

Methodology for assessment of financial health of state-owned and municipality-owned companies

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Project

The methodology was created within the initiative "**Promoting transparency and financial sustainability of regional policies, state-owned enterprises and local authorities in Moldova**". This initiative is being implemented from September 2017 until March 2019 by the Institute for Economic and Social Reforms in Slovakia (INEKO), in partnership with IDIS "Viitorul" in Moldova with the financial support of the Official Development Assistance of the Slovak Republic (SlovakAid). The initiative aims to increase the transparency, financial accountability, and quality of regional policies, state-owned enterprises and local authorities in Moldova.

Objective

Improving financial stability of state-owned enterprises through financial analysis tools – INEKO and IDIS will analyze financial indicators of top 50 MD state-owned companies or municipality-owned companies¹, compare them among each other, compare their performance with private sector standards, and create an interactive portal with the results for individual companies.

Activities

1. IDIS: Identification of state/municipality-owned companies and data availability check
Prepare the list of 50 largest state-owned or municipality-owned companies (see note below the line) according to their revenues. Check the availability of financial data required for the financial analysis. The list of data is specified in the "methodology section" below.
2. INEKO+IDIS: Elaboration of methodology for financial analysis of MD state/municipality-owned companies and proposal of financial indicators
@INEKO: Prepare the methodology and the plan of activities for IDIS. Consult the scope of financial analysis with IDIS. Decide on the final set of financial indicators to be used in the analysis of financial health of state/municipality-owned companies. Suggest the Financial health Index containing the

¹ Largest municipality-owned companies will be added to the list in case there is not enough state-owned companies to be analysed.

main financial analysis indicators (the basic set specified in the “methodology section” to enable easy comparison with SK companies).

@IDIS: Propose methodology and further indicators to be analyzed in MD companies, which are relevant for MD stakeholders, and which goes beyond the basic set of indicators defined in the “methodology section”.

3. INEKO: Analysis of financial stability of SK state-owned companies vs SK privat companies to set benchmark for MD companies
Prepare the financial analysis of selected state-owned companies and selected private companies; the analysis will comprise the same set of basic financial indicators to set the benchmark for comparison with MD companies.
4. IDIS: Collection and processing of MD data & blog (containing general findings from financial indicators of MD state/municipality-owned companies) INEKO: Best practices in governance of SK state-owned companies influencing their financial stability
*@IDIS: Collect financial data required for calculation of financial indicators (from Balance sheet and Profit and Loss statement of companies or from other sources); rewrite them to xls sheet to enable further processing (programming). Use MD data to analyze financial performance of companies and summarize the key findings to a blog article.
@INEKO: Prepare the analysis of the key measures introduced by SK government that improved the financial stability of state-owned companies in SK.*
5. INEKO: Programming of the interactive web portal with financial indicators of companies
Program the interactive portal containing key financial indicators of MD and SK companies; enable sorting by various criteria and easy comparison of MD and SK companies (state-owned and private ones);
6. IDIS+INEKO: Publication of results, consultations in selected companies, general publicity, blogs
Organize the seminar and prepare the press release to present the key findings from the analysis; publish the blog article; offer companies the individual consultations of their results (max 3 visits).

Timeline

Activity/Month	2017				2018							Responsible	
	9	10	11	12	1	2	3	4	5	6	7		
1. Identification of state/municipality-owned companies and data availability check	x	x	x										IDIS
2. Elaboration of methodology for financial analysis of MD state/municipality-owned companies and proposal of financial indicators	x	x	x										NEKO+IDIS
3. Analysis of financial stability of SK state-owned companies vs SK privat companies to set benchmark for MD companies			x	x	x								INEKO
4. Collection and processing of MD data, best practices in SK state-owned companies			x	x	x	x	x						IDIS+ INEKO

<i>governance, blog (general findings – financial indicators of MD state/municipality-owned companies)</i>												
<i>5. Programming of the interactive web portal with financial indicators of companies</i>								x	x			INEKO
<i>6. Publication of results, consultations in selected companies, general publicity, blog</i>										x		IDIS+ INEKO

Background

Generally, the financial indicators are difficult to read, understand and evaluate. It is the main reason why public and many media representatives are not interested in monitoring or evaluation of performance of the state/municipality-owned companies. The Slovak experience says that if these data are processed and published in easy and understandable way (with the possibility to compare companies' performance data with the reference values) it attracts the public and media attention and increases the pressure on companies to increase their efficiency. The outcomes of this project activity are useful also for politicians who can use them as the source of information for comparison and evaluation of management boards and for evaluation of trends in financial performance of the companies tracking if it is improving or deteriorating.

Being aware about the necessity to hold government and parliament accountable for the decisions they take on daily basis, citizens should have the necessary tools to do this. Citizens' wealth is affected by how the public property is managed by state and municipal owned companies. Moldova, as any other countries, after declaration of independence has controlled huge stakes in the national economies and it still does. Being fully aware of the risks related to vicious management of state property, as the recent scandals related to theft of money from the state controlled bank Banca de Economii and opaque and faulty decisions of the management of various state-owned companies, we developed this methodology to assess the financial stability of these companies in a more complex way.

State and municipal companies in Moldova are governed mainly by several law but the most important are:

1. The law on state companies approved in 1994². In 2017 government proposed a draft³ for a new law on state companies, which unfortunately does not address the main problems related to state companies such as: the sectors and the purpose of funding the state owned companies are not defined; there is no important change related to holding management accountable; the professional

² <http://lex.justice.md/index.php?action=view&view=doc&id=311598>

³ <http://particip.gov.md/proiectview.php?l=ro&idd=4018>

- requirements for the management and the transparency requirements of management selection;
there are no delimitation and specifications related to acquisition procedures;
2. The law on public and local administration since 2006⁴;
 3. The law on public property of local administrative units approved in 1999⁵;

In addition, it is important to mention that the state agency that monitors the state property – as stakes in companies or companies created from scratch by local and state institutions – is the agency of public property⁶.

Methodology

We will analyze mostly the **balance sheet** (assets and liabilities) and **profit and loss statement** (revenues and costs) of state/municipality-owned companies. We will calculate a **basic set of 10 financial analysis indicators** for each company (figures and indicators are described below).

INEKO expect IDIS to suggest extended methodology and further indicators to be analyzed in order to get the broader picture about the overall financial performance of the biggest MD companies.

The basic set of 10 financial indicators will be processed to calculate the overall rating of financial health of companies (calculation of the rating will be done by SK experts). The same indicators will be calculated for selected state-owned and private companies in SK (by SK experts) to set the benchmark and enable international comparison of companies. All results will be published on the interactive web page that will enable users to sort companies by indicators or overall rating, and will enable them to compare financial health of MD companies with SK ones.

KPIs:

- **50 MD companies** included in the analysis (primarily state-owned; if not enough, we'll include also municipality-owned companies)
- **10 financial analysis indicators** per company
- **10 media releases** related to this part of the project (including **2 blog articles**)
- **1000 views on the portal per Quarter**

Sources for verification:

- Internet – state/municipality-owned companies financial health portal
- Media monitoring

⁴ http://lex.justice.md/document_rom.php?id=C8E304A4:037190E8

⁵ <http://lex.justice.md/md/311681/>

⁶ <http://www.app.gov.md/ro/advanced-page-type/registrul-patrimoniului-public>

- Stakeholder survey – views of 10 stakeholders to evaluate if the project helps to increase the public pressure on financial efficiency improvements of the companies

Financial Analysis Indicators (the basic set):

Liquidity Ratios	Current Ratio	$\text{Current Assets} \div \text{Current Liabilities}$
	Quick Asset Ratio	$\text{Cash} + \text{Marketable Securities} + \text{Accounts Receivable} \div \text{Current Liabilities}$
	Cash Position Ratio	$\text{Cash} \div \text{Current Liabilities}$
Profitability Ratios	ROA - Return on Assets	$\text{Net Profit} \div \text{Total Assets}$
	ROE - Return on Equity	$\text{Net Profit} \div \text{Equity}$
	ROS – Return on Sales	$\text{Net Profit} \div \text{Sales}$
Leverage ratios	Total Debt to Total Assets	$\text{Total Debt} \div \text{Total Assets}$
	Debt-to-EBITDA Ratio	$\text{Total Debt} / \text{Earnings Before Interest Taxes Depreciation \& Amortization}$
Activity ratios	Working capital turnover ratio	$\text{Net Sales} \div ((\text{Beginning Working Capital} + \text{Ending Working Capital}) / 2)$ Note: Working Capital = Current Assets Minus Current Liabilities)
	Accounts receivable turnover ratio	$\text{Net Sales} \div ((\text{Beginning Accounts Receivable} + \text{Ending Accounts Receivable}) / 2)$
Indirect efficiency indicator of the company	The sales generated by one employee	$\text{Net sales} / \text{number of employees}$

List of required data (for the basic set of financial indicators):

- Total Assets
- Current Assets
- Cash
- Marketable Securities
- Accounts Receivable
- Equity
- Net Profit
- Total Debt
- Current Liabilities
- Sales
- Net Sales
- EBITDA (Earnings Before Interest Taxes Depreciation & Amortization)
- Number of employees

Reliability of data

Since 2009, Ministry of Finance approved a methodical recommendation for the implementation of IFRS standards⁷, and especially the public companies such as banks, insurance companies and other joint stock companies had to comply to IFRS standards as the article number 4 from accountancy law⁸ specify this directly. As most of the selected state-owned companies are joint stock companies, we assume that they report their statements according to IFRS standards. Regarding the State and municipal companies that have a juridical status of “I.S (state enterprise) or I.M (municipal enterprise)”, they still report their statements according to National Standards of Accountancy, which are not very different in terms of classification, recognition, evaluation and reliability principles.

The data will be collected from the 3 financial statements (Balance sheet, Income Statement and Cash Flow statement) that every company is obliged to issue for the fiscal year and to present it to fiscal inspectorate yearly. Regarding the data on state aid – the information is public. The only difficulty we think can arise is related to the information about the number of employees.

Methodology and required data for advanced analysis

1. Additional criteria for analysis

IDIS and INEKO identified several indicators mostly used by financial analysts to evaluate the financial health of the companies. Even though it is of much interest to perform equity valuation to assess the value created by the state companies, the results can be biased as there is no strong capital market in Moldova which can help us to infer or forecast the development of the state-owned companies. In this respect, our analysis can be anchored partially on assets in place, but estimation of the prospects of the selected companies will be more speculation rather than valuation.

The key indicators are divided into 5 pillars (see table on page 4), but as state companies have also a social and economic impact on local and national economies in terms of employment, management of public services, etc., we propose to identify the **Key performance index** that includes the five pillars and to use the Index to compare companies divided to clusters by following criteria:

1. Number of employees on a 4 scale (less than 50 employees – 1; between 51 and 100 – 2; between 101 and 200 – 3; more than 300 – 4)

⁷ <http://lex.justice.md/viewdoc.php?action=view&view=doc&id=335683&lang=1>

⁸ <http://lex.justice.md/viewdoc.php?id=351443&lang=1>

2. Economic sector on a 3 scale: Utilities – 3; Service sector (evidence of population, financial services and other types of services) – 2; Production (ex. Wine industry, textiles, machinery and equipment, etc) – 1;
3. State aid on a 3 scale: Company is entitled with a state aid in the analyzed period on a permanent basis – 1; Company has been entitled with a state aid in past but not in the analyzed period – 2; Company was not entitled with a state aid – 3.

2. Selection process

We aim to analyze companies from different sectors and according to their size, in terms of assets in place. The selection process will be conducted according the information presented by the agency on public property that holds the books with the companies that are owned by state and municipal institutions. These registers⁹ are published and there is no problem to access them.

Initial activities by IDIS:

- 1) Prepare the list of 50 biggest state-owned companies. In case there is not enough state-owned companies, add municipality-owned companies to the list to have 50 companies for analysis.
- 2) Check availability of data; we will need **balance sheet** (assets and liabilities) and **profit and loss statement** (revenues and costs) – two basic accounting reports reported annually. We will need 2016 and 2015 data (note: In Slovakia companies always publish current and previous year data in the latest accounting reports; if so also in MD, there will no need to collect 2015 data separately).
- 3) Check the structure of data in balance sheet and profit and loss statement. Look at the yellow field in the Financial Analysis Indicators table above – can we identify all required parameters in the accounting reports?
- 4) Prepare the methodology and the list of data for the extended analysis of MD companies.
- 5) Collect accounting reports and re-write raw data to xls sheet for all companies.

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⁹ <http://www.app.gov.md/ro/advanced-page-type/registrul-patrimoniului-public>