

Corporate Governance and Financial Accountability of SOEs in Azerbaijan: Key Findings and Recommendations

Roundtable with the economists of Azerbaijan

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КРАТКО О СЕБЕ

Ирина Горделадзе, LL.M.
Эксперт по корпоративному управлению

- ✓ Более 10 лет руководство деятельностью по корпоративному управлению IFC и World Bank в Грузии
- ✓ Участие в разработке закона о Бухучёте, Отчётности и Аудите Грузии
- ✓ Участие в разработке Кодекса Корпоративного Управления Грузии
- ✓ Соавтор публикаций IFC и World Bank по корпоративному управлению Азербайджана и Узбекистана
- ✓ Работа по усовершенствованию КУ частных компаний и госпредприятий в Грузии и центральной Азии
- ✓ Член жюри и организатор Конкурса Лучшего Годового Отчета при фондовой бирже Грузии



SOEs: Why here? Why now?

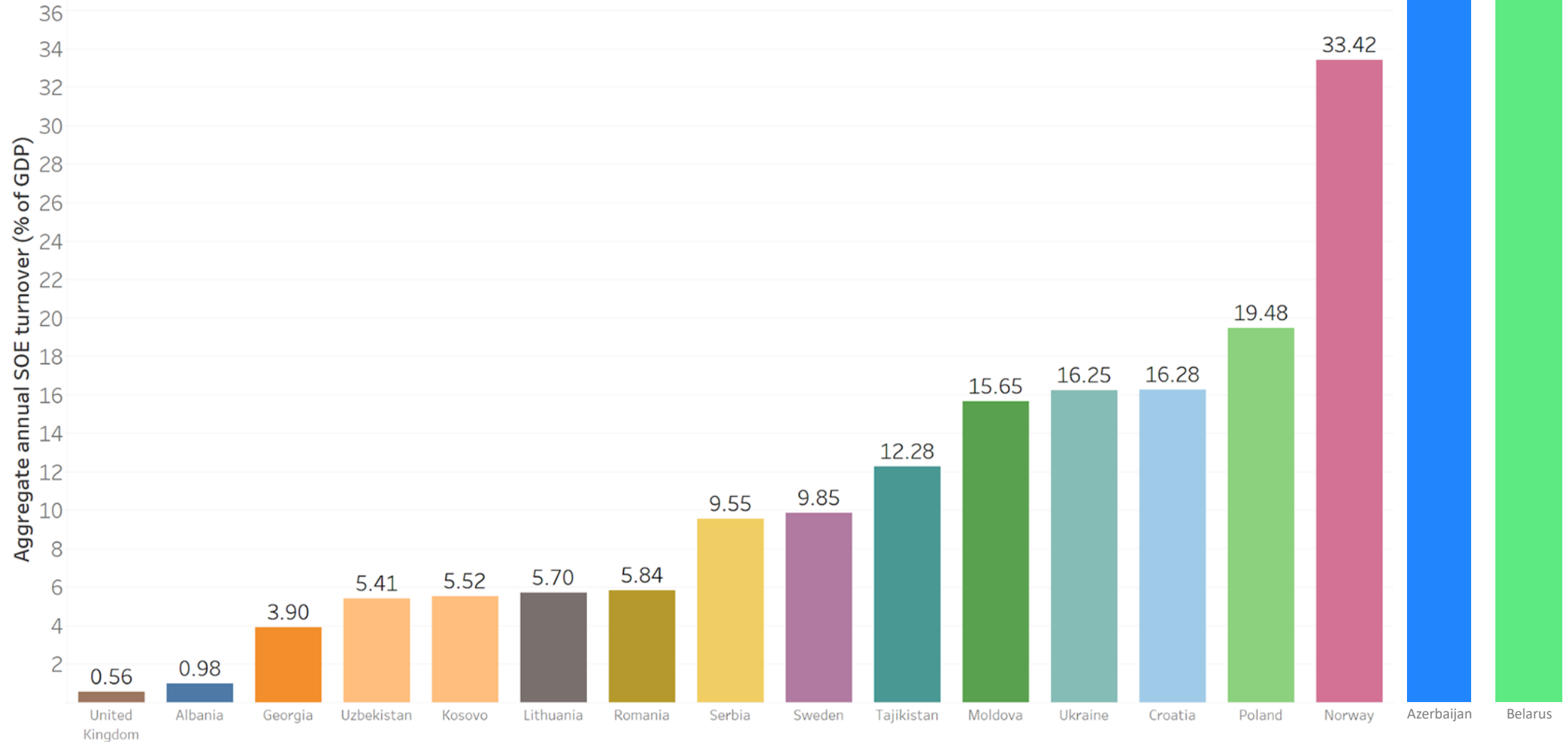
In our region SOEs remain significant players in many areas:

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

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

SOEs: Why here? Why now?

Aggregate annual SOE turnover (percentage of GDP) in ECA and other selected countries 42.0

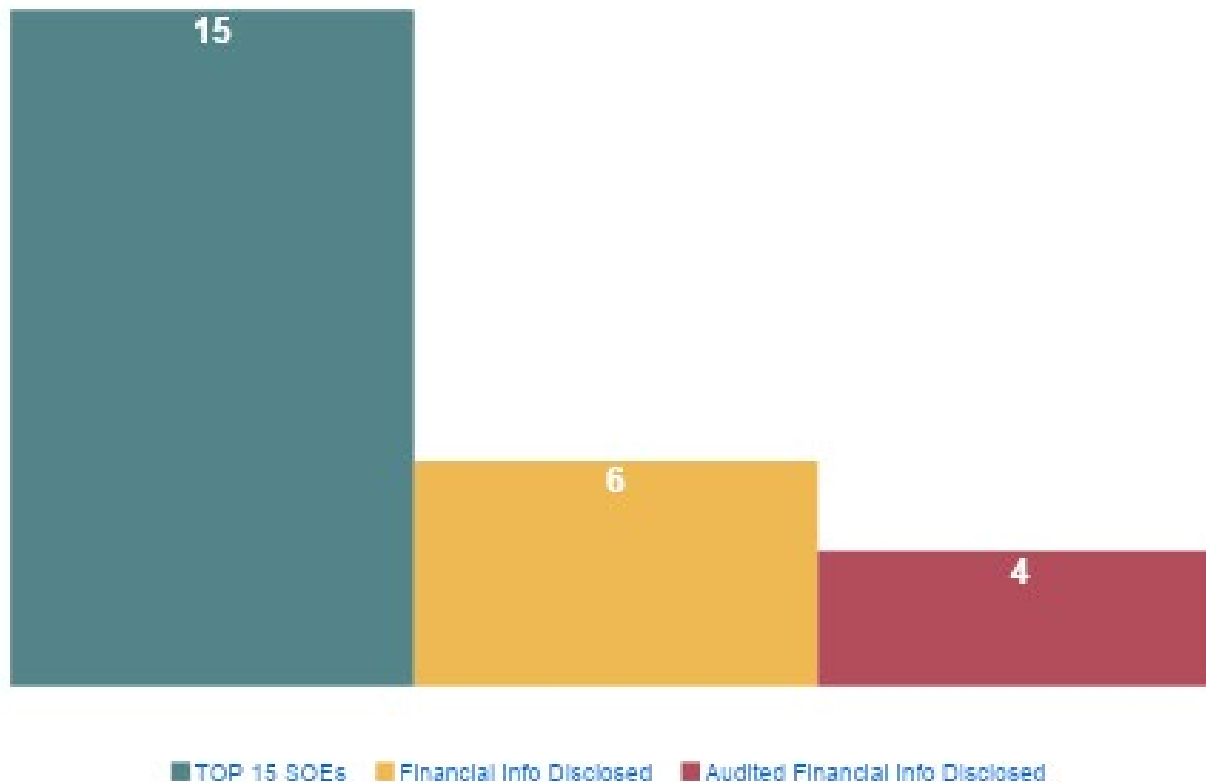




Main Findings and Policy Recommendations

SOE landscape in Azerbaijan: data quality and accessibility

- Information on SOEs is limited or not publicly available, leading to =>
- Government has limited view of SOEs financial position and performance
- Very few SOE make their annual reports, financial and other information available



SOE reform and legislative frameworks in Azerbaijan

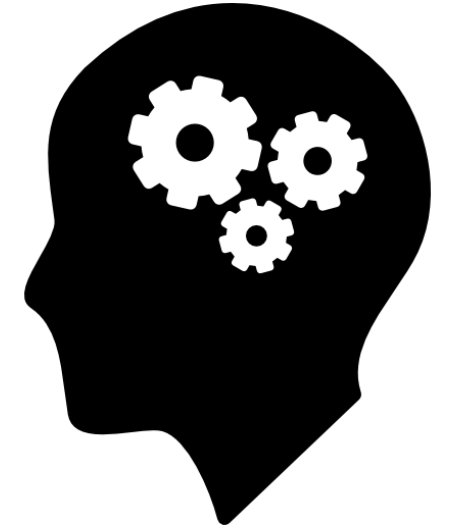
- Initial reforms in SOE governance initiated:
 - ✓ Many SOEs are corporate entities (JSC)
 - ✓ Supervisory Boards are established at some SOEs
 - ✓ Financial reporting and disclosure legislated for SOEs = OJSC, incl.
 - ✓ IFRS reporting for Top 8 SOEs
 - ✓ Top SOEs = Public Interest Entities
 - ✓ Corporate Governance regulation, SOE performance monitoring and incentives
- Fragmented statutory framework for SOE ownership, oversight, and operation
- Low transparency and absence of coherent SOE policy
- Implementation of reforms and existing legislation is not consistent

SOE reform and legislative frameworks in Azerbaijan

Areas for Consideration

- Consolidating existing relevant legislation on SOE objectives, ownership, oversight, and corporate governance under a single set of Guidelines or Rules
- Implementation of incentives, monitoring mechanisms, efficiency assessment
- Capacity constraints to be addressed at Government agencies involved in SOE governance

SOE Ownership



SOE Ownership in Azerbaijan

- Lack of strategic view on SOE ownership and development
- No publicly defined objectives of state ownership
- Ownership and supervision functions are decentralized
- Limited assessment of SOEs performance

Areas for Consideration

- Formulate and disclose comprehensive SOE Ownership Policy, incl. objectives of ownership, accountability, and periodic revision.
- Consolidate legislation on SOE ownership, oversight and operations.
- Introduce a more centralized SOE ownership model, i.e. Advisory model.

Potential considerations for the Azerbaijan SOE Ownership

- Advisory Model may be an option for short- to medium-term:
 - ✓ Builds on the existing SOE oversight structure of line Ministries
 - ✓ Introduces strong intermediary to collect, process and analyze SOE information
 - ✓ Proposes informed decisions and hold line Ministries accountable
 - ✓ Requires minimal legislative changes
 - ✓ May provide quick wins if advisory body is properly empowered to carry out its functions and staffed with qualified specialists
 - ✓ Works across various sectors, requiring minimal specifications for industry specifics
 - ✓ Builds foundation for further centralization in longer-term perspective

SOE Supervisory Boards



Role and Functions of SOE Supervisory Boards

- Scarce legislative provisions on supervisory boards and their role
- Out of the twenty largest SOEs, only fin sector SOEs have supervisory boards
- Audit committee exists only in few of top twenty SOEs
- Supervisory boards of non-fin sector SOEs are composed of civil servants
- No independent board members
- Process of nominations and appointments of SOE board members is non-transparent
- Supervisory boards of SOEs are not active in strategy-setting, appointing / removing management, deciding remuneration, or assuming responsibility over internal controls

Role and Functions of SOE Supervisory Boards

Areas for Consideration

- Strengthen the role of SOE supervisory boards by providing more authority and autonomy | decision making power
- Increase capacity of SOE boards members and Government agencies involved in SOE governance through training and awareness raising activities
- Streamline nomination and appointment process of state representatives to SOE supervisory boards by defining rules and procedures of nomination, appointment and dismissal of state representatives, and disclosure of relevant information
- Gradually reduce presence of civil servants and introduce qualified independent board members

Role and Functions of SOE Supervisory Boards

Areas for Consideration

- Establish clear selection criteria for SOE supervisory board members, considering relevant industry expertise, financial and/ or legal background, risk management, internal controls
- Envisage supervisory board committees to support SOEs supervisory boards in taking well-informed and considered decisions i.e. audit committee, compensation committee, other committees depending on the needs of specific SOEs
- Consider staffing supervisory board committees with board members possessing appropriate skills and experience, preferably headed by independent board members



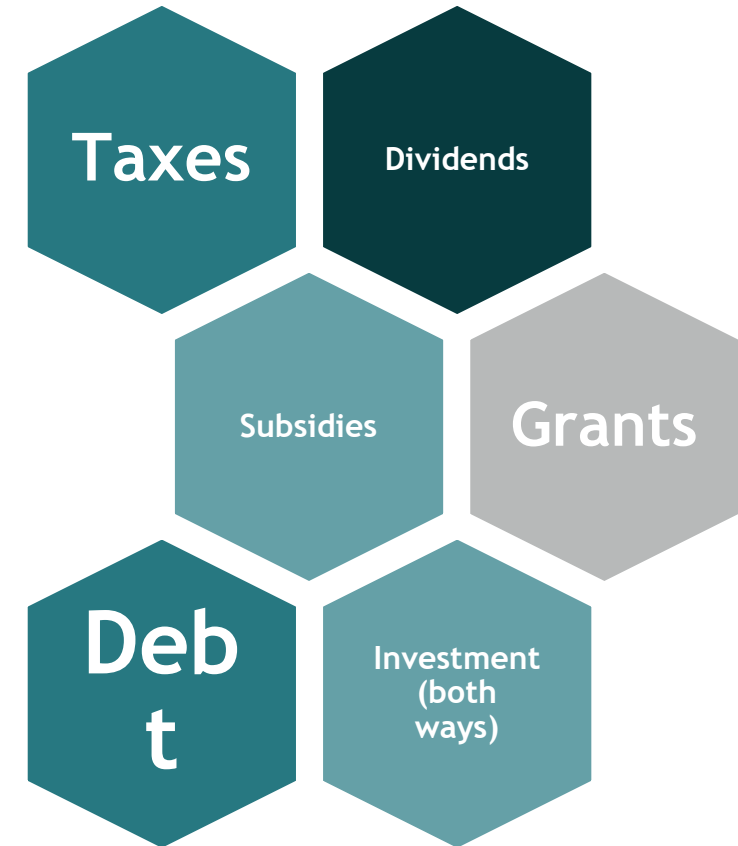
Financial reporting and accountability of SOEs

Financial reporting and accountability of SOEs

Why is SOEs financial information so important???

- SOEs are large tax payers
- Dividend revenue for the budget
- Subsidy | grants allocation from the budget
- Capital investment by SOEs into public good
- Investments attracted by SOEs from 3rd parties
- Large issuers of debt

Serves as a basis for effective management and decision making



Financial reporting and accountability of SOEs

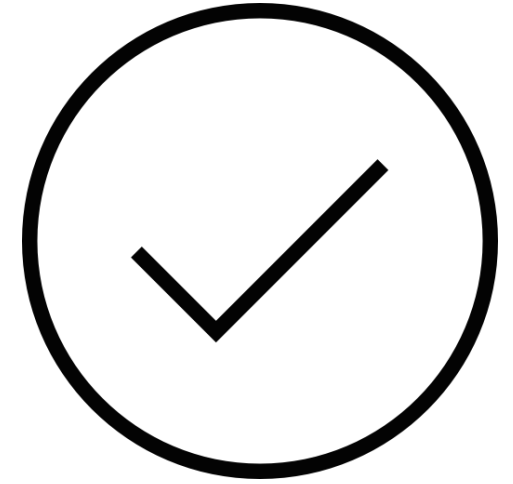
- Insufficient public information available on SOE finances, governance and performance
- Limited use and enforcement of IFRS
- Discrepancies in SOE accounting and disclosure practices, i.e. publication
- Absence of audit committees => lack of monitoring over financial reporting, internal controls and risk management
- Most transparency and disclosure requirements apply only to top 20 SOEs, enforced at very few in practice
- Lack of linkage of SOE strategy & objectives with performance indicators and targets
- No connection between SOE performance and SOE incentives, i.e. management remuneration and bonuses

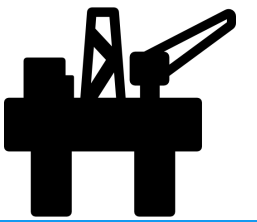
Financial reporting and accountability of SOEs

Areas for Consideration

- Consolidate SOE oversight and monitoring at one Government agency
- Perform periodic (at least yearly) review of each SOE's performance
- Link key financial and non-financial performance indicators to SOEs strategy and objectives to measure and evaluate results
- Legislate transparent system of incentives for SOEs management, linking it to SOEs performance, considering potential sanctioning (dismissal, reappointment)
- Enforce SOE reporting requirements (IFRS or National Standards) through appropriate measures
- Enforce SOE publication requirements ensuring audited financial statements and management reports are publicly disclosed by SOEs

Conclusions





Conclusion

Evidence shows that a good corporate governance system is associated with a number of benefits for all companies, whether private or state owned:

- better access to external finance
- larger investments and lower costs of capital
- higher growth
- higher valuation
- greater employment creation and growth
- improved operational performance and more efficient management
- reduced risk of corporate crises and scandals
- further reduce poverty and income inequality.



Taken together, these benefits can boost the efficiency of SOEs and economy as a whole, make transactions among companies more competitive and transparent; result in more efficient allocation of resources; reduce fiscal burden and fiscal risk of SOEs; lead to greater public and private investment in critical sectors, contribute to competitiveness and growth; and reduce vulnerabilities in the financial system.

Questions and Discussion

