

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

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Technical assistance objectives and activities

- ✓ December 2016: Government of Azerbaijan requested the WB assistance in SOE governance
- ✓ January 2017: WB initiated technical assistance activities
- ✓ April and May 2017: video seminars delivered on SOE policy and ownership
- ✓ June 2017: Technical Note shared with the Government

Main objectives of this work is to support the Government of Azerbaijan in:

- (i) identification of key gaps in corporate governance of SOEs vis-a-vis relevant benchmarks or international comparators; and
- (ii) propose policy options and approaches to improving the corporate governance and financial accountability of SOEs in Azerbaijan.

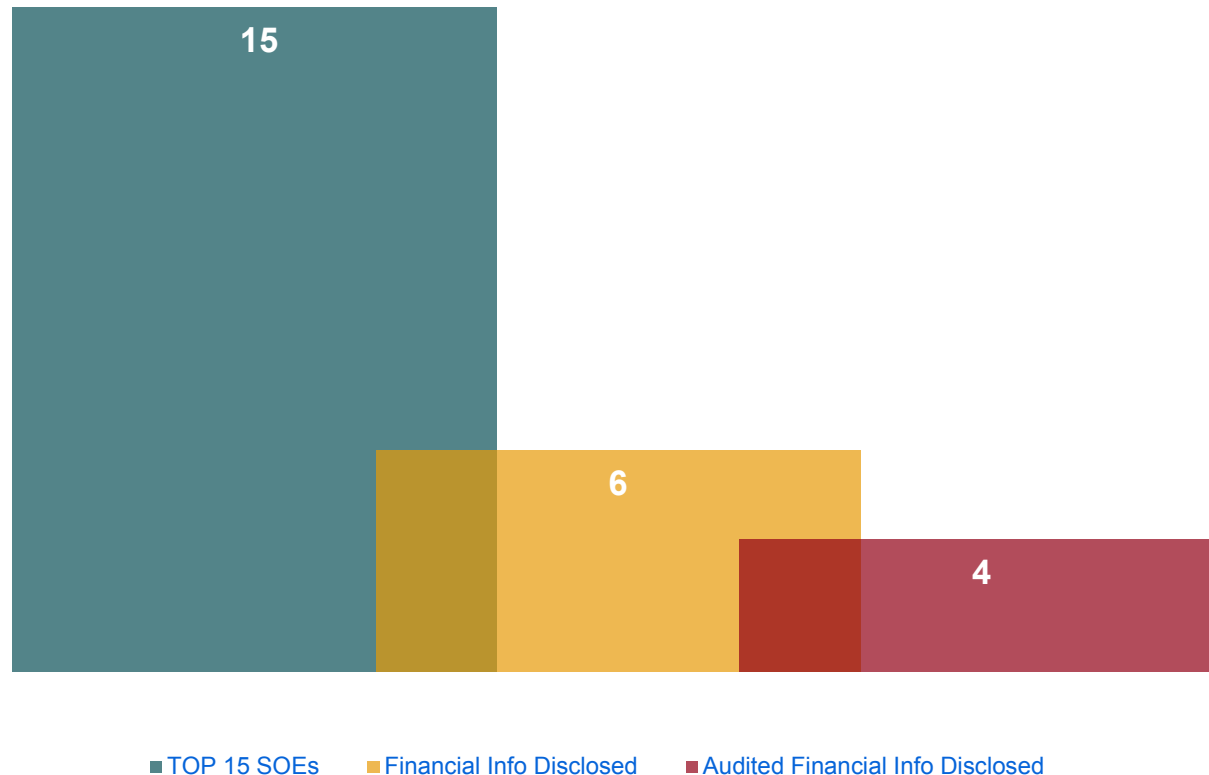


Technical Assistance

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



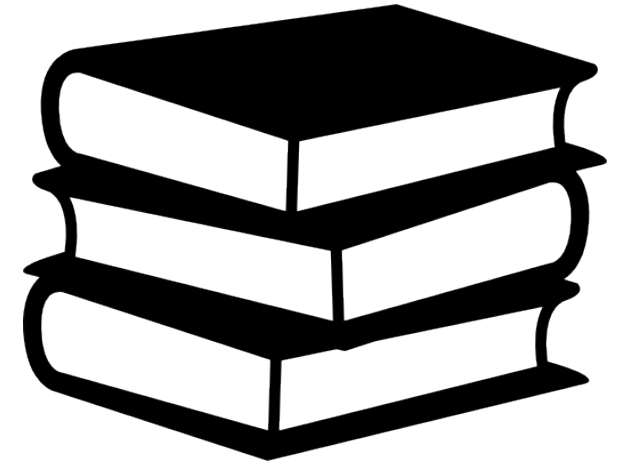
SOE landscape in Azerbaijan: data quality and accessibility

Important reform steps initiated by the President and Cabinet of Ministers

Concrete implementation steps by: Ministry of Finance, Ministry of Economy, State Committee on Property Issues

Key => launch and enforcement

Legislative Framework



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
 - ✓ Draft of 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



- Exercise Voting Rights
- Nominate Board Members
- Set and Monitor SOE Objectives
- Set SOE Reporting System
- Develop Disclosure Policies
- Liaise with External Auditors
- Establish Remuneration for Board Members

SOE Ownership in Azerbaijan

- Lack of documented 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.

SOE Supervisory Boards



Role and Functions of SOE Supervisory Boards

- Scarce legislative provisions on supervisory boards and their role
- Supervisory boards are not yet established at all SOEs
- 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
- SOEs could follow 2011 Corporate Governance Standards before the Corporate Governance package for SOEs is adopted



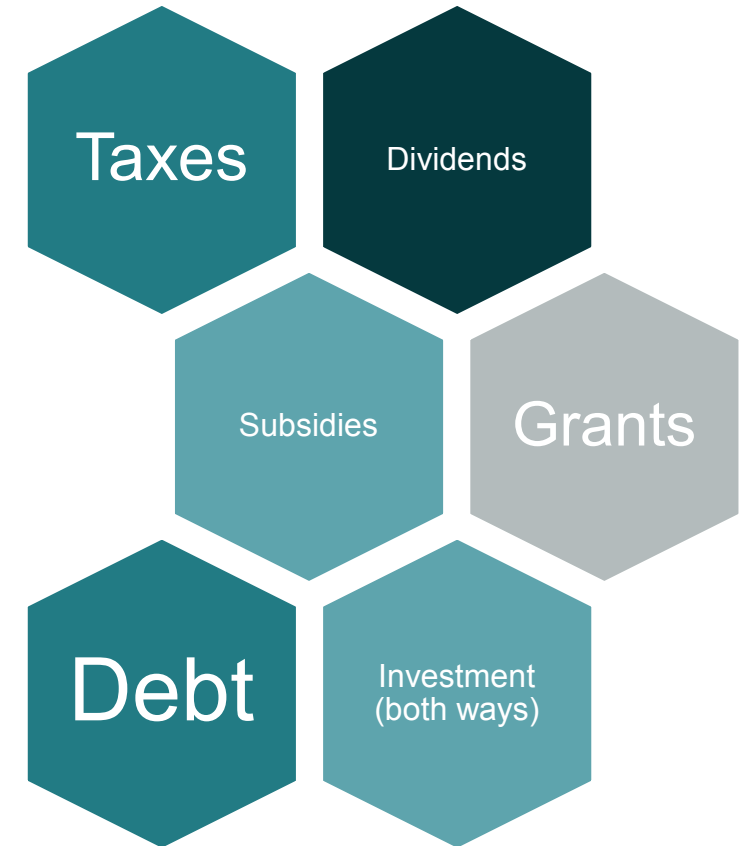
Financial reporting and accountability of SOEs

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)
- Enforce SOE publication requirements ensuring audited financial statements and management reports are publicly disclosed by SOEs

Conclusions

