantee and fiscal risk units. b. Existence of full consolidated public sector accounts.</td>
<td>5</td>
</tr>
<tr>
<td>2. Formal Project Appraisal</td>
<td>3.1. Existence of external institution (university or research institute) with independent technical capacity in sector analysis and project appraisal to conduct technical reviews of large and complex projects.</td>
<td>3.1. Number and share of feasibility or prefeasibility studies of large or complex projects by SOEs in regulated sectors or receiving significant government support subjected to external technical review</td>
<td>6</td>
</tr>
<tr>
<td>3. Independent Review of Appraisal</td>
<td>3.2. Existence of interministerial committees (finance, planning and sector ministries) for technical review of project feasibility studies</td>
<td>3.2. Number and share of feasibility studies of large or complex projects by SOEs in regulated sectors or with significant government support subjected to review by interministerial technical committee.</td>
<td></td>
</tr>
<tr>
<td>4. Project Budgeting and Selection</td>
<td>4.1. PIM manual* and budget procedures should make clear where government approval is required in addition to Board approval. These would include all large projects with significant externalities, significant government support and/or significant social or policy functions.</td>
<td>4.1. Government approval process for affected SOE investments and government budgeting of contingent and direct liabilities. Explicit budgeting of all compensation for social or policy services provided by entity and all guarantees and contingent liabilities on government</td>
<td>7 &amp; 15</td>
</tr>
<tr>
<td></td>
<td>4.2. Mechanisms should be mandated to ensure transparent and unbiased competitive selection of companies to provide regulated products or services.</td>
<td>4.2. Transparent procedures are used to select providers of regulated products or services.</td>
<td></td>
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<tr>
<td></td>
<td>4.3. To ensure full transparency, SOE and public entity investment plans and financial accounts should be available to public ministries, appropriate committees of legislature, and unless security issues are involved, general public. Ideally plans and reports should be posted on website of entity and parent ministry.</td>
<td>4.3. Digital publication on internet websites of SOE and other entity and parent ministry of all investment plans and financial statements (subject to redaction for national security reasons).</td>
<td>10</td>
</tr>
</tbody>
</table>

* PIM manual should be in the form of regulations or otherwise sanctioned by legislation and regulations regarding public finance management and/or public investment management.
<table>
<thead>
<tr>
<th>Core PIM Function</th>
<th>Desirable institutional arrangements</th>
<th>Indicators</th>
<th>Related PEFA-PIM indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>5. Project Implementation</strong></td>
<td>5.1. Transparent and competitive e-procurement rules and procedures should be adopted</td>
<td>5.1. Existence of transparent and competitive e-procurement rules and procedures of both government and SOEs</td>
<td>15 Procurement</td>
</tr>
<tr>
<td></td>
<td>5.2. All SOEs and other public entities shall have (i) clear project implementation management procedures, (ii) monitoring and reporting procedures on project implementation physical and financial milestone achievements, (iii) requirements for a completion review and report and (iv) asset registration and management.</td>
<td>5.2. Regular (at least quarterly) progress reports and final completion report to parent ministry or regulator agency on all projects that required government approval and registration of assets</td>
<td>16, 17 &amp; 18 Project implementation management, control, monitoring and reporting; physical and financial milestones; and project handover, asset registration and completion review</td>
</tr>
<tr>
<td><strong>6. Project Adjustment</strong></td>
<td>6.1. Clear allocation of authority and clear procedures for government and/or a regulator to review and approve any major adjustment to any project and its funding that initially required government and/or regulatory approval</td>
<td>6.1. Documentation of explicit allocations of authority and procedures to manage project adjustments</td>
<td>19 Project adjustment</td>
</tr>
<tr>
<td></td>
<td>6.2. Procedures and institutional capacity to handle budget reallocations where adjustments have budget implications for government.</td>
<td>6.2. Documented procedures and evidence of actual practice of budget reallocations in response to project adjustments</td>
<td></td>
</tr>
<tr>
<td><strong>7. Facility Operation</strong></td>
<td>7.1. Regular (at least quarterly) reporting of service delivery, operating and maintenance costs and receipt of budget support (where applicable) by projects requiring initial approval by government and/or regulatory authority</td>
<td>7.1. Regular reports of service delivery, operating and maintenance costs and receipt of budget support (where applicable) by projects requiring initial approval by government and/or regulatory authority received by these agencies and ministry of finance</td>
<td>20 Control, monitoring and reporting; financial and service delivery performance</td>
</tr>
<tr>
<td><strong>8. Project Evaluation</strong></td>
<td>8.1. Where entity has a major social or policy activity output, entity should conduct impact evaluation of service delivery.</td>
<td>8.1. Impact evaluation reports where a major social or policy related service delivery by entity</td>
<td>22 &amp; 23 Scope, nature and follow-up of external audit and ex post evaluation; and legislative scrutiny of external audit reports</td>
</tr>
<tr>
<td></td>
<td>8.2. Timely submission and where appropriate publication of external audit reports to government and legislature audit committee. Effective scrutiny of audit reports by legislature and effective responsiveness by entity to recommendations of legislature.</td>
<td>8.2. Timely review and recommendations from audit committees on entity external audit reports and timely responsiveness by entity to recommendations</td>
<td></td>
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<tr>
<td></td>
<td>8.3. For large and complex projects requiring government approval, ex post evaluations should be conducted after about 10 to 15 years from project start</td>
<td>8.3. Ex post project evaluation reports of large-scale and complex projects are publicly available</td>
<td></td>
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</tbody>
</table>

*PIM manual should be in the form of regulations or otherwise sanctioned by legislation and regulations regarding public finance management and public investment management.*
Tier 3: Methodological guidance, detailed criteria, standardized parameter values and procedural documentation. A project appraisal manual plays the key role in specifying the detailed methods involved in a full-integrated appraisal, parameter values, spreadsheet methods and the conduct of any simplified appraisal for smaller and repeated projects.

The roles of PFM or equivalent legislation, PIM manuals and project appraisal manuals are noted in the descriptions of the desirable institutional arrangements for the diagnosis of the PIM system for projects of SOEs and other government entities.

The second major consideration is that the diagnosis of the PIM system for projects of SOEs and other government entities should be conducted after or in conjunction with the diagnosis of the government PIM system using existing diagnostic tools such as the PEFA-style PIM diagnostic framework. This is critical for two reasons. First, the PIM for SOE diagnostic presented here builds on the PEFA-style PIM diagnostic framework and its application would be facilitated by the results of the diagnosis of the government PIM system. Second, it is important to know whether the basic government PIM system itself needs fundamental reforms that would need to be implemented before or in conjunction with any reforms of the PIM system for projects of SOEs and other government entities.

5.3 Rationales for the Institutional Arrangements and Indicators for PIM for SOEs

The rationales for each of the institutional arrangements and related indicators presented in Table 6 should be understood in the context of the rationales for the diagnostic assessment indicators developed for the PEFA-style diagnostic tool. The existing elaboration of this tool already provides extensive explanations for the 23 diagnostic assessment PIM indicators covering the assessment of the eight core PIM functions. The institutional arrangements diagnosed here are essentially providing the links, coordination, reporting and review mechanisms between the core government PIM system and the PIM arrangements within quasi-independent SOEs and other public entities. The objective is to check whether the combination of the internal PIM system of the SOE or other public entity and these institutional arrangements results in investments undergoing a comprehensive integrated appraisal in the project preparation phases as well as effective and efficient management in the implementation phases resulting in net economic benefits and financial stability and sustainability of the public sector. The indicators for PIM for SOEs should be understood in conjunction with the corresponding PEFA-PIM indicators. Table 6 provides the related PEFA-PIM indicators for the PIM for SOE indicators to facilitate this joint consideration and application. The rationales for each of the institutional arrangements and related indicators presented in Table 6 are elaborated on here for the eight core PIM functions.

27 Graham Glenday and G.P. Shukla, “Proposals to strengthen the PIM component of the PEFA framework and indicators,” Report prepared for Public Sector & Governance, PREM, World Bank, October 2014
1. Strategic guidance and preliminary screening

1.1. Sector planning co-ordination
It is crucial that investment in the public sector (including SOEs) is targeted at current and forecast excess demand whether in the utility, transportation, social service, etc. sectors. Public sector performance is achieved by combined activities of government sector and SOEs. This requires that government general economic and sector plans incorporate all sector information available through SOEs, but is essential in all sectors that incorporate price-regulated entities or that receive significant direct support or indirect targeted tax expenditures. Where SOEs are in competitive market-driven industrial sectors, sector performance is more a function of the private entities unless SOEs are dominant in domestic production and need to be explicitly reflected in the sector performance and plans. This approach to incorporating SOEs in economic planning allows the general economic and sector strategic plans to provide guidance to investment projects being screened for project design and appraisal before decisions on financing and implementation whether in the government or in SOEs. (See also PEFA-PIM Indicator 1.)

Basic questions include: Do central and sector ministries receive details of SOE output and investment performance and plans? What level of detail of these outcomes and plans do SOEs share with these ministries? Do these plans include estimates of current and future excess demand and prices for their products? In cases of price-regulated sectors, do the regulatory authorities receive detailed output and investment data and also share information with the relevant sector ministry? Does government develop guidance for priority investments in the sectors and the SOEs, especially where SOEs are required or supported to undertake specific policy or social activities?

An indicator of comprehensive and coordinated general economic and sector strategic planning is the explicit recognition of the roles of SOE output and investment in the government published general economic and sector plans. Any rating of this indicator would be based on the quality and comprehensiveness of the inclusion of the SOEs in sector output and investment performance and strategic plans.

1.2. Entity performance targets for social policy activities
Where SOEs and other government entities receive direct budget support (including explicit loan guarantees) or targeted tax expenditures to undertake social or policy activities (including producing services with large positive economic externalities), then it is important that explicit performance targets are established so that budget effectiveness and efficiency can be monitored and reviewed. These can be achieved through performance contracts with the entity or through explicit budget performance targets that require reporting by the entity and, in turn, by the government. This integrates the government required and supported activity by SOEs and other government entities into the government budget management system and gives explicit guidance to the entity investment plans. (See also PEFA-PIM Indicator 2.)

Basic questions include: How does the government manage the performance targets and results for the SOEs and other public entities receiving direct or indirect financial support to
undertake specific social or policy activities? How are targets communicated, monitored and enforced?

An indicator is the existence of documented performance contracts or explicit or published performance targets for SOEs or other public entities receiving government support to undertake specific social or policy activities. Rating of this indicator would depend on the quality and comprehensiveness of the contracts and targets and the reporting of performance across SOEs and other public entities.

2. Formal Project Appraisal

2.1. Project appraisal capacity

All SOEs and other government entities should be required to conduct project appraisal according to a project appraisal manual that details the methodologies for applying an integrated approach to economic, financial, risk and distributive analyses. The types of analyses required and whether a full analysis is required or not should be specified in a PIM manual. The entities should have sufficient human and organizational capacity and access to training facilities and operational funding to sustain this capacity to conduct project appraisal. (See also PEFA-PIM Indicators 3 and 4.)

Basic questions include: Does a project appraisal manual exists for the public sector? Does it covers an integrated approach to project appraisal? Is there adequate professional staffing to conduct the required levels of project appraisal in the government and all other public entities? Is the staff supported with adequate training and financing?

An indicator is the existence and requirement to use a project appraisal manual along with training arrangements and funding to sustain capacity in all public entities. Ratings would reflect the existence and adequacy of the content of an appraisal manual and the adequacy of the professional staffing and their training and financial support.

2.2. PIM manual directing appraisal requirements

The conduct of PIM functions should be stated in a PIM manual or equivalent that is specified in the form of regulations or otherwise sanctioned by legislation and regulations regarding public finance management and/or public investment management. The PIM manual should lay out the channels for screening and appraising projects based on size, complexity and prior experience with similar projects. The channels should indicate whether full-integrated project appraisal is required or whether more limited analysis and criteria can be used. The manual should also specify its application to SOEs and other government entities including where exceptions in appraisal requirements for purely competitive commercial SOEs may apply. (See also PEFA-PIM Indicator 5.)

Basic questions include: Does a PIM manual exist? Is it sanctioned by legislation and regulations? Does it cover the PIM operations of SOEs and other government entities? Does the manual specify the channels for screening and appraising projects of SOEs and other government entities?
An indicator is the existence of a PIM manual specifying appraisal channels and application of integrated appraisal to SOEs and other government entities. Ratings would reflect the comprehensiveness of the coverage of the PIM manual to include all public entities and the clarity of the analyses and criteria required to screen and appraise projects of SOEs and other government entities.

2.3. **Public sector debt and fiscal risk management capacity**

SOEs accounts fall outside of the general government accounts, but nevertheless, create financial and fiscal risks for the government through government ownership of the residual risks of their financial operations and through direct on-lending, and explicit and implicit loan guarantees provided to these entities. In addition, to debt management units for debt financing operations of governments, specialized units are often established to manage loan guarantees to SOEs, public-private partners and other entities given the relatively large size formed by these contingent liabilities. Government should budget for the contingent liabilities excepted to be realized each year and charged to general revenues. In addition, governments are coming to realize the need to establish full consolidated public sector accounts (balance sheet and financial operations) to access the impacts of the SOE financial risks on the fiscal operations of government. (See also PEFA-PIM Indicator 5.)

Basic questions include: Does the government budget for contingent liabilities arising from SOEs and other government entities? What units has the government established to manage on-lending, loan and other guarantees, and the overall fiscal risks generated by the full public sector? Does the government maintain a full set of consolidated accounts for the public sector financial operations?

Indicators are (a) the existence of unit(s) to manage government debt (including on-lending), loan and other guarantees to the wider public sector, and assessment of the fiscal risks posed by SOE and other government entities on government revenues and sustainability, and (b) the maintenance and publication of full-consolidated public sector accounts. Ratings of these indicators would include the existence and effectiveness of the units managing on-lending, guarantees and fiscal risk assessment, and the existence, coverage and quality of the public sector accounts.

3. **Independent Review of Appraisal**

3.1. **External project appraisal review capacity and practice**

In order to review alternatives, assumptions and methodologies in project appraisal to ensure the objectivity and quality of appraisal, it is advisable to have all large and complex projects reviewed by independent technical capacity such as may be established in a university or research institute. Such review and screening could take place at the prefeasibility or feasibility stage. Large and complex projects of SOEs and other government entities should be subjected to external technical review. Such review is facilitated if the project appraisal manual of the government prescribes the structure and format of the
electronic spreadsheets containing the integrated project appraisal. (See also PEFA-PIM Indicator 6.)

Basic questions include: Does the country have an independent technical appraisal capacity outside of the central ministries? Is the technical appraisal capacity used to review specified types of projects in the public sector? If not, what types of reviews are required of prefeasibility or feasibility studies for projects of different types outside of the agency preparing the project?

An indicator is the number and share of feasibility or prefeasibility studies of large or complex projects by SOEs in regulated sectors or receiving significant government support subjected to external technical review. Ratings of the indicator would depend on the independence and capacity of the review institution, the coverage and quality of the reviews conducted, and the impact of the reviews on the screening of projects.

3.2. Inter-ministerial project appraisal review practice

The quality of oversight of the general practice of project appraisal in the public sector depends upon the existence of inter-ministerial committees (finance, planning and sector ministries) for technical review of project feasibility studies, including the consideration of the external technical reviews or acting as an external review institution in the absence of an external institution outside of the central ministries at least for large and complex projects. The technical and policy review of the screening and appraisal of projects conducted by any public agency should be conducted at least by its parent agency and for large and complex projects by the central agencies in an inter-ministerial committee. (See also PEFA-PIM Indicator 6.)

Basic questions include: Which external government agencies routinely review the projects screened and appraised by SOEs and other government entities? Which types of projects are required to be reviewed by central agencies? Does this review include consideration by an inter-ministerial committee?

An indicator is the number and share of feasibility studies of large or complex projects by SOEs in regulated sectors or with significant government support subjected to review by inter-ministerial technical committees. Ratings of this indicator would depend on the comprehensiveness of the coverage and the depth of the reviews conducted.

4. Project Budgeting and Selection

4.1. PIM guidelines for project approval and budgeting channels

It is expected that all SOE and other government entity projects require budget and go-ahead approval by their board of directors. Some projects may require approval by a regulatory agency and also require government approval, especially where the project has direct and/or contingent implications for the government budget. Such projects would include all large projects with significant externalities, significant government support and/or significant social or policy functions. The PIM manual and budget procedures should make
clear where government approval is required in addition to Board approval. (See also PEFA-PIM Indicator 7.)

Basic questions include: Does the government require large SOE projects with significant externalities, significant government support and/or significant social or policy functions to seek regulatory agency and/or government approval? Does the government budget for all direct and contingent liabilities arising from SOE projects? Does the PIM manual and/or budget procedures make clear the approval and budgeting channels that need to be followed?

An indicator is that the government has an approval process for affected SOE investments and for approval of government budgeting for contingent and direct liabilities. In addition, explicit budgeting is provided for all compensation for social or policy services provided by entity and all guarantees provided by and contingent liabilities on the government. Ratings of this indicator would depend on how comprehensive and detailed are the budget allocations for all budget liabilities arising from SOE projects.

4.2 Unbiased competition in selection for supply of regulated products

To promote efficient investment where SOEs are competing with private companies to provide regulated products (such as electricity), the regulator and/or government should ensure the selection process is unbiased so as not to favor SOE bids. Mechanisms should be mandated to ensure transparent and unbiased competitive selection of companies to provide regulated products or services.

Basic questions include: Is there competitively supplied product or services in regulated sectors. Do SOEs compete with private companies to supply these regulated products or services? What mechanisms are in place to ensure transparent and unbiased selection of companies to provide regulated products or services?

An indicator is that transparent procedures are used to select providers of regulated products or services. Rating of this indicator depends upon the selection process conducted by the regulatory or other agency in terms of its transparency and ease of access to allow competitive bidding and efficient procurement.

4.3 Transparency of SOE and other government entity investment plans

To ensure full transparency, SOE and other government entity investment plans and financial accounts should be available to parent ministries, appropriate committees of legislature, and unless security issues are involved, the general public. Ideally, plans and reports should be posted on website of an entity and its parent ministry. (See also PEFA-PIM Indicator 10.)

Basic questions include: Do SOEs and other government entities regularly make their detailed investment plans and financial accounts available to government ministries and legislature? Do they make them publicly available? How and where are these documents made available or published? Are these documents available digitally on the internet? On which websites are they available and how frequently?
An indicator is the digital publication on internet websites of the SOEs and other government entities and of the parent ministry of all investment plans and financial statements (subject to redaction for national security reasons). Rating of this indicator would be on the regularity, comprehensiveness and ease of access of publication of the investment plans and financial accounts of SOEs and other entities.

5. **Project Implementation**

5.1. **Transparency and competitiveness of project procurement**

SOEs and other government entities, like government, should have transparent and competitive e-procurement rules and procedures. These should be consistent with the public financial mismanagement and procurement legislation of the country. Weak and corrupt procurement capacity can undermine the cost-effectiveness and productivity of SOE projects and operations. In addition, government should ensure that it is unbiased in its procurement of products or construction services where SOEs are competing with private companies for government contracts. (See also PEFA-PIM Indicator 15.)

Basic questions include: Does the country have procurement legislation? Does it mandate transparent and competitive procurement practices? Is e-procurement required and practiced in the public sector? Do SOEs supply construction services to the government? Are SOEs and other government entities required to follow the same or similar procurement practices? Does government provide effective oversight and dispute resolution mechanisms?

An indicator is the existence of transparent and competitive e-procurement rules and procedures both by SOEs and by government procuring services from SOEs competing with private companies. Rating of this indicator depends upon the quality of the procurement systems of government and SOEs in terms of its transparency and ease of access to allow competitive bidding and efficient procurement.

5.2. **Project implementation monitoring and reporting guidelines and practice**

All SOEs and other government entities should have (i) clear project implementation management procedures, (ii) monitoring and reporting procedures on project implementation physical and financial milestone achievements, (iii) requirements for a completion review and report and (iv) requirements for asset registration and management. (See also PEFA-PIM Indicators 16, 17 and 18.)

Basic questions include: What project implementation procedures are required and used by SOEs and other government entities? How is the implementation of projects reported and monitored? Does this reporting and monitoring include the achievement of physical and financial milestones by the project? Are SOEs required to conduct completion reviews and do they produce completion reports? Are SOEs required to register all newly created or acquired assets? Do they have procedures for managing these assets?
An indicator is the availability of regular (at least quarterly) progress reports and a completion report to the board, parent ministry and/or regulatory agency on all projects that required government approval. Ratings of the indicator depend on the frequency and quality of reports and the recipients and transparency of the reports.

6. Project Adjustment

6.1. Authority to manage and approve project adjustments
Major projects with significant construction periods tend to experience changes in economic parameters and/or discover unexpected implementation problems that require adjustments to contractual arrangements. The project adjustments could have implications for government support or fiscal risks. Some of adjustments may be prescribed in the construction agreement, but others may demand contractual changes. The latter require transparent allocation of authority and clear procedures for government and/or a regulator to review and approve any major adjustment to any project and its funding that initially required government and/or regulatory approval. (See also PEFA-PIM Indicator 19.)

Basic questions include: How are adjustments to major SOE projects approved and budgeted, especially where initial project approval required government approval and/or budget allocations? In cases of price-regulated projects, is the authority and procedures of the regulator clearly prescribed? In cases of projects relying on government funding or guarantees, are the procedures for government approval of project adjustments clearly prescribed? Are adjustment procedures prescribed in legislation and regulations?

An indicator is the documentation of explicit allocations of authority and procedures to manage project adjustments. Rating of this indicator would depend upon the comprehensiveness and quality of the documented procedures in covering the range of project and SOE types.

6.2. Budget reallocation procedures and practice
Adjustments to SOE and other government entity projects can have government budget allocation consequences. Procedures and institutional capacity are required to handle these budget reallocations. (See also PEFA-PIM Indicator 19.)

Basic questions include: Does the government have the institutional capacity and prescribed procedures to handle project budget reallocation in response to approved adjustments? Is there evidence of the frequency and successful implementation of budget reallocations?

An indicator is that documented procedures exist and there is evidence of the actual practice of budget reallocations in response to project adjustments. Rating of this indicator depends upon the availability and capacity to use the prescribed procedures to implement budget adjustments along with the evidence of the successful application of budget adjustments.
7. Facility Operation

7.1. Service delivery and operating & maintenance reporting requirements and practice
Following project construction completion, government needs to be able to monitor the operation of projects to ensure its effective delivery of services and monitor its costs and ensure the provision for and supply of any budgeted support. This requires regular (at least quarterly) reporting by the SOE or other government entity of its service delivery, operating and maintenance costs, and receipt of budget support (where applicable) by projects requiring initial approval by government and/or regulatory authority. (See also PEFA-PIM Indicator 20.)

Basic questions include: How does the government monitor service delivery, and the operating and maintenance costs of SOEs and other government entities? What reports and how regularly do these entities report to the government? What are the reporting channels? Does the government monitor its supply of any budgetary support to these entities?

An indicator is the availability of regular reports of service delivery, operating and maintenance costs and receipt of budget support (where applicable) by projects requiring initial approval by government and/or regulatory authority. The regulatory agencies and ministry of finance should receive these reports.

8. Project Evaluation

8.1. Impact evaluation reporting and practice
To evaluate the effectiveness and efficiency of the outputs of SOEs and other government entities, impact evaluations of their service delivery should be conducted. Where an entity has a major social or policy activity output, the entity and/or the government should conduct impact evaluation of service delivery. (See also PEFA-PIM Indicators 22 and 23.)

Basic questions include: Does the government require the conduct of impact evaluations of the service delivery of any SOEs or other government entities? Which ones have been conducted? What types of studies have been conducted and are the reports available?

An indicator is the production and availability of impact evaluation reports by SOEs especially where there is a major social or policy related service delivery by the entity. Ratings of this indicator depend on the coverage, frequency and quality of impact studies.

8.2. Audit Committee roles
The legislature, especially the audit committees, play an important oversight role for public investments. Accordingly, there should be timely submission and, where appropriate, publication of external audit reports of SOEs and other government entities to the government and legislature audit committee. Effective scrutiny of audit reports by legislature (or its audit committee) should be completed, and effective responsiveness by the
entity to recommendations of legislature should follow. (See also PEFA-PIM Indicators 22 and 23.)

Basic questions include: Does the government and audit committee of the legislature receive external audit reports of the financial operations of SOEs and other government entities on a regular and timely basis? Are these audit reports made available to the public? Does the legislature (typically through its audit committee) conduct an adequate review of these reports and make recommendations for any remedial actions forthcoming?

An indicator is the timely review and recommendations from audit committee on entity external audit reports, and timely responsiveness by entity to recommendations. Ratings of this indicator depend upon the coverage and timely submission and consideration of audit reports by the audit committee and effectiveness of the follow up by the entities to the recommendations.

8.3. Ex post project evaluation requirements and practice
To assist with strategic and operational planning of future projects, the government should arrange for ex post evaluations of projects. For large and complex projects requiring government approval, ex post evaluations should be conducted after about 10 to 15 years from project start. These reports should be available to the entities, sector and central ministries, and the legislature and public. (See also PEFA-PIM Indicators 22 and 23.)

Basic questions include: Does the government make arrangements for ex post evaluations of large and complex projects by SOEs and other government entities initially approved by the government? What is the quality of the ex post evaluations? Who gets access to these evaluations? How are these evaluation reports used?

An indicator is the production and availability of ex post project evaluation reports of large-scale and complex projects. Ratings of the indicator depend upon the coverage and quality of ex post evaluations, and availability of these reports to key institutions and the public.

6. Way forward
While a diagnostic framework for PIM systems for projects of SOEs and other government entities is provided in this report, the preparation of this report has also revealed some basic weaknesses in the general understanding of the importance, diversity and roles of SOEs and the legal and institutional arrangements governing PIM by these entities, especially for developing and emerging economies. These weaknesses should ideally be corrected as efforts to conduct PIM diagnoses across countries move forward.

Generally, the availability of data on the numbers, sizes, sectors and types of SOE is weak outside of the OECD countries and some other selected countries as surveyed by the OECD. Similarly, the IMF has only consolidated public sector balance sheet data largely for advanced economies and for few others. While, no doubt, considerable information on SOEs
exists at the country level, the effort to consolidate it as part of a broader public sector database internationally has not yet been made. Such data would be of considerable help to identifying countries in need of general SOE reform as well as reform of PIM systems in the public sector.

A key element of a sound PIM system is its legislative underpinnings. While many countries have undertaken PFM reforms and revised PFM related legislation, there does not appear to be any cross-country comparative analysis of the PFM-type legislation. Moreover, of particular interest here is the legislation affecting the PIM system in general and PIM for SOEs and other government entities in particular. This lack of comparative analysis of legislative frameworks limits the ability to recognize any best practice for PIM system legislative reforms.

The diagnostic framework developed here should be subject to review, testing and revision. In depth, country case studies are needed to test the diagnostic framework for SOEs and other government entities. In addition, PEFA-style PIM diagnoses of more government PIM systems should be conducted before or in conjunction with conducting diagnoses of PIM for SOEs and other not-for-profit government entities. The outcomes of these diagnostic efforts should be a PIM reform agenda.

Each desirable institutional arrangement identified in Table 6 provides an indicator that would allow an objective assessment for a country of whether its PIM system for SOEs and other public entities contained the desirable arrangements or not. The rationales for the desirable institutional arrangements along with key questions to assess and rate the indicators of the strength and performance of these institutions. This, in turn, should be used to develop a work plan to strengthen the institutional arrangements in place for the PIM system for SOEs, particularly where major gaps are identified in how PIM for SOEs is structured and managed.

A core theme that can be noted from the assessment framework is the importance of having a PIM manual for the public sector. It should include the specification of the roles and responsibilities of the SOEs and other government entities as well as their parent ministries and regulatory agencies, the central ministries and legislature in order to ensure public investments are coordinated with the economic strategy of the country and prepared and implemented in an efficient and effective manner. The PIM manual should prescribe the need for a project appraisal manual that is used by all public sector entities in a manner laid out in the PIM manual. The PIM manual should have legislative and regulatory backing through the legislation for public financial and management, budgeting and SOE regulation.

It is recognized that where the system and human capacities of some developing countries are limited that the work plan for institutional development may need to be intensive and lengthy to allow for the development of both the professional staff and systems within the public sector. This should also be accompanied efforts to target scarce resources at the largest and most complex projects with the largest economic externalities and risks. PIM reform is expected to be an ongoing effort to strengthen institutions. Reform of the PIM system for SOEs and other public entities is an important element of this broader reform effort.
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Annex 1. General definition of SOEs in the public sector

In national accounting, as laid out in the Government Financial Statistics Manual, the public sector normally is divided into two main sectors: general government (central and subnational governments) and public corporations (financial and non-financial corporations). The remainder of the economy is broadly broken out into sectors formed by households, and the private corporations and private nonprofit institutions serving the household sector. From an institutional unit perspective, however, the public sector is somewhat more complex. Corporations, whether private or public, are considered legal entities that undertake market production, supply products at economically significant prices such that they could be financially self-sustaining, and maintain full books and accounts for the entity. Quasi-corporations are also included as “corporations” where unincorporated entities operate in a similar manner to corporations. Public corporations are also referred to as state owned enterprises (SOEs) or parastatals. The government sector is composed of institutional units that produce non-market goods or distribute or transfer goods, services, assets or funds to communities or households and rely primarily on taxation or other compulsory transfers.

OECD has developed a definition of a state owned enterprise (SOE) based on the OECD Guidelines on Corporate Governance of State-Owned Enterprises as follows:

A state-owned enterprise is any corporate entity recognized by national law as an enterprise and in which the central level of government exercises ownership and control. This includes joint stock companies, limited liability companies and partnerships limited by shares. In addition, statutory corporations, whose legal personality is established through specific legislation, should be considered as SOEs if they engage in economic activities, either exclusively or together with the pursuit of public policy objectives. An economic activity is one that involves offering goods or services on a given market and which could, at least in principle, be carried out by a private operator in order to make profits. Quasi-corporations, which are autonomous commercial activities carried out inside the general government sector, should be considered as SOEs if they are financially autonomous and charge economically significant prices.

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Annex 2. Dimensions and elements of SOE governance reform

The World Bank in its report on Corporate Governance of State-Owned Enterprises: A Toolkit, 2014, presents in the Executive Summary a useful set of dimensions and elements of SOE governance reform as follows:

1. Establishing a sound legal and regulatory framework for corporate governance by
   - Bringing SOEs under company law and applying other laws and regulations to SOEs to create a level playing field.
   - Listing them on the stock markets to create capital market discipline.
   - Developing modern SOE laws and regulations.
   - Uniting SOEs under a national code of corporate governance or creating a specific SOE code to codify good practices.

2. Creating proper ownership arrangements for effective state oversight and enhanced accountability by
   - Identifying and separating the state’s ownership functions from its policy-making and regulatory functions.
   - Developing appropriate arrangements for carrying out ownership functions.
   - Creating safeguards against government interventions.
   - Centralizing the state’s ownership functions to bring focus, consistency, and good practices to the SOE sector.

3. Developing a sound performance-monitoring system by
   - Defining SOE mandates, strategies, and objectives.
   - Developing key performance indicators and targets, both financial and nonfinancial.
   - Establishing performance agreements between SOE owners and SOE boards.
   - Measuring and evaluating performance with the goal of holding SOEs accountable for results and ensuring good performance.

4. Promoting financial and fiscal discipline by
   - Reducing preferential access to direct and indirect public financing.
   - Identifying, computing, and financing the true cost of public service obligations.
   - Monitoring and managing the fiscal burden and potential fiscal risk of SOEs.

5. Professionalizing SOE boards by
   - Developing a structured and transparent process for board nominations.
   - Defining the respective roles of the state, as owner, of boards, and of management and empowering boards with core responsibilities such as strategy setting, choosing and overseeing the chief executive officer (CEO), and managing risks.
   - Enhancing board professionalism through the separation of chair and CEO, development of board committees, and the like.
   - Putting in place board remuneration and evaluation policies and practices.
   - Providing training to members of boards of directors.

6. Enhancing transparency and disclosure by
   - Applying private sector principles and international standards to SOEs.
   - Improving SOE reporting and disclosure.
   - Strengthening the control environment.
   - Carrying out independent external audits.

7. Protecting shareholder rights in mixed-ownership companies by
   - Overseeing minority government stakes.
   - Promoting shareholder participation and equitable treatment of shareholders.
   - Encouraging participation in shareholders’ meetings.
   - Ensuring representation of minority shareholders on SOE boards.
   - Protecting against abusive related-party transactions.
Annex 3. Integrated project appraisal or cost-benefit analysis framework\textsuperscript{31}

Integrated project appraisal is a decision-making framework that provides a formal set of procedures to identify, design and evaluate public projects and programs. Given most projects have many stakeholders or parties affected by the project, many of whom may be external to the parties directly involved in the ownership or sponsorship and operation of the project, the framework has to be able to integrate the multiple perspectives on the different costs and benefits, both internal and external to the project. The full-integrated appraisal of investment projects is referred to as cost-benefit analysis (CBA) to distinguish it from other simplified fallback approaches such as multi-criteria assessment (MCA) using some kind of points scoring selection method, some form of cost-effectiveness analysis (CEA) or some minimum level of added service delivery by a project subject to financial, managerial and technical feasibility requirements.

CBA is basically about estimating the benefits and costs of all the parties affected by a decision that causes a change in the use of resources in the economy. Decisions to undertake investment projects typically affect the welfare of many players or stakeholders such that investment decisions can and should be analyzed from the perspective of all key stakeholders so that who is gaining and who is losing through the implementation of a particular project or specific design of that project can be understood and evaluated. Typically, the sponsors of a project (the equity and debt holders in a corporate investment or the government in a budget-sponsored project) are key to any decision to invest. These interests are analyzed through the financial appraisal of the project. If government approval is required in some regulated private investment or some government guarantee or tax incentive affects the private investment decision, then the government also becomes a player in private investment decisions. The welfare of many other stakeholders may also be affected including consumers, suppliers, labor, and competing businesses. Hence, CBA of an investment is conducted from three key perspectives:

i. Financiers perspective
Financial analysis (including the internalized risks of the equity and debt holders\textsuperscript{32} and internalized environmental costs) is key to assessing the financial viability of sponsors and default risks of debt holders and, in the case of public sector projects, the demands of the project on future government budget revenues to sustain project


\textsuperscript{32} The fiscal risks faced by a government by an SOE arise out of its roles as owner and as revenue collector of taxes and social contributions from its operations, possible debt or loan guarantee provider, possible provider of subsidies, and protector of public adversely affected by its operations.
operations. Financial analysis is also key to estimating the bids that private firms are expected to make to participate in a public-private partnership or to supply a service under a contract or the financial viability at a regulated price.

ii. **Economic perspective**
Economic analysis (including the external risks and environmental costs) determines the aggregate net benefits generated by the project to all stakeholders and other affected persons in the economy. It is the key determinant of the economic wealth creation (or diminution) expected from a project. It is the key decision-making perspective for any government for any decision that affects the use of resources either by the public sector itself or by the private sector (where the project depends on government approval, such as by means of tax expenditure policy, direct funding, regulation or some other contractual arrangement.)

iii. **Distributional perspective**
Distributional analysis disaggregates the aggregate net economic benefit to reveal the net benefits or costs expected by all key stakeholders: service beneficiaries, government and other project financiers or sponsors, competing businesses, suppliers of inputs, and workers and populations displaced or otherwise affected by the project. This analysis is key to assessing, for example, whether target beneficiaries of basic needs services are capturing the intended gains, whether contractors are making excessive gains at the expense of taxpayers or consumers, whether displaced populations have been compensated out of the gains of the project or similar key distributional concerns have been addressed that affect the attractiveness of the project to key stakeholders, and hence, its political feasibility.

The integrated approach has to be able to handle a wide range of types of projects from the typical public sector project such as a public road improvement to a private sector commercial venture that has some level of government intervention through regulations or tax expenditures. The three perspectives on a project are captured in the **viability matrix** in Figure 1, which recognizes that any particular project can financially viable or not (NPV financial is positive or negative, respectively) and also can be economically attractive or not (NPV economic is positive or negative, respectively.) From the public sector perspective, only projects that are economically attractive should be undertaken, which includes all projects in blocks B and D of Figure 1. Ideally, projects in blocks A and C should be rejected. From a financial perspective,
however, a project could be attractive (blocks C and D) or not (blocks A and B). Generally, two broad types of project can be recognized that change the role of the financial analysis in the appraisal of the project:

1. **Non-self-financing or revenue-financed projects** (in blocks A and B) where all or most of costs are ultimately covered by budget revenues as is the case with the typical public investment in infrastructure and social service facilities. Here, the financial issue is both the availability of capital financing and the assessment of the availability of incremental future budget revenues to assure the financial sustainability of the operations and maintenance of the incremental project in order to achieve the desired service delivery
that underpins the expected gross economic benefits of the project derived by the service users.

2. **Self-financing or commercial projects** (in blocks C and D) where all or most of costs are ultimately covered by revenues from sale of project outputs. Such projects include investment in price-regulated sectors and concession arrangements for private participation in the supply of utilities and infrastructure services, aside from commercial private projects supported by tax expenditures, international financial institutions or development agencies. Here, the focus of the financial analysis is to assess whether all financiers are comfortable with the viability of their financial investments, including the financial risks born by institutions providing loan guarantees. This financial appraisal is also key to estimating the bids that private firms are expected to make to participate in a public-private partnership or supply a service at a regulated price.

    The private sector is expected to be willing to undertake projects that are financially attractive to the sponsors and other financiers such as the debt holders. These would include all self-finance projects where the revenues earned by the project after taxes and subsidies (including aid or tax expenditures) are sufficient to attract private sector investment. Ideally, private sector projects should be found in block D such that private investment decisions are also benefiting the wider economy. Private sector investments are found in block C, however, where they are financially attractive to private investors, but are generating large negative externalities such as water or air pollutants or major greenhouse gas emissions or are surviving on major public sector subsidies including significant trade protection.

    Public sector investments typically land up in blocks C and D where they involve self-financing or commercially-oriented projects such as those undertaken by SOEs. These could be SOEs involved in market production of private goods in competition with other private suppliers or price regulated natural monopolies typically in the utility and transportation sectors. SOEs could be financially viable, but economically unattractive in block C when all externalities are included in the economic appraisal. This points to a key issue with SOE investments. Is an economic appraisal undertaken and used in project design and selection? If so, who conducts what types of appraisal, who reviews the appraisal methods, and who sanctions project selection? These arise out of three essential project preparation functions, namely functions two, three and four in Boxes 1 and 4 in the main text above. When an SOE is self-financing out of its product revenues, it becomes more independent outside of government budget preparation and selection procedures and could well operate based solely on its financial performance and ignore the externalities arising from its operations. As noted above, corporate entities operating with degrees of discretion over their operation are used to gain improved performance in the sense of technical efficiency. This discretion needs to be balanced with how the entity is directed to achieve better economic outcomes as well as to improve economic allocative efficiency.

    The projects undertaken by the government, including its corporate entities servicing public policy and administration functions, typically fall in the category of non-self-financing or commercial projects.
revenue-financed projects in blocks A and B in the viability matrix. In these cases of supplying non-market goods and services, the dual criteria have to be met of the project generating net economic gains and the adequacy of budget revenue to support both capital and future recurrent expenditures. Without adequate funding, the economic benefits cannot be achieved leaving the country with the economic waste of unproductive expenditures. While a government should be able to enforce proper project preparation (screening, design, appraisal, review and selection for budgeting) within its ministries, departments and agencies, where semi-autonomous corporate entities are established with some degree of expenditure discretion, then special mechanisms for ensuring good project preparation may be needed.

The fiscal risks that a government faces with ownership of an SOE that is off balance sheet are summarized in a fiscal risk matrix. Table 4.1 gives the fiscal risks on the government faces from the SOE financial operations that show up as added liabilities on the government or added assets. The table breaks these risks out into the direct or contingent (where they depend upon a particular event occurring such as an unplanned loan default) and explicit (expected, planned or contracted) or implicit. Under the direct changes in assets or obligations, for example, are the expected dividends paid to government, the expected capital gains in the SOE valuation, the expected net tax revenues (including the impact of any tax expenditures) the SOE operations generate, and the on-lent loans reduced by the loan repayments, support for required social or policy activities and forgone revenues from pension payments, social security contributions and tax obligations in arrears. Under the contingent changes in assets and liabilities are the positive/negative changes in dividends, capital gains and net tax revenues reduced by defaults on on-lent loan repayments or guaranteed loans, arrears on payments to suppliers, contractors and employees, defaults on government guaranteed power purchasing agreements (PPAs), and potentially SOE bail outs and compensation for major negative externalities affecting local communities. These fiscal risks would also be identified and captured in consolidated accounts of the government and its SOEs.
<table>
<thead>
<tr>
<th>Liabilities and Assets</th>
<th>Direct (change in asset or obligation in any event)</th>
<th>Contingent (change in asset or obligation if a particular event occurs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explicit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ownership</td>
<td>∆A Expected royalties</td>
<td>Ownership</td>
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<tr>
<td></td>
<td>∆A or ∆L Ownership</td>
<td>∆A or ∆L Variance in dividends</td>
</tr>
<tr>
<td></td>
<td>∆A Expected dividends</td>
<td>∆A or ∆L Variance in royalties</td>
</tr>
<tr>
<td></td>
<td>∆A Expected capital gains on SOE value: accrued or realized</td>
<td>∆A or ∆L Variance in capital gains on SOE value: accrued or realized</td>
</tr>
<tr>
<td>Legal or contractual</td>
<td>∆A On lent loan disbursement</td>
<td>∆A or ∆L Variance in net tax revenues</td>
</tr>
<tr>
<td></td>
<td>∆A On lent loan repayment</td>
<td>∆L Partial or full default on loan repayment</td>
</tr>
<tr>
<td></td>
<td>∆L On lent loan repayment</td>
<td>∆L Partial or full default on guaranteed loan repayment</td>
</tr>
<tr>
<td></td>
<td>∆L Compensation paid or foregone taxes or interest receipts for required social or policy activities by SOE</td>
<td>∆L Arrears or default in payment of suppliers, contractors and/or employees.</td>
</tr>
<tr>
<td></td>
<td>∆L Arrears in funding pensions and paying social security contributions and/or tax obligations</td>
<td>∆L Default on a government guaranteed purchasing power agreement (PPA)</td>
</tr>
<tr>
<td><strong>Implicit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>∆L Arrears in funding pensions and paying social security contributions in case of SOE bankruptcy</td>
<td>∆L Major project cost overrun or persistent and growing operating cost increases and revenue under performance or collections leading to effective bankruptcy</td>
</tr>
<tr>
<td></td>
<td>∆L Major pollution spill or plant explosion causing major losses in neighboring communities</td>
<td></td>
</tr>
</tbody>
</table>

∆A = Change in Assets; ∆L = Change in Liabilities