BORROWING POLICY for STATE OWNED ENTERPRISES in SOLOMON ISLANDS

May 2013

EXECUTIVE SUMMARY

A State Owned Enterprise (SOE) is a legal entity created by central Government to undertake commercial activities on behalf of the Government, as owner (or part owner). SOEs typically provide services essential to society. Solomon Islands currently has eight SOEs; Commodities Export and Marketing Authority (CEMA), Investment Corporation of Solomon Islands (ICSI), Solomon Airlines Ltd, Solomon Islands Broadcasting Corporation (SIBC), Solomon Islands Electricity Authority (SIEA), Solomon Islands Ports Authority (SIPA), Solomon Islands Postal Corporation (SIPC) and Solomon Islands Water Authority (SIWA).

The operations of these SOEs are governed by the *State Owned Enterprises Act 2007* (SOE Act) and (with the exception of Solomon Airlines, which is a company) enabling legislation. The SOE Act states that the principal objective of every SOE shall be to operate as a successful (commercial) business. However, the debts of SOEs are a contingent liability for the Solomon Islands Government (SIG). This is because in Solomon Islands and elsewhere, central Government has a moral obligation to pay when SOEs default on debt repayments. Therefore, SIG as owner has an interest in ensuring good management of SOEs, in SOE borrowing and in monitoring the contribution of SOE debt to total public sector debt.

The purpose of this policy is clarify how the Debt Management Strategy (DMS) will apply to SOEs and to provide a balance between allowing SOEs to operate as 'profitable and efficient businesses' with managing total public sector debt levels.

The DMS sets up a framework with four key features; limits to borrowing, borrowing proposals meeting certain criteria and being assessed and recommended by a Debt Management Advisory Committee (DMAC) before they are approved by the Minister of Finance as sole authority.

Borrowing by SOEs must fit within an annual limit for new borrowing determined by debt sustainability analysis that aims to keep public sector debt within conservative affordability and sustainability thresholds. Since SOE debt is a contingent liability it will count towards the borrowing limit depending on the risk.

SOEs will be expected to bring their business plan and associated borrowing proposal to the DMAC at an early stage to make sure that borrowing is appropriate for the purpose, and terms and conditions are anticipated to be acceptable. The DMAC will assess the impact of SOE borrowing on total public sector debt position, the project (purpose and viability) and the creditworthiness of the SOE (ability and willingness to repay). SOEs are expected to have audited financial statements, up to date payments and strong balance sheets. The terms and conditions of the loan will be assessed for cost and risk to both the SOE and to SIG.

The Borrowing Policy provides details on the approval and assessment process and criteria and the information that will be provided to the Minister in its evaluation.

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ABBREVIATIONS

1. INTRODUCTION TO STATE OWNED ENTERPRISES (SOEs)

A State Owned Enterprise (SOE) is a legal entity created by a central Government to undertake commercial activities on behalf of the Government, as owner (or part owner). SOE functions are usually considered highly important to society. The rationale given for Government ownership is generally to allow for services that the private sector is unwilling or unable to provide and to give a clearer opportunity for non-commercial aims. Many of Solomon Islands' essential services are delivered by SOEs, including electricity, water, port services, air transport, post and broadcasting. These services are used by the community directly, and also by businesses in the course of production.

Solomon Islands currently has eight SOEs:

1. Commodities Export and Marketing Authority (CEMA)
2. Investment Corporation of Solomon Islands (ICSI)
3. Solomon Airlines Ltd
4. Solomon Islands Broadcasting Corporation (SIBC)
5. Solomon Islands Electricity Authority (SIEA)
6. Solomon Islands Ports Authority (SIPA)
7. Solomon Islands Postal Corporation (SIPC)
8. Solomon Islands Water Authority (SIWA)

(Another SOE, Solomon Printers, is in the process of liquidation.) These are governed by the *State Owned Enterprises Act 2007* (SOE Act) and individual enabling legislation (except for Solomon Airlines which is a company under the Companies Act):

Commodities Export and Marketing Authority	*Commodity Export Marketing Authority Act 1985* (Cap 36)
Investment Corporation of Solomon Islands	*Investment Corporation of Solomon Islands Act 1988* (Cap 143)
Solomon Airlines Ltd	*Companies Act 1996* (Cap 175)
Solomon Islands Broadcasting Corporation	*Broadcasting Act 1977* (Cap 112)
Solomon Islands Electricity Authority	*Electricity Act 1969* (Cap 128)
Solomon Islands Ports Authority	Ports Act 1956 (Cap 161)
Solomon Islands Postal Corporation	Post Office Act 1971 (Cap 113)
Solomon Islands Water Authority	Solomon Islands Water Authority Act 1993 (Cap 130)

Each SOE business is accountable to the Government, as owner. Under the SOE Act the Finance Minister, together with the Responsible Minister, is an 'Accountable Minister' and role of Accountable Ministers is to oversee the operations of an SOE, particularly the nature and scope of the activities to be undertaken and to identify and manage any potential risks to the Solomon Islands Government (SIG).

Accountable Ministers are responsible for the Corporate Objectives (Part IV, Section 13 of the SOE Act) which set out, *inter alia*, borrowing intentions. Enabling legislation relating to individual SOEs contain general financial provisions relating to SOE borrowing. (Notes on this are given in Annex I.) In general, Acts allow for SOE borrowing in certain circumstances following approval of the Finance Minister or the Responsible Minister after consultation with the Finance Minister. Although Solomon Airlines Ltd comes under the *Companies Act 1996* rather than enabling legislation, the provisions of the SOE Act take precedence (Section 25 of the SOE Act).

SOE Act

Interpretation
2."Accountable Ministers" means the Minister of Finance and the Responsible Minister;

Responsibility of Ministers
7. The Accountable Ministers of a State Owned Enterprise shall be responsible to Parliament for the performance of the functions given to them by this Act or the rules of the State Owned Enterprise.

Powers of Accountable Ministers in respect of statement of corporate objectives
12. (1) Subject to section 12 (2) but notwithstanding any other provision of this Act or other Act or the roles of any company: -

(a) the Accountable Ministers may from time to time, by written notice to the board, direct the board of a State Owned Enterprise to include in, or omit from, a statement of corporate objectives for that State Owned Enterprise any provision of a kind referred to in paragraphs (a) to (h) of section 13(2) of this Act;

Statement of corporate objectives
13. (2) Each statement of corporate objectives shall specify for the group comprising the State Owned Enterprise and its subsidiaries (if any), in respect of that financial year and each of the immediately following 2 financial years, the following information: -

(a) the objectives of the group;
(b) the nature and scope of the activities to be undertaken;
(c) the ratio of consolidated shareholders' funds to total assets, and definitions of those terms;
(d) the accounting policies;
(e) the performance targets and other measures by which the performance of the group may be judged in relation to its objectives;
(f) a statement of the principles adopted in determining the annual dividend together with an estimate of the amount or proportion of annual tax paid earnings (from both capital and revenue sources) that is intended to be distributed to the Crown;
(g) the kind of information to be provided to the Accountable Ministers by the State Owned Enterprise during the course of those financial years, including the information to be included in each half-yearly report;
(h) the procedures to be followed before any member of the group subscribes for, purchases, or otherwise acquires shares in any company or other organisation;

Relationship to other legislation
25. (1) Where a State Owned Enterprise is registered under the Companies Act the provisions of this Act apply in addition to the Companies Act.

2. APPLICATION OF DEBT MANAGEMENT STRATEGY TO SOEs

2.1 Why SOE debt is a concern for Government

Solomon Islands, like many countries around the world, has had a difficult history with debt. SOE debt has been part of this history. SOE debt is a contingent liability for SIG as owner. A contingent liability is a liability dependent (contingent) upon the occurrence of a particular event, such as default of a loan. SOE debt is a contingent liability for central Government because if SOEs fail to pay their debts, central Government is usually obliged to make the payments. This is not a legal obligation, but a societal, political or moral one.

SOE debt becomes a liability for central Government when SOEs are unable or unwilling to manage their finances and when there are no hard budget constraints[1]. If SOEs are able to exert pressures for central bailouts as *ad hoc* financial transfers or accounting 'adjustments' that take significant tax and spending activity off-budget, then SOE debt has the potential to increase central Government's debt burden to unmanageable levels – especially at times of economic stress. This problem is exacerbated when governments are unaware of their total public sector debt position and debt is allowed to increase beyond sustainable and affordable levels.

The source of SOE debt can be trade creditor arrears, failure to pay wages, tax and pension dues, and debt arising from borrowing. SIG has provided SOEs with financial assistance (equity) when SOEs have insufficient funds to pay their debts as a result of poor financial management, poor policy decisions by Government or insufficient capital. From 2002 to 2009, SIG provided new funds for underperforming SOEs through cash transfers, debt forgiveness and asset donations which totalled around $52 million[2]. For example, SIG has repaid debts owed to Maruha Seafood Company, to the National Provident Fund and to SIEA and has forgiven loans to SIEA[3] and Solomon Airlines.

2.2 The development of a Debt Management Strategy

In the past, SIG borrowed in an *ad hoc* fashion for projects that did not necessarily contribute to GDP growth. Debt levels overall were not scrutinised or monitored and increased to unsustainable levels. After a period of ethnic tensions that began in the late 1990s, SIG's financial position deteriorated until it was unable to make debt repayments. Similarly, the SOEs were in financial difficulty and had poor financial records. The debts of SOEs thus contributed to the overall untenable debt position of the Government.

In 2005, faced with debt arrears and unaffordable external debts, SIG signed what has become known as the 'Honiara Club Agreement' (HCA) in an effort to regularise its debts and to seek debt relief. The HCA

[1] Gooptu, S. (2005) Achieving Fiscal Sustainability Chapter 3. pp. 53- *65 East Asia Decentralises: Making Local Government Work*. World Bank.

[2] ADB (2011) *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga*. ADB. p.7.

[3] In the 2013 Budget $15 million was allocated to provide a further capital contribution to SIWA. It will be paid by SIWA to SIEA in part settlement of the debt owed to them by SIWA. This payment is a key contribution to ensuring that these two important SOEs are commercially sustainable.

placed a moratorium on all new borrowing and guarantees. The HCA also applied to borrowing by SOEs and issuing Sovereign guarantees for SOE borrowing. The HCA has been upheld, with two exceptions. In 2007 SIG provided a guarantee for a Solomon Airlines loan of $17.4 million. The guarantee was cancelled when the Solomon Airlines fully repaid the loan in 2010. Another guarantee (for $50 million) was provided to ANZ when a loan to Soltai was transferred from the National Provident Fund (NPF) in 2010.

The HCA has provided a strong framework for guiding debt management. The fiscal discipline afforded by the HCA assisted SIG in reducing its debt levels, which are currently around 15 per cent of GDP. As a result, SIG is no longer eligible for 100 per cent grant funding from the Asian Development Bank (ADB) and World Bank but can apply for funding as a combination of around 50 per cent conditional grants and 50 per cent concessional loans. Therefore if SIG wants to support infrastructure development, for example, from these sources it must resume borrowing.

A Debt Management Strategy (DMS) has been developed to provide a framework for concessional borrowing by SIG and for debt management. The DMS sets out the conditions for limited prudent borrowing by SIG for high value projects. The DMS was endorsed by Cabinet in May 2012 and at a meeting of the Honiara Club in July 2012. Representatives of the Honiara Club also unanimously agreed that the HCA should continue, but be amended to allow for borrowing that followed the DMS processes.

With indications that SOEs would resume borrowing, and past experience in Solomon Islands and elsewhere indicating that borrowing by SOEs creates considerable risk for Government, SOEs were included in the remit of the DMS. It was also a concern that if strict controls were placed around central Government borrowing, the pressures to borrow would move to the subnational level. The aim of including subnational borrowing in the DMS is to have some measure of control over public debt sustainability and affordability and to make sure that all borrowing is for the best possible use of funds. At the time of the DMS release it was envisaged that the details of how the DMS applied to SOEs would be resolved later. This policy document provides those details.

2.3 Management of Total Government Debt

The DMS sets out a framework to encourage good decision making with respect to all borrowing in an effort to avoid the mistakes of the past and to support sound public financial management that increases the well-being of Solomon Islanders. There are four key elements to this framework. The first is to keep borrowing within thresholds so that debt is sustainable and affordable even if there are times of economic difficulty in the future. Borrowing is to be restricted to high value projects. There is centralized control over debt authorization so that debt can be prioritized within the envelope that is sustainable and affordable and so that total actual and potential liabilities can be recorded and monitored. And there is a mechanism to guide borrowing decisions by the Finance Minister as sole authority.

Sections 4 and 5 explain in detail how this framework applies to SOEs.

2.4 Review of the Public Finance Act

Currently the *Public Finance and Audit Act 1978* is under review, and it is intended that it will be replaced with a new Public Financial Management Act (PFM Act). Borrowing by SOEs will be dealt with in this Act along the lines indicated in this policy document and in Consultation Paper Number Four (Managing Debt and other Financial Commitments) of the Review of the *Public Finance and Audit Act 1978* released in August 2012.

3. SOE AND DEBT POLICY OBJECTIVES

3.1 Objectives of Debt Management Policy

SIG's public debt management policy objectives, as expressed in the DMS and Medium Term Fiscal Strategy (and as proposed for the PFM Act), are to:

1. Ensure that the servicing and management of the Solomon Islands Government's financing requirements and payment obligations are met on a timely basis, and at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk; and
2. Support the development of a domestic debt market.

3.2 Objectives of SOE Policy

SIG's policy aims with regard to SOEs are contained within the SOE Act and are to put the enterprises on a sound commercial footing. The purpose of the SOE Act (Section 4) is "… to enhance the performance of State Owned Enterprises so that they provide the best possible service for the people of Solomon Islands and contribute to the long term economic and social development of Solomon Islands."

Furthermore, the SOE Act at Section 5(1) states that …" The principal objective of every State Owned Enterprise shall be to operate as a successful business and, to this end, to be (a) as profitable and efficient as comparable businesses that are not owned by the Crown or established as statutory bodies by an Act of Parliament; and (b) a good employer; and (c) an organisation that exhibits a serve (*sic*) of social responsibility by having regard to the interests of the community in which it operates."

Although SIG's aim is for SOEs to operate as commercial enterprises, they differ from private sector enterprises in some important respects that mean it is incumbent on SIG to have oversight over SOE borrowing. Private sector companies face the scrutiny of investors, analysts and commentators. Private sector companies are accountable to shareholders (owners) and financiers. SOEs do not operate with the same efficiency incentives as private sector companies; there are few consequences for poor financial performance and few rewards for profitability[4]. Private sector companies that fail to be profitable in the long run, or that have unsustainable balance sheets will be unable to continue to operate.

There is an implicit government guarantee in the event of poor performance or insolvency of an SOE. This is because of the essential services that SOEs provide, the government as (part) owner, and past behavior by governments. When a private sector companies fails (with a few exceptions, typically systemically important financial institutions and airlines), the losses are largely private. That is, they are contained to the shareholders that lose their investments and employees that lose their jobs. While these can be significant, depending on the size of the enterprise, they do not generally have consequences for entire countries or economies.

[4] ADB (2011) *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga.* ADB p. iii.

Private sector companies with poor balance sheets are unable to borrow and hence take on unsustainable levels of debt. There is a powerful profit incentive for owners of private sector companies whereas it is often difficult for governments to provide profit incentives for SOEs and in many cases there is political resistance to this idea. In the absence of competition, mandating commercial behaviour by SOEs through government policy alone is unlikely to be effective in improving performance.

The expectation of government support generates a range of behaviors relating to debt that need to be controlled. Lenders are likely to see the behavior of governments as providing an implicit guarantee that reduces their risk, and be more inclined to provide higher levels of finance than a for comparable commercial operation. SOEs are thus more likely to be able to take on higher levels of debt than they can comfortably service.

The past behaviour of SOEs with respect to debt, their low level of profitability, and poor record-keeping and poor state of balance sheets would argue for an exceptionally cautious approach to allowing such entities to enter into costly debt that might not reflect the highest national priorities. SOE borrowing therefore needs to be carefully considered in the national context rather than in isolation.

3.3 Objectives of SOE Borrowing Policy

It is intended that this policy will form part of the DMS. It is also intended to be used as a guide for SOEs contemplating borrowing. The purpose of this policy is to:

1. Harmonise the debt management framework with the SOE Act and enabling legislation;
2. Provide the Government with a means of controlling, measuring and monitoring the risks associated with borrowing by SOEs; and
3. Pave the way for the PFM Act and subsidiary legislation, including new Regulations and Financial Instructions.

The scope of this policy is limited to borrowing by SOEs from entities other than central Government (that is, it does not include on-lending or Sovereign guarantees, which will be covered in separate policies). It also does not deal with debt incurred through trade creditor or other arrears. **Note that the definition of borrowing does not including within year cash management or financing arrangements such as overdrafts and Letters of Credit.**

4. DEBT MANAGEMENT STRATEGY

The DMS sets up a framework with four key features:

1. Borrowing limit;
2. Borrowing proposals meet certain criteria;
3. Debt Management Advisory Committee (DMAC); and
4. Centralised control – Finance Minister with sole authority to approve borrowing.

4.1 Borrowing Limit

An annual limit, or ceiling, applies to all forms of new borrowing, including loans, borrowing for the purposes of on-lending, Treasury Bill issuance, guarantees and other formal explicit contingent liabilities entered into by SIG. Loans or guarantees entered into by SOEs are included.

The annual borrowing limit is calculated with reference to debt sustainability and affordability policy limits, and follows the guidelines established by the Joint World Bank–IMF Debt Sustainability Framework for Low-Income Countries[5]. The threshold for total net public sector debt to GDP, as a measure of debt sustainability, is set at 25 per cent and the threshold for debt servicing cost to domestically sourced revenues is set at 8 per cent. The annual borrowing limit is set such that these thresholds are not exceeded in the future when forecast key macro-economic parameters are subject to shocks such as loss of logging revenues, a decline in GDP or a depreciation of the currency under scenarios that are feasible or have a historical basis such as the global financial crisis. IMF has strongly recommended that SOE debt be included when undertaking this analysis.

Borrowing by SOEs is included in the limit for new borrowing on the principle that debt levels for central Government must be affordable and sustainable and that SOE debt is a contingent liability that poses a risk for central Government.

However, there is a concern that contingent liabilities such as SOE borrowing and Sovereign guarantees could 'crowd out' other suitable borrowing proposals. (Similarly, there is a concern that central Government borrowing could displace viable and essential SOE borrowing and interfere with their ability to conduct commercial operations.) For example, if an SOE borrowed SBD 150 million for much needed infrastructure and the borrowing limit was SBD150 million this would mean that other worthwhile projects would have to be postponed, even if the borrowing SOE was well managed and profitable and the risk to government was low. There is an argument that debt that is a contingent not an actual liability should not be given the same reckoning.

The extent to which SOE borrowing should be included in the borrowing limit will be based on materiality thresholds and the level of risk the loan poses to SIG. Further information on assessment is

[5] Accessible at http://www.imf.org/external/np/exr/facts/jdsf.htm

given in Section 5. The details of how this is applied will also be included in the Financial Instructions of the PFM Act.

4.2 Assessment of Borrowing Proposals

4.2.1 Fit purpose

Consistent with both the debt management objectives and the SOE Act, borrowing by SOEs must provide the 'best possible service for the people of Solomon Islands and contribute to the long term economic and social development of Solomon Islands'. As outlined in the DMS (Section 5.2.1) and to be included in the new PFM Act, a fit purpose is the provision of essential social and economic infrastructure identified as a high priority in SIGs Medium Term Development Plan (MTDP) in the National Development Strategy. It is intended that the new Financial Instructions will cover in more detail what constitutes a fit purpose (for example, high value development projects).

To comply with both the SOE Act which states that operation of an SOE must be consistent with operating a successful (profitable and efficient) business and with the DMS which states that for revenue-generating projects, the rate of return must be sufficient to make debt servicing payments and contribute to the future capital requirements of the enterprise, borrowing by SOEs must be for commercial purposes only. To be consistent with the DMS and principles of operating a profitable business, borrowing must **not** be for funding recurrent expenditure losses, shortfalls or deficits.

SOEs can apply for grants (as is consistent with the DMS) and CSO[6]s (as is consistent with the SOE Act) when they need to fund non-commercial projects that have a social benefit.

4.2.2 Acceptable Source

The DMS states that borrowing by SIG should be restricted to concessional sources of finance from multilateral or bilateral donors. The reason for this constraint is that such financing generally comes with highly concessional interest rates and grace periods, and greater scrutiny and oversight, making sure that funding is used for the purposes for which it was provided and decreasing reputational risk. The MOU signed with the IMF for the use of the Standby Credit Facility also effectively prohibits long and short term *external* borrowing on commercial terms for any purpose.

Preventing SOEs from commercial borrowing is contrary to the SOE Act which states that the operation of SOEs must be consistent with operating a successful business. It is also inconsistent with the proposed policy of SIG on-lending to SOEs at a commercial interest rate except to the extent that community service benefits can be identified and valued.

Cabinet has agreed to an amendment to the DMS to allow, in certain circumstances, low cost and low risk commercial borrowing by SOEs from commercial sources. Commercial funding for SOEs can be

[6] Community Service Obligation (CSO) (section 2 in the SOE Act) includes, for example, (a) the provision of a good or service by a SOE to a consumer or user on terms that are not expected to generate a normal return to the SOE; (b) the entering into an agreement by the SOE on any terms other than normal commercial terms applying from time to time; and (d) the forgiveness or reduction by a SOE of a debt or an amount of money owed to the SOE other than on normal commercial terms applying from time to time. Further information is given in Annex II.

justified where it has a comparable cost/risk profile to the concessional funding **available for SOEs**. As outlined in the DMS, acceptability of source will depend on the individual characteristics of the loan, and any limitations and conditions on the loan.

If some of the issues associated with commercial funding are not present or can be mitigated then domestic funding from this source should not necessarily be prohibited for SOEs. As stated in the DMS, the main reasons for prohibiting borrowing from commercial sources is to avoid high, variable interest rates, refinancing risks associated with short term loans, lack of transparency and requiring assets to be offered as collateral.

Interest rate cost is not the only parameter that should be evaluated. As indicated in the DMS, a balance must be sought between reducing cost and risk. Concessional loans have a low interest rate cost but a high foreign exchange rate risk. Domestic funding denominated in SBD does not have any exchange rate risk. On the other hand, multilateral concessional funding is unlikely to be in SBD and will therefore carry foreign exchange risk. For example, a depreciation of the SBD by 30 per cent equates to an interest rate of around 6 per cent[7]. If a loan is available in SBD (and hence has no exchange rate risk) at interest rates of around six per cent for a short term project and with no significant increase in collateral, then there should be no prohibition on commercial funding for SOEs.

Domestic commercial lending for profitable SOE projects is a means for local investment. As is common in developing countries, there has been a lack of good quality investment opportunities in Solomon Islands, leading to excess liquidity in the banking system. Over recent years, the loan books of domestic banks to most sectors of the economy have fallen quite significantly in real terms. This has impacted negatively on the profitability of these banks and placed pressure on them to scrutinise their cost structures. This may have contributed to the withdrawal of financial services in some provincial areas. Domestic banks are looking for opportunities to expand their loan books where that is appropriate and concessional lending from multilateral and bilateral banks should not crowd out domestic commercial lending when cost/risk analysis suggests that there is no reason to do so.

Another consideration is the length of time and the administrative burden associated with borrowing from multi and bilateral organisations. Recent experience has shown that domestic banks can be more flexible and responsive in some circumstances.

The long grace periods and long tenors of concessional loans are less appropriate for SOEs where there would be a mismatch with cash flows from a project. With extended maturity dates, the burden of repayment is partially transferred to future generations and debt can accumulate, increasing debt to equity levels and reducing the ability of the SOE to borrow in the future. In any case, SOEs are unlikely to have the same access to highly concessional funding from multilaterals as Sovereign Governments. For example, funding for SOEs from ADB is available as a blended ADF grant-loan to SIG which is then on-lent to the SOE. If the SOE borrows directly through ADB's 'non-sovereign window' (Private Sector

[7] For example, 30 per cent depreciation is equivalent to 5.5 per cent increase in interest rates on a semi-annual amortizing bond with a ten year term.

Operations Department, PSOD), then the terms and conditions are market-based (and not denominated in SBD).

While Export-Import (Exim) Banks offer concessional loans, the purpose of Exim Bank loans is to promote exports of goods and services of their country. The conditions attached to such loans need to be examined carefully to ascertain the additional costs and risks.

4.2.3 Acceptable Terms and Conditions

The terms and conditions of the borrowing proposal will be assessed to determine whether they are favourable and whether the cost and risk of the loan is acceptable. Details are given in Section 5.4.

4.3 Debt Management Advisory Committee

The Debt Management Advisory Committee (DMAC) is a high level committee with expertise in debt management, planning and economic and monetary policy that can support the Finance Minister in decision making. Membership from the Ministry of Finance and Treasury includes representatives from the Economic Reform Unit (ERU), which is responsible for SOE reform and the Debt Management Unit (DMU). The Ministry of Development and Aid Coordination and the Central Bank Solomon Islands (CBSI) are also represented. The remit of the Committee is to provide advice to the Minister of Finance on, *inter alia*, borrowing decisions, including borrowing by SOEs.

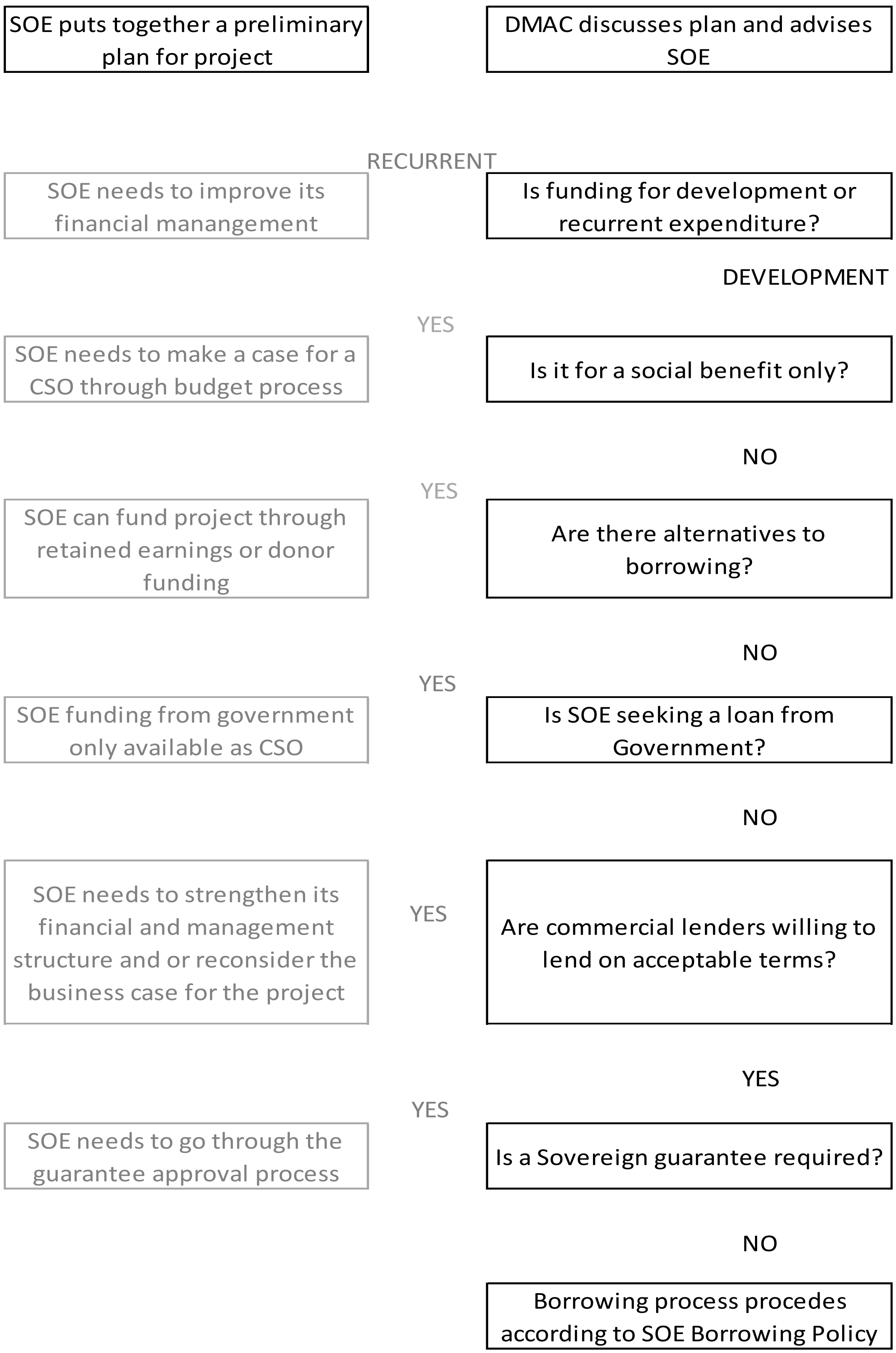
4.4 Centralised Control

The DMS (Section 5.4.3) states that the Finance Minister has sole authority to approve borrowing and this requirement will be included in the PFM Act. In this capacity, the Finance Minister is responsible for the Government's 'ownership interest' in the SOE and for carrying out effective ownership oversight. The involvement of the Finance Minister is consistent with the SOE Act and enabling legislation (see Section 1). As stated in section 2.3 and in Roy and Williams[8], having centralized control of borrowing represents international good practice and allows governments to monitor how much borrowing has occurred. Where multiple borrowing authorities exist, there are problems with accountability and transparency. Under such circumstances, it is difficult to monitor total debt and so the level of debt can increase to levels which can cause the Government major difficulties.

The decision of the Finance Minister to authorize borrowing will be based on a recommendation made by the DMAC. The DMAC will assess borrowing proposals and advise the Finance Minister who has sole authority. The purpose is not to interfere in strategic decision making or management of SOEs but rather to advise the Finance Minister who is the legitimate representative of the Government, as owner. Assessment of borrowing proposals by the DMAC will assist SOEs in operating without political interference and on a sound commercial basis.

[8] Roy, A. and Williams, M. (2010) *Government Debt Management: A Guidance Note on the Legal Framework* Commonwealth Secretariat. p. 14.

BORROWING POLICY DECISION TREE



5. APPROVAL PROCESS

This section outlines the approval process for SOE borrowing[9]. SOEs should liaise with the SOE team in ERU in the Ministry of Finance and Treasury.

5.1 Eligibility

To be eligible for borrowing, the SOE must be able to provide evidence of:

a) a set of audited annual financial statements that indicate sufficient financial ability to manage and service the loan;
b) current payments to NPF; and
c) current payments of tax

for the immediately prior financial year, unless the entity was not in existence in the prior financial year.

The SOE must also have a business plan, with the project clearly identified in this plan.

5.2 Preliminary case for borrowing

SOEs should bring a preliminary case for borrowing before the DMAC at early stage in project development, before funds are spent on feasibility studies or similar and before the SOE or SIG demonstrates its commitment to the project. This is important because SOE borrowing is not part of SIG's budget process and so it needs to be prioritised within the borrowing limit.

Discussion at an early stage will also assist the SOE in making a case for the borrowing that is in line with the DMS (and PFM Act) and obtaining advice on alternative sources of funds. It would be expected that at this stage the project is already part of the SOE's business planning.

1. Credit worthiness	1. SOE has up-to-date audited financial statements. 2. SOE has demonstrated strong management and ability to operate as a profitable business.
2. Is borrowing for a fit purpose?	1. Identified in Corporate Objectives of SOE 2. Outlined in SOE's business plan.
3. Borrowing source, terms and conditions	Indication that there is an acceptable source of funds willing to lend at acceptable terms and conditions.
4. Project viability	Preliminary information indicates that the project is viable.

[9] A similar approval process has been followed in 2012 for a loan to Solomon Airlines from a commercial bank for the purpose of purchasing a Dash-8 aircraft.

5.3 Impact of SOE borrowing on total public sector debt position

Sufficient information must be presented such that the DMAC (and the Finance Minister) can make an informed assessment of the impact of the proposed borrowing on the sustainability and affordability of SIG debt position. For a loan this would include:

- ☐ Volume;
- ☐ Currency;
- ☐ Grace period;
- ☐ Tenor (Term to maturity);
- ☐ Debt servicing payments (timing and amount);
- ☐ Residual payment (if applicable); and
- ☐ Interest rate and interest rate variability.

As discussed in Section 4.1, the extent to which SOE borrowing should be included in the borrowing limit will be based on materiality tests and the level of risk the loan poses to SIG. Factors such as those itemized in the table below will be used to determine the level (50 to 100 per cent) to which the borrowing counts towards the annual new borrowing limit.

Higher risk (100 per cent inclusion)	**Lower risk (50 per cent inclusion)**
Loan is guaranteed by Government.	Loan is not guaranteed by Government.
Entity's balance sheet has only moderate strength as determined by ratio analysis.	Entity has strong balance sheet as determined by ratio analysis.
Foreign exchange risk.	No foreign exchange risk.
Entity has a poor history of repaying debt.	Entity has a good history of meeting financial obligations.
Business model associated with projects has assumptions that are difficult to test or that rely on increases in fees to consumers or changes to business operations that have not yet been implemented.	Business model associated with project based on status quo.
Business plan relies on unknown factors or persistent moderate balance sheet strength.	Business plan is sound.

There are also other considerations relevant to Government including:

- ☐ Legal position of SIG and SOE in relation to debt (such as guarantees, contractual agreements);
- ☐ Impact on fiscal and monetary policy;
- ☐ Public policy and precedents; and
- ☐ Regulatory environment.

5.4 Terms and Conditions of Proposed Loan

As outlined in the DMS, the terms and conditions of the loan must be acceptable. The following factors will be examined:

Grant associated with loan	*Ceteris paribus*, preference should be given to loans with an attendant grant. However, the terms and conditions of the grant must be examined carefully, since they may lessen or annul the advantages of receiving a grant.
Interest rate	Loans with a lower interest rate will have a lower cost.
Fixed or floating rate	A fixed rate is preferable because then future cash flows are known. However, most commercial loans are based on a floating rate. The interest rate risk can be managed through interest rate swaps.
Residual payment	No or low residual payment is preferred. Commercial loans typically have a large residual payment that can lead to refinancing risk. Interest rates may be higher when the loan is renegotiated or refinanced if the borrower is unable to repay the residual payment at the end of the term.
Currency	Commercial loans *must be* denominated in SBD. Depreciation of the Solomon Islands dollar against the loan currencies will increase the cost of the loan. SOEs typically do not have the means of hedging foreign exchange risk. External (non-domestic) loans must be concessional.
Tenor (length of the loan)	The tenor of the loan should match the projected cash flows and tangible benefits of the project. Concessional loans have a standard long time to maturity (32 or 40 years) and are typically cheaper to repay but come with greater uncertainty about future ability to repay and can lock in high debt levels unless there is the provision and discipline for prepayment. Commercial loans are typically for five years.
Grace period	The length of the grace period should be assessed in terms of factors such as the revenue stream from the project, its duration, inter-generational equity and the time value of money. Interest payments during long grace periods can add to the cost of a loan. Commercial loans typically do not have any grace period.
Repayment profile	The SOE should be able to afford the debt repayments over the life of the loan and repayments must be timed for months with lower repayment volumes or where the SOE has peaks in cash collection.
Conditions	Preference should be given to debt with positive characteristics such as project administration or

	management and advisory services. Negative characteristics such as tied procurement[10], future expense commitments (such as auditing or equipment maintenance expenses) need to be factored into assessments of the cost of debt. Commercial lenders typically place restrictions on the ability to change business activity, change in ownership, and appointment of the board. While these conditions are intended to protect the ability of the borrower to repay the loan, they should still be given careful consideration.
Collateral	Commercial Lenders usually require collateral (security) to be given for any loans. As owner, SIG needs to consider how this would affect the Government in the case of default.
Guarantee	Loans to SOEs that do not have an explicit Government guarantee attached will be preferred to those that do.

5.5 Assessment of borrowing on SOEs financial position

Sufficient information must be presented such that the DMAC (and the Finance Minister) can make an informed assessment of the SOEs credit worthiness (ability and willingness to repay). Lenders will conduct a business health check, and a credit worthiness or due diligence report will be prepared depending on the size of loan. SIG should work with lenders to obtain access to this information because SIG has limited capacity to perform in depth checks or research. However, in using information provided by lenders, SIG needs to be cognizant of the different circumstances for commercial lenders compared with Government. For example, collateral decreases risks to lenders but not necessarily to Government.

5.5.1 Ability to Pay

The ability to pay relates to the financial health of the enterprise. Up to date audited financial statements (for each of the three years preceding the loan or if the entity has been in existence for less than five years, financial statements for each year in which it has been operating) plus a business plan and a five year cash flow projection are required to help make this assessment. Examples of the sorts of questions that need answers are:

- ☐ Are there trade creditor arrears?
- ☐ Are there tax or NPF arrears?
- ☐ Does the SOE have any other current debts including debts to Government and to other SOEs?
- ☐ What is SOE’s ability to make loan repayments on time?
- ☐ Does the SOE have a Business plan?
- ☐ What is the history of repayment including debts to Government?

[10] EXIM banks typically require the borrower to procure goods and services from the lender country and to use particular companies for project implementation.

Analysis of the financial statements will include calculation of standard financial ratios[11] such as:

REVENUE INDICATORS	
Rate of return on net fixed assets in service	Net operating income x 100 / Average of net fixed assets in service
Operating ratio	Total operating expenses x 100 / Total operating revenues
Self-financing ratio	Cash from internal sources / Average annual capital expenditure
Return on equity	Net profit / Owners' equity
CAPITAL STRUCTURE INDICATORS	
Debt to equity ratio	Total debt / Total Equity
Debt service coverage ratio	Net revenues (excluding interest charges) / Estimated annual debt service requirement
LIQUIDITY INDICATORS	
Quick ratio	Current assets – inventories / Current liabilities

It is expected that the ERU and DMU in the Ministry of Finance and Treasury would be looking at these indicators regularly in their monitoring role. Judgement will be applied in interpretation of the ratios and comparison with the relevant industry. Analysis may not be straightforward for SOEs because assets can be difficult to value and wages might not be at 'fair' market rate.

5.5.2 Willingness to pay

Willingness to pay relates to the strength of the management structure such as the Board. Board appointments must be consistent with the SOE Act. Board members and senior management such as the CEO and CFO must be suitably qualified and able to demonstrate their ability to manage the SOE well.

5.6 Assessment of project

5.6.1 Project is for a fit purpose

The Debt Management Strategy requires borrowing to be for a fit purpose.

- ☐ The project should align with a development priority in the MTDP;
- ☐ The objectives and proposed outcomes of the project are consistent with the SOE's statement of corporate objectives; and
- ☐ The project is part of the SOE's business plan.

[11] Refer to ADB (2002) *Guidelines for the Financial Governance and Management of Investment Projects.* http://www.adb.org/documents/guidelines-financial-governance-and-management-investment-projects-financed-adb

5.6.2 Project is viable

The viability of the project itself must also be assessed. Where commercial lenders are involved they should be encouraged from the outset to share analysis with SIG. The following is an indication of what is required:

- ☐ Information on how borrowed funds will be invested in a manner that boosts productivity and reduces costs. (Borrowed funds must be used for capital expenditure with broader economic benefits and not propping up poor management or funding recurrent expenditure. Similarly funds must not be used for cross subsidizing other SOEs or Government departments.);
- ☐ Cash flow analysis;
  - o CAPEX (Capital expenditure) analysis/Cost benefit analysis (Benefits from capital expenditure must be greater than the additional costs, including the costs of servicing the loan); and
  - o Estimate of expected operating cash flows and NPV analysis (NPV must be positive)[12].
- ☐ Business plan with reasonable assumptions (for example acceptable pricing policy);
- ☐ Risk assessment of project;
- ☐ Timeframe for project implementation;
- ☐ Statement about what assumptions have been made with respect to (for example):
  - o Exchange rate;
  - o Depreciation;
  - o Inflation; and
  - o Interest rates.
- ☐ Scenario analysis including an assessment of the impact of changes in the assumption variables on the viability of the project.

This information will be used to assess the financial indicators for the project. For example[13]

Interest coverage ratio	$\frac{\text{Earnings before Interest and tax (EBIT)}}{\text{Interest expense}}$
Return on investment[14]	$\frac{\text{Gain from investment – cost of investment}}{\text{Cost of investment}}$

5.7 Report to Minister

The DMAC must provide the Finance Minister with an evaluation/assessment of the proposal.

1. Value of Project to Solomon Islands
   - Identified priory in MTDP;
   - Consistent with DMS; and
   - Statement of rationale (benefits) of project.
2. Financial analysis of project

[12] Although determining the discount rate for weighted average cost of capital can be problematic.

[13] Refer to ADB (2002) *Guidelines for the Financial Governance and Management of Investment Projects* http://www.adb.org/documents/guidelines-financial-governance-and-management-investment-projects-financed-adb

[14] Although this can be difficult to measure and subject to manipulation.

- Summary of analysis of costs and benefits; and
- Assumptions used.

3. Credit worthiness of SOE
   - SOE is creditworthy as determined by financial statement analysis and if possible supported by documentation from lender(s).
4. Loan terms and conditions
   - Statement of loan terms and conditions;
   - Analysis of cost of loan;
   - Loan terms and conditions reasonable and consistent with policies; and
   - Recommendation for any renegotiating of terms and conditions.
5. Risks to SIG
   - Consistent with legislation and regulatory policies;
   - Quantified impact is below SIG thresholds for debt affordability and sustainability;
   - Is within the Government's annual borrowing limit;
   - Is consistent with fiscal and monetary policy; and
   - Statement of expected cost and risk to Government.

6. REPORTING AND MONITORING

Under the SOE Act it is a requirement for SOEs to provide audited financial statements to the Finance Minister on a timely basis. The Finance Minister is the Government's representative, as owner, and performs the duties for ownership monitoring and oversight. Financial statements are essential to monitor performance, improve fiscal disciple, transparency and accountability. The ability to produce audited financial statements is in itself a measure of an SOE's financial health.

SOE Act

Annual report, accounts, and dividend

14. (1) Within 3 months after the end of each financial year of a State Owned Enterprise, the board of the State Owned Enterprise shall deliver to the Accountable Ministers: -

(a) a report of the operations of the State Owned Enterprise and a separate report of each of its subsidiaries during that financial year; and

(b) audited consolidated financial statements for that financial year consisting of statements of financial position, profit and loss, changes in financial position, and such other statements as may be necessary to show separately the financial position of the State Owned Enterprise and each of its subsidiaries and the financial results of their operations during that financial year; and

(c) the auditor's report on those financial statements.

(2) Every report under section (1) (a) of this section shall: -

(a) contain such information as is necessary to enable an inform assessment of the operations of the State Owned Enterprise and of the operations of each of its subsidiaries, including a comparison of the performance of the State Owned Enterprise and subsidiaries with the relevant statement of corporate objectives; and

(b) state the dividend payable to the Crown by the State Owned Enterprise or the financial year to which the report relates.

Financial statement information will be used by DMU and ERU within the Ministry of Finance and Treasury to monitor the debt status and financial health, respectively, of SOEs (see Section 5.4 above). It should be part of the loan conditions that SIG has adequate powers to scrutinise repayments of loans to SOEs. This will enable SIG to monitor and report on the default risk of SOEs and Government's total debt position.

7. CONSISTENCY WITH SOE REFORM

Application of the SOE borrowing policy will be consistent with SOE reform that aims to target:

1. Accountability;
2. Performance monitoring;
3. Scrutiny of large capital investments; and
4. Public reporting and transparency.

The SOE borrowing policy is consistent with SOE policy, as expressed in the SOE Act, in that it requires SOEs to operate in a business-like manner. In particular, the ability of SOEs to take out commercial loans under specific circumstances:

- ☐ Is consistent with the policy of operating SOEs as a successful business;
- ☐ Creates a level playing field for SOEs to compete with the private sector in contrast to subsidised debt that can create economic distortions and encourage waste where pricing is below true cost;
- ☐ Requires thorough scrutiny of borrowing proposals;
- ☐ Is subject to the strictures and discipline imposed by commercial lenders;
- ☐ Promotes good governance because failures are public;
- ☐ Requires the discipline of putting together borrowing proposals, business plans, audited financial statements, and
- ☐ Entails monitoring and increased accountability for performance.

In addition, where Government financial institutions (such as the pension provider) lend to SOEs at below market rates this reduces the return on investment for these institutions at the expense of cross subsidizing SOEs.

However, SOE borrowing will only lead to improved SOE performance when governments have the political will to:

1. Impose hard budget constraints – continued financing of poorly performing SOEs does not restore their profitability and often creates negative performance incentives.[15]
2. Insist on consistently robust strong governance;
3. Introduce accountability for results and provide management performance incentives;
4. Allow management independence - the business should be free to make commercial decisions and 'run' operations; and
5. Allow profit orientation to justify existence.

However, Government also needs to take into consideration that all SOEs acting in isolation may in aggregate present unacceptable risks and potential costs to Government.

[15] ADB (2011) *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga* ADB p.iv.

ANNEX I: Notes on enabling legislation

The general financial provisions of the existing legislation relating to SOEs contain provisions relating to SOEs taking on debt. These acts contain mechanisms to limit and control borrowings of SOEs. In general, acts allow for SOE borrowing in certain circumstances following approval of the relevant Minister after consultation with the Finance Minister.

Commodities Export Marketing Authority

1. The financial arrangements relating to the Commodities Export Marketing Authority are set out under Part IV of the Commodities Export Marketing Authority Act [Cap 36].

2. Section 22 confers a power to borrow. It notes that the Authority may 'from time to time raise or borrow such sums of money for or in connection with the purposes of this Act and on such terms and conditions as are approved in writing by the Minister after consultation with the Minister of Finance.'

3. In addition, section 23 provides the Authority with the power to guarantee the repayment of principal and interest and other charges on bank loans made to commodity producers for the production of a commodity or carrying on any other prescribed activity in a commodity, on the recommendation of the Authority. Such guarantees require the written approval of the Minister, after he or she has consulted with the Minister for Finance. Such guarantees create a liability for the Authority, and indirectly for the Government.

   a. Section 2 defines 'prescribed activity' as any activity that the Minister prescribes for the purposes of the Act. CEMA's activities, as defined in the Act are: 'any activity or dealing of whatever description, which results in producing, processing, buying, selling, storing, marketing, transporting or shipping of any commodity for the purpose of its export, whether such activity or dealing is carried on by a person for himself or for the benefit of any other person, or as an agent or trustee of any other person, and includes such other activity or dealing so carried on for the purpose of the export of a commodity, as the Minister may, by notice published in the Gazette, specify.' [section 2]

Solomon Airlines

4. Solomon Airlines is a corporation within the meaning of the Companies Act [2009], and was originally incorporated under the British Solomon Islands Protectorate Companies Ordinance 1959. It is owned by the Investment Corporation of Solomon Islands. The company's articles of association, dated 1968, set out the arrangements that govern the operation of the company.

5. Borrowing powers are set out in articles 42 to 47. These note that the directors may, 'from time to time, at their discretion, borrow or raise any sum or sums of money for the purpose of the Company' (article 42). Article 42 further notes that the directors may secure the repayment of such sums in a manner they see fit, including by mortgage charge or other security on the undertaking or the present and future property of the company.

6. The memorandum of association sets out that one of the objects for which the company is established is 'to borrow or raise money or receive money on deposit either without security or secured' including by 'any part of the undertaking, property, assets and right of the company including its uncalled capital' (articles 2(xiv) and 2(xvi)). The company can also guarantee the contract or liabilities of any person, 'whether corporate of unincorporated with or without security' (article 2(xviii)).

Investment Corporation of Solomon Islands

7. The Investment Corporation of Solomon Islands Act [Cap 143] sets out that the Corporation may, subject to the provisions of the Act, and with the approval of the Minister 'borrow moneys and issue securities, including guarantees, debentures, stock, bonds, bills or other promissory notes.' [section 5(3)(e)]. This provision is set out under the powers of the corporation. The Minister in this case is the 'Minister charged with the responsibility for Finance' [section 2]. The Corporation may also make or grant loans to enterprises in which it holds a commercial interest [section 3(e)].

Solomon Islands Broadcasting Corporation

8. Part III of the Broadcasting Act [Cap 112] sets out the financial provisions relating to the Solomon Islands Broadcasting Corporation. Under section 11, SIBC may, from time to time, borrow money for purposes including the provision of working capital, performing its functions, the acquisition of undertakings, any other expenditure properly chargeable to capital account, and for any other purpose approved by the Minister of Finance. SIBC, however, may only do so with the approval of the Minister of Finance [section 11(1)].

   a. In addition, the Broadcasting Act allows SIBC to borrow by way of temporary overdraft or loan 'such sums as it deems fit not exceeding an amount approved by the Minister' [section 12].

Solomon Islands Electricity Authority

9. Solomon Islands Electricity Authority's power to borrow is set out under section 16 of the Electricity Act [Cap 128]. This section provides that the Authority may, from time to time, borrow money 'in whatsoever manner and subject to such terms, security, guarantee, mortgage pledge or charge as may be so approved, including for the provision of working capital, performing its functions under the Electricity Act, and expenditure chargeable to capital account {Electricity Act section 16(1)). However, the Authority may do so only with the approval of the Minister of Finance.

   a. In addition, the Electricity Act allows the authority to borrow by way of temporary loan or overdraft of 'such sums as it deems fit not exceeding an amount approved by the Minister'.

Solomon Islands Water Authority

10. The powers of the Solomon Islands Water Authority are set out in Part II of the Solomon Islands Water Authority Act [Cap 130]. Section 10(3)(b) provides that the Authority may enter into 'any

commercial operations in respect of its activities, services or products.' This is not further defined, however it could extend to entering into a borrowing arrangement.

11. The Financial Arrangements are set out in Part V of the Act. The Authority may 'borrow by way of loan or overdraft such sum of money it deems fit not exceeding an amount approved by the Minister' (section 34). In this case, the Minister is defined in section 3(1) of the Act as 'the Minister who for the time being is charged with the responsibility of administering urban water supply (currently the Minister of Mines is the Responsible Minister).

<u>Solomon Islands Ports Authority</u>

12. The financial arrangements relating to the Solomon Islands Ports Authority are set out in part VI of the Ports Act [Cap 161]. This includes the power to borrow money. Under section 21, the Authority may, 'with the consent of or in accordance with any general authority given by the Minister of Finance, borrow by way of loan, overdraft or otherwise such sums as the Authority may require for meeting its obligations and discharging its functions'. Whether the Authority borrows from the Government or from another source, the terms and conditions must be approved by the Finance Minister.

<u>Solomon Islands Postal Corporation</u>

13. Solomon Post's powers are set out in Part II of the *Solomon Islands Postal Corporation Act 1996*, relating to functions and powers. Section 8 provides that the corporation has the power to do anything calculated to facilitate its functions. This includes the power to enter into contracts and agreements (section 8(2)(c)) and to borrow from the government or other persons in Solomon Islands and to give securities over assets and pay interest on loans (section 8(2)(i)).

14. Financial arrangements are set out in Part III of the Act. Sections 19 and 20 relate to loans and overdrafts and borrowing respectively. Under section 19, the Corporation may borrow up to the limit of an amount approved by the Minister. 'Minister' is defined by the Act as the Minister charged with responsibility for the administration of the Act (section 2), currently the Minister for Communications.

a. On borrowing, the act notes that the Government may guarantee borrowings made by SIPC from any international or foreign organization approved by the Government (section 20(1)) and that all sums payable by the government under the guarantee should be charged to the Consolidated fund (section 20(2)). The act is silent on the approval processes for a guarantee, but this suggests that each guarantee would be a separate decision of the Government.

b. Section 17 requires the corporation to deliver its financial estimates to the Minister, within three months of the beginning of the financial year. If these are not approved, the Corporation is prevented from undertaking any borrowings. The SOE Act provisions on timing of financial estimates would overtake those of the Solomon Islands Postal Corporation Act.

ANNEX II: Community Service Obligation

SOE Act

Interpretation

2.

…"Community Service Obligation" means –

(a) the provision of a good or service by a State Owned Enterprise to a consumer or user on terms that are not expected to generate a normal return to the State Owned Enterprise;

(b) the entering into an agreement by the State Owned Enterprise on any terms other than normal commercial terms applying from time to time;

(c) the forbearance by a State Owned Enterprise to exercise a right or entitlement other than on normal commercial terms applying from time to time;

(d) the forgiveness or reduction by a State Owned Enterprise of a debt or an amount of money owed to the State Owned Enterprise other than on normal commercial terms applying from time to time; but

(e) does not include the State Owned Enterprise exercising its commercial judgement to make donations to worthy causes or to price goods and services at or below the cost of their production.

"government assistance" means any value provided to a State Owned Enterprise by the Crown other than value provided on terms consistent with an arms length commercial transaction or standard government policy, and includes (without limitation) tax rebates or waivers, government guarantees provided for less than fair value, and loans on terms more favourable than would be expected in an arms length transaction;

ANNEX III Checklist of Information Required from SOE

PURPOSE OF PROJECT	
	Statement of purpose of project
	Relevant section in NDS
	Statement of Corporate Objectives
	Identification in business plan
	Relevance to other plans, strategies or benchmarks
CHARACTERISTICS OF LOAN	
	Loan offer from lender (if relevant)
	Volume
	Currency
	Grace period
	Tenor (Term to maturity)
	Debt servicing payments (timing and amount)
	Residual payment
	Interest rate and interest rate margin for floating rates
	Collateral requirement
	Requirement for Government guarantee
	Other conditions
SOE OPERATIONS	
	Up to date (audited) financial statements
	Annual reports (if published)
	Names and credentials of Board and senior management
	Details about arrears (trade creditors, PAYE, NPF)
	Details about other debts
	Business plan
	Due diligence or credit worthiness reports from lenders
	Other relevant information (about, for example, donor assistance)
PROJECT VIABILITY	
	Cash flow projections
	Summary of analysis of costs and benefits
	Assumptions used
	Supporting information such as Feasibility studies, Due diligence reports

ABBREVIATIONS

ADB	Asian Development Bank
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CSO	Community Service Obligation
DMAC	Debt Management Advisory Committee
DMS	Debt Management Strategy
DMU	Debt Management Unit
ERU	Economic Reform Unit
GDP	Gross Domestic Product
HCA	Honiara Club Agreement
IMF	International Monetary Fund
MTDP	Medium Term Development Plan
NDS	National Development Strategy
NPF	National Provident Fund
PFM	Public Financial Management Act
PSOD	Private Sector Operations Department
SIG	Solomon Islands Government
SOE	State owned Enterprise