



# Use of Financial Statements for Validating or Deriving Information on Foreign Investment (FI)- Introduction

- Among sources available to compile FIS, surveys and financial statements are the most important;
- Financial statements will be discussed under the following topics:
  - (a) Types of financial statements (FS)
  - (b) General Template of Financial Statement
  - (c) Correlation between a FS and GCC CFIS
  - (d) Distinction between Local Enterprise Group (LEG) and Enterprise Group (GEG)

## Use of Financial Statements for Validating or Deriving Information on F) – Introduction (cont)



- (e) Exclusion from FS of transactions between residents and residents and non-residents and non-residents
- (f) Identification of data relevant to LEG and arriving from GEG data to LEG data;
- (g) Completion of GCC CFIS Survey in case of no response;
- (h) FIS validation and verification using FS

## (A) Balance Sheet data and BOP/IIP data



- Most important FS for compiling flows (BOP) and stocks (IIP) is the Balance Sheet (BS);
- Most of the Stocks related data will come from the equity, long-term and short term liabilities related to foreign ownership;
- Some accounting concepts different from BOP concepts e.g. treatment in BS of debt maturity with less than one year;
- Data from FS must fit BOP/IIP concepts; but FS not constructed according to BOP/IIP concepts such as functional classifications of investments (FDI, FPI, FD, FOI) directional basis of FDI or assets/liabilities basis of FDI; maturity classification of financial instruments varies between accounting and BOP/IIP concepts;
- Hence data from BS should be used in conjunction with Notes to the FS and data ownership of an enterprise which very few FS disclose and hence have to be obtained from surveys or administrative sources;

## (A) Other Financial Statements

- The other important FS is the Profit/Loss statement which has relevant data on income accruing from FI(interest, dividends and re-invested earnings on FDI, contra entries in the financial account of the BOP to re-invested earnings on FDI)
- The third one is Statement on Changes in Equity – It shows the movement in shareholders' equity over an accounting period and comprises the following elements (a) Net profit or loss during the accounting period attributable to shareholders (b) Increase or decrease in share capital reserves(c) Dividend payments to shareholders (d) Gains and losses recognized directly in equity (e ) Effect of changes in accounting policies (f) Effect of correction of prior periods.
- The fourth one is Statement on Cash Flows – It reports the cash generated and spent during a specific period of time (i.e., a month, quarter, or year). The statement of cash flows acts as a bridge between the income statement and balance sheet by showing how money moved in and out of the business through operating activities; investing activities from the acquisition and disposal of long-term assets and other investments not included in cash equivalents; and financing activities which result in changes in the size and composition of the contributed equity capital or borrowings of the entity (i.e., bonds, stock, dividends)

- The various FS could be prepared either on a (a) consolidated basis or (b) unconsolidated basis;
- Consolidated FS are prepared for a group of related companies, also known as enterprises e.g. MNEs
- Consolidated FS could be prepared at various levels (a) Global (GEG) (b) Regional (REG) (c ) Sub-regional (SREG) (d) Individual Country (LEG);
- Not all entities of a MNC operating in an individual country could be consolidated on a LEG basis;
- Ultimately controlled enterprises by residents and non-residents
- Methods of consolidation (a) Full consolidation including minority interest (b) Consolidation based on equity; (c ) Cosolidation based on cost (d) Consolidation for joint-ventures (50-50 ownership) (e ) Accounting for farm- ins in Oil and Gas ventures (f) Accounting for PSAs/DSAs



- Enterprises will also have FS for individual companies/branches within their enterprise structure (e.g. Shipping companies may incorporate each ship they own as a separate entity for financing reasons).
- Determination of the ultimate control of an enterprise has received a lot of interest in recent times especially by policy makers but also by BOP/IIP data compilers;
- Who ultimately controls Zain of Kuwait? How? Discuss control with reference to pages 5-7 of Chapter 10 of GCCSTAT – Compilation Guide on FIS.
- According to some Indonesian governmental entities, UAE's Mubadala had \$650 investments in Indonesia at the end of 2018. Will these investments be reflected in the official FIS data of UAE and Indonesia. For an introduction to the special case of the SWFs, see page 7 of Chapter 10.

## (B) General Template of a Financial Statement



- Four types of FS – Balance Sheet, Profit/Loss Account, Statement of Changes in Equity and Cash Flow Account
- Which of the statements necessary for FIS compilers?
- While all of them would be helpful to understand all of the financial operations of a company, in most cases, compilers can obtain most of the key data necessary from the Balance Sheet and Profit/Loss account and the accompanying notes to the financial statements and ownership data from the surveys or administrative data.
- Discuss calculation of Profit/Loss with reference to Table 2, Page 8 of Chapter 10 of of GCCSTAT – Compilation Guide on FIS.
- Discus calculation of Other Comprehensive Income from Table 3, of Page 9 of Chapter 10 of of GCCSTAT – Compilation Guide on FIS.
- Discus calculation of Statement of Financial Position (Balance Sheet) Table 4, of Pages 9 - 10 of Chapter 10 of of GCCSTAT – Compilation Guide on FIS.

## (C )Correlation between FS and the GCCSTAT CFIS



- Correlation between Section 1 of the CFIS and the FS. Discuss with reference to Pages 10-13 of Chapter 10 of of GCCSTAT – Compilation Guide on FIS and the CFIS of GCCSTAT.
- Correlation between Sections 2 and 3 of the CFIS and the FS. Discuss with reference to Pages 13-14 of Chapter 10 of of GCCSTAT – Compilation Guide on FIS and the CFIS of GCCSTAT.
- Section 2 and its associated Sections 6, parts of 8 and 9 are on outward FI except for data on reverse investments associated with FDI liabilities.
- Section 3 and its associated Sections 4,5,7, and parts of 8 and 9 are on inward FI except for the data on reverse investments associated with direct investment assets.
- Section 2 “Financial Assets (Claims) on Non-residents” are discussed on pages 15-18.
- Section 3 requests similar type of data as in Section 2 but for liabilities to non-residents.



## (C )Correlation between FS and the GCCSTAT CFIS

- Changes in Stock Positions - Both Section 2 (Assets) and 3 (Liabilities) request beginning and end of year stock positions and changes by net transactions and other changes during the year.
- Changes in position are called flows which should not be confused with financial transactions.
- Transactions on assets should be kept separate from transactions on liabilities.
- Reporting of transactions on a net and gross basis – short and long term
- Changes other than those related to transactions are caused by changes in exchange rates, prices (differences in market and book valuation), write offs, revaluation etc. These would be reflected in the other comprehensive income in the FS.
- Most respondents do not differentiate between net transactions and other changes. They report all changes between stock positions in two consecutive periods in either transactions or other changes.

## (C) Correlation between FS and the GCCSTAT CFIS



- For assets abroad, respondents may have to report for several entities unlike for one entity in the case of liabilities;
- Practical considerations should be applied to deriving data on changes to stock positions. Concentrate on enterprises with substantial assets with or liabilities with non-residents.
- Shareholders' Equity – Section 4 - Discuss with reference to pages 20 – 23
- Sections 5, 6 and 7 are further details on inward and outward FDI obtained in Sections 2, 3 and 4. Refer to pages 23 and 24.
- Section 8 is on Portfolio investments – Assets and Liabilities – Discuss with reference to page 24. Portfolio investments differentiated between equity and debt instruments by country of non-resident issuer/holder. For assets abroad, the industry of the home country used, the same for liabilities
- Section 9 – Income Receivables and Payables to Non-residents – Discuss with reference to pages 24 -25
- Section 10 – Activities of MNEs – Discuss with reference to page 25
- Section 11 – Local Enterprise Group (LEG) – Discuss with reference to page 25

## (D) Local Enterprise Group and Global Enterprise Group



- Discuss with reference to pages 25 -27

## **(E) Excluding Residents to Residents and non-residents to non-residents positions and flows**

- References to this are made in other sections of Chapter and in Section H

## (F) Arriving from GEG to LEG

- It is not possible to arrive from GEG to LEG except for relevant associates, joint ventures and other investments which are not consolidated but shown on an equity or cost basis. Discuss with reference to page 27 of Chapter 10.

## (G) Completion of GCCSTAT CFIS in case of non-response

- Discuss with reference to pages 27- 33 of Chapter 10.

## (H) FI data validation and verification using FS.

- Discuss with reference to pages 33- 39 of Chapter 10.

