



TECHNICAL ASSISTANCE REPORT

REPUBLIC OF ARMENIA

Strengthening State-Owned Enterprises Accountability Framework

JUNE 2023

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Abbreviations and Acronyms

AMD	Armenian dram
ANIF	Armenian National Interests Fund
ARFI	Armenia Financed Crowdfunding Platform
CBA	Central Bank of Armenia
CD	Capacity Development
CEO	Chief Executive Officer
CJSC	Closed Joint Stock Company
CPC	Corruption Prevention Commission
E+SACI Fund	Entrepreneurship + State Anti-Crisis Investments Fund
E+SACI Manager	Entrepreneurship + State Anti-Crisis Investments Manager CJSC
ESG	Environmental, Social & Governance
EU	European Union
FAD	Fiscal Affairs Department
FDI	Foreign direct investment
FMO	FMO (Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.) –
FRMD	Fiscal Risks Management Department
GDP	Gross domestic product
GFSM	IMF Government Finance Statistics Manual 2014 (GFSM)
GSM	General shareholders meeting
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
JSC	Joint Stock Company
MEFP	Memorandum on Economic and Financial Policies
MoF	Ministry of Finance
MTEF	Medium-term Expenditure Framework
NOK	Norwegian Krone
NWF	National wealth fund
OECD	Organization for Economic Co-operation and Development
PPP	Public–private partnership
PSRC	Public Services Regulatory Commission
RA	Republic of Armenia
SMEs	Small and Medium Enterprises
SOE	State-owned enterprise
SPMC	State Property Management Committee
SWF	Sovereign wealth fund
USD	United States Dollars

Preface

At the request of the Minister of Finance of Armenia, a team from the IMF's Fiscal Affairs Department (FAD) undertook an in-person mission from January 11 to 20 in Yerevan, to provide advice on strengthening the accountability framework of State-owned Enterprises, including the Armenian National Interests Fund (ANIF). The mission team was led by Ms. Nino Tchelishvili and included Ms. Natalie Manuilova (both FAD), and Mr. Andriy Boytsun (FAD short-term expert).

The mission team met with the Minister of Finance, Mr. Vahe Hovhannisyan, and his team from the Ministry of Finance: Deputy Minister Avag Avanesyan; Mr. Ara Avetisyan, Head of Fiscal Risks Monitoring Department, Mr. Hayk Ohanyan, Fiscal Risks Monitoring Department; Hrayr Yesayan, Budget Department; Mr. Raffi Aleksanyan, Accounting Department; and Mr. Arshaluys Hovsepyan, Accounting and Audit Regulation, Reporting Monitoring Department.

From other agencies, the team met with Narek Teryan, Deputy Minister of Economy; Mr. Armen Nurbekyan, Vice Governor of the Central Bank of Armenia; Mr. Gegham Gevorgyan, Chairman, Competition Protection Commission; Mr. Sergey Grigoryan, Deputy CEO, ANIF; Ms. Bella Manoukian, Vice President, ANIF; Mr. Arayk Abrahamyan, Acting CEO, HayPost; Mr. Ararat Movrovyan, Head of Financial Department, High Voltage Electric Networks CISC; Messrs. Zorayr Karapetyan and Karapet Oganesyanyan, State Audit Chamber.

The mission team also met with Armineh Manookian, the World Bank; Ms. Zuzana Sorocinova and Mr. Karen Azaryan, EU Delegation to Armenia; Mr. Joao Pedro Farinha and Ms. Elena Khachvankyan, Asia Development Bank; Mr. Giorgi Akhalkatsi, Head, EBRD Armenia; and Mr. Grigor Harutyunyan, Amber Capital.

The mission team would like to particularly thank Messrs. Ara Avetisyan and Hayk Ohanyan for their excellent assistance and guidance; Mr. Mehdi Raissi, IMF Resident Representative, and his team for their guidance and administrative support. The mission would also like to thank Ms. Marietta Sahakyan and Mr. Arthur Aroustamov for the interpretation support provided.

Executive Summary

The Republic of Armenia's (RA) State-owned Enterprises (SOEs) portfolio is manageable as compared to its regional peers. The government retains ownership over SOEs operating in economically significant sectors, such as energy, healthcare, and other utility sub-sectors. The total assets of the SOEs sector as a share of GDP accounted for around 10 percent at the end of 2021, lower than in most countries in the region. The Government performs SOE oversight for various purposes – fiscal risks monitoring, dividend calculation, and performance analysis. The list of monitorable entities currently varies depending on the purpose of monitoring. The synchronization of such SOE lists could ensure that all entities are accounted for, evaluated, and monitored. This would also ensure the alignment of lines of accountability, fiscal oversight, and enforcement of corporate governance and financial accountability requirements. It is advisable to maintain and publish a single, up-to-date registry of SOEs to ensure there is transparency about public ownership of SOEs. The government oversight function should prioritize macro-critical SOEs over the entire SOE portfolio, and focus analysis based on the size, importance, and risk category of the potential fiscal impacts of each entity.

To ensure the sustainability of public finances, it is critical for the MoF to be aware of and manage the fiscal implications of the SOEs sector. MoF's ability to cope with fiscal risks depends on the quality of information, the likelihood and potential magnitude of impact, and the Ministry's capacity to manage them. The MoF should aim to strengthen its mandate and role in assessing proposals to provide loans, guarantees, equity injections, and subsidies to the SOEs that it monitors. It is important to strengthen the analytical approach by incorporating analysis of financial and non-financial indicators, and ensure adequate resources and capacity to undertake this function.

The role of SOEs and their contribution to the national development priorities identified in the Government Program needs to be closely aligned. This can be achieved through: (i) revisiting the presence of SOEs across various sectors of the economy, leaving state presence only in priority sectors; (ii) increasing the effectiveness of SOEs through enhanced corporate governance practices and management models aligned with SOE performance; (iii) implementing accountability mechanisms and transparency requirements; and (iv) taking measures to prevent the establishment of any new SOEs when no apparent rationale is present.

An effective state ownership policy will be important for streamlining the state's presence across economic sectors and establishing clear accountability lines. Although Armenia has no formulated state ownership policy, the country's implicit rationale for owning SOEs is not based solely on profitability, but also covers SOEs' contribution to achieving public policy objectives. This mission recommends adopting a state ownership policy that states that Armenia will only choose to own an enterprise in one or all following circumstances: (i) to make a specific contribution to the promotion of the national development priorities and national security that cannot be made by the private sector; or (ii) to ensure the provision of critical public services when the private sector is not willing or able to provide effectively.

Implementation of good corporate governance practices in Armenian SOEs will be key to improving their performance. While many important legislative improvements, including the adoption of the Corporate Governance Code (based on a "comply or explain" principle), have been introduced over the past few years, SOE corporate governance practices remain weak. Weaknesses include low independence and engagement of boards, minimal presence of board committees, and underdeveloped

control functions. These significantly reduce SOE autonomy and efficiency. The implementation of good corporate governance practices, including strengthening the boards by adding independent professionals with strong industry expertise, should be mandated and enforced for the priority SOEs.

The Armenian SOE sector is dominated by legacy companies¹ with one notable exception – the Armenian National Interests Fund (ANIF) — established in 2019. ANIF, wholly owned by the Government, holds a very broad mandate summarized as (a) generating additional income for RA and (b) contributing to the economic development of Armenia. ANIF’s investment initiatives and projects range from the hospitality industry to consumer finance and large infrastructure projects. Due to very limited disclosure, it is impossible to assess the viability and rationale of ANIF’s investment initiatives. The information on how the investment choices relate to the company’s mandate/strategy, the outcomes and financial performance of these investments, investment and risk policies are either lacking or are not publicly available. ANIF and its two subsidiaries are 100% funded from the state budget. After carefully examining the corporate governance of ANIF against global best practices, this mission concluded that it remains relatively immature today.

From the state ownership policy, the Government should distill a clear rationale for owning ANIF and define its mandate and priorities. Should the Government determine that ANIF functions—all or part—are aligned with the state ownership policy, it should be stated explicitly. The respective ANIF decree should clearly specify the rationale for owning ANIF based on specific national economic development priorities and detail its scope: (a) the policy objectives that ANIF is required to (help) achieve; (b) sectors in which ANIF will be involved; and (c) what its role in these sectors will be. To ensure that ANIF investments are made in a responsible, efficient, and monitorable manner, a requirement should be established that ANIF investments are matched with co-investment by reputable investors and require a rate of return no lower than the cost of capital, on a project basis. In case it is determined that ANIF has no significant role in delivering government’s public policy objectives and/or competes with private sector investment, the ANIF decree should be revised and steps taken towards ANIF’s dissolution.

Table 1 summarizes the key recommendations of this mission.

Table 1. Key Recommendations

Area/ Recommendation	Time frame
I. SOE Landscape in Armenia	
Recommendation 1.1: Finalize the SOE categorization and clarification of all public sector entities into (i) SOEs; or (ii) Government Units. (MoF, MoE)	Q4, 2023
Recommendation 1.2: Focus the MoF monitoring on the priority SOEs based on the size of SOEs total assets, their net result and related risk to the public finances, as well as their importance in delivering critical public services. (MoF, MoE)	Q2, 2023

¹ Companies inherited with the country’s independence in 1991, such as Yerevan Thermal Power Plant, Armenian Nuclear Power Plant, High Voltage Electric Networks, HayPost, and others.

II. Managing Fiscal Risks from SOEs	
Recommendation 2.1: Strengthen the MoF's mandate to monitor and manage SOE fiscal risks, focusing on priority SOEs. (MoF)	Q4, 2023
Recommendation 2.2: Require SOEs to submit the ex-ante information to the MoF, including in their strategic plans, information on significant risks to financial and operational performance. (MoF)	Q2, 2024
Recommendation 2.3: Strengthen analytical approach by incorporating financial ratio analysis and other indicators. (MoF)	Q2, 2024
Recommendation 2.4: Build capacity of the FRMD to conduct stress tests of the projected financial performance of priority SOEs. (MoF)	Q4, 2023
III. SOE Governance, Accountability, and Oversight	
Recommendation 3.1: Develop a state ownership policy defining the rationale for owning SOEs based on policy objectives. (MoE, PM's office, MoF)	Q2, 2023
Recommendation 3.2: Define the rationales for owning each priority SOE and translate them into SOE-level policy objectives. (MoE, ownership entities)	Q4, 2023
Recommendation 3.3: Mandate the adoption of the Corporate Governance Code (upcoming) for all priority SOEs. (MoE)	Q1, 2024
Recommendation 3.4: Strengthen priority SOEs' boards, appoint independent professionals with strong industry expertise. (MoE, ownership entities)	Q4, 2024
Recommendation 3.5: Define additional requirements for reporting and transparency for priority SOEs, such as debt levels, significant increase of SOEs accounts payable, and other financial and non-financial indicators. (MoF, MoE, ownership entities)	Q4, 2023
Recommendation 3.6: Implement performance assessment for SOEs management aligning their incentives with SOEs performance and ensuring SOEs financial sustainability. (MoE, ownership entities)	Q4, 2024
IV. Armenian National Interests Fund	
Recommendation 4.1: From the state ownership policy, distill a clear rationale for owning ANIF and, based on that, define the scope of ANIF, or determine its dissolution if no contribution to the Government public policy objectives. (MoE, PM's office, MoF)	Q2, 2023
Recommendation 4.2: Only after establishing the rationale for owning ANIF and defining its scope, establish proper corporate governance at ANIF. (PM's office)	Q2, 2024
Recommendation 4.3: Refrain from / introduce a moratorium on any further ANIF capital injections until the above steps have been completed. (PM's office, MoF, ANIF)	Q1, 2023

I. SOE Landscape in Armenia

A. Overview of Public Sector Units

1. Over the past decades Armenia has made significant reforms to reduce the state footprint in the economy. Following the mass privatization between 1990s and early 2000s, the share of SOEs in the Armenian economy was further reduced during the past decade— the number of entities owned at the central government level went down from 480 in the 2010s to 85 in 2022 through privatization, merger, and liquidation of entities (Table 2). The number of SOEs owned at the regional government level was reduced to 68, and mainly include health and medical facilities operated at the regional level.

Table 2. Armenia’s SOE Portfolio²

	Number of SOEs with State's share above 50%	Number of SOEs with State's share of 50% and less
Central Government, Ministries, Agencies	85	14
Regional Governments	68	0
TOTAL	153	14

Source: MoF, SPMC, Mission compilation

2. The Armenia public sector remains relatively large and fragmented, leaving room for further consolidation. Public sector units categorization was carried out by the MoF with IMF assistance during 2021-2022. It took stock and categorized public sector units based on their association with the state budget and type of economic activity, classifying all public entities into: (i) Public Corporations (SOEs); and (ii) General Government Units, as per the IMF Government Finance Statistics Manual 2014 (GFSM).

3. Designation of public sector units based on their type of economic activity depends on the mandate and funding of respective institutions. With the targeted IMF technical assistance, the Government identified a total of 3,456 institutional public sector units, most of which should be treated as government units:³

- 3,214 entities were classified as General Government Units, as they do not perform commercial activities, permanently depend on Government subsidies and other types of financial support, and which are to be included in the public sector balance sheet.
- 129 entities were classified as Public Corporations – state-owned enterprises, or public financial corporations – stand-alone legal entities incorporated as entities of private law.
- 113 public units are yet to be classified by the Government.

² These statistics only include parent companies and do not include SOEs' subsidiary companies.

³ David Bailey. *Republic of Armenia: Report on Government Finance Statistics Mission* - September 27-October 8, 2021, IMF.

4. Sectorization of public sector units is important for improving public sector performance, reporting and accountability. Proper compilation and regular update of a list of all public sector units and their categories ensures the completeness of oversight and monitoring and provides transparency of fiscal reporting across the entire public sector. Once all public sector units are categorized, the Government will be able to properly account for such entities and closer align their accounts to the IMF GFSM (2014). The list will also help the MoF identify and comprehensively assess fiscal risks stemming from all types of public entities.

5. Recent analysis of public sector units identified that the Government of the RA has 230 state-owned joint-stock companies (JSCs) that need to be further re-grouped as per their purpose and activity type. Of these 230 joint stock entities owned by the State and identified by the *IMF Report on Government Finance Statistics Mission*, only 79 satisfy the GFSM criteria for the SOE definition, while 151 should be reclassified into government units.⁴

6. Governance, accounting, and reporting requirements vary across public sector units and SOEs depending on their category. While government units should be incorporated into the budget cycle and government reporting, public corporations (or SOEs) should follow good practices and recognized international standards, such as the OECD Guidelines on the Corporate Governance of State-Owned Enterprises (“OECD SOE Guidelines”) and the International Financial Reporting Standards (“IFRS”).

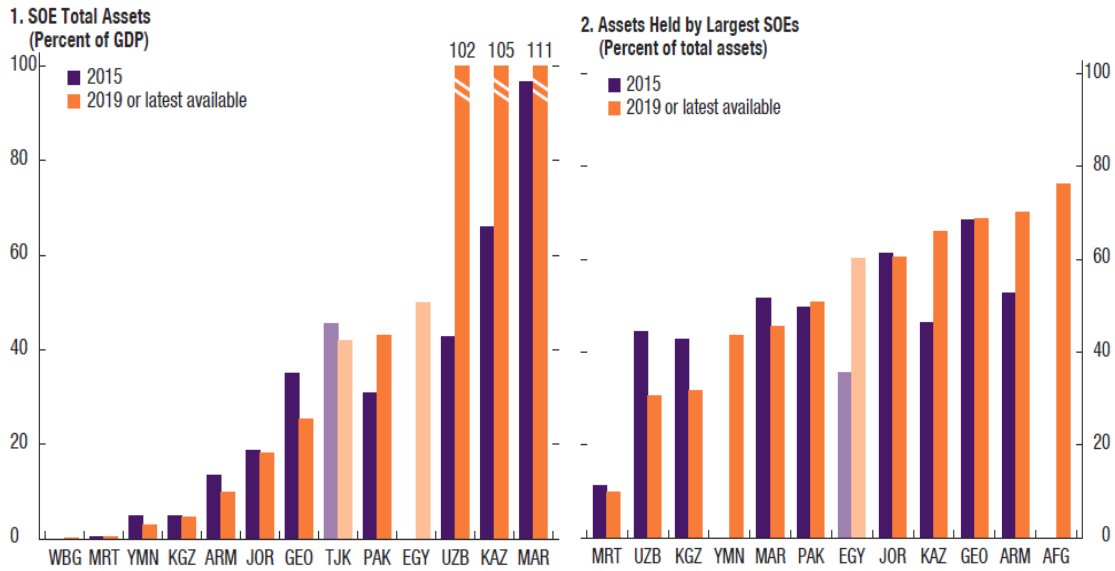
7. The rest of this section and the following section of this report focus on SOEs, which remain important players and providers of critical public services in the Republic of Armenia.

B. SOE Landscape

8. The Armenian legislation defines SOEs as companies with state participation over 50 percent, or majority owned. Such SOEs are managed and overseen by 24 government agencies, including line ministries, the Prime Minister’s office, their subordinated bodies, and regional administrations. The overall financial oversight at the SOE portfolio level is carried out by the State Property Management Committee (SPMC), based on the financial reports shared by respective ownership line ministries, agencies, and municipalities.

9. The RA has successfully reduced its SOE portfolio, as compared to its regional peers. The value of total assets of SOEs as percent of GDP was around 14% in 2015, and was further reduced to some 10% in 2019-2021, concentrated in the largest SOEs (Figure 1). The state remains the owner of strategic SOEs operating in economically significant sectors, such as energy. As of July 1, 2022, the number of majority owned SOEs stood at 153, with 85 owned by the central Government, and 68—by regional governments. SOEs in Armenia, account for a much lower share of total employment and government revenue, as compared to their regional peers— their share of total employment in the country remains below 1 percent, and they contribute less than 1 percent of total government revenue.

Figure 1. SOEs Total Assets and Concentration in the Middle East and Central Asia Region



Source: IMF (2021) *State-Owned Enterprises in Middle East, North Africa, and Central Asia: Size, Role, Performance, and Challenges*. Note, light-colored bars show data from alternative data sources.

10. The main agency that performs oversight over majority owned SOEs—the SPMC—maintains a list of SOEs held at the central government and regional levels. This list is publicly available on its website. The SPMC prepares regular reports summarizing performance data for majority owned SOEs held by the central government, and line ministries, except, for SOEs held by the SPMC itself.⁴ The MoF maintains its own SOE lists for analyzing fiscal risks and monitoring dividend calculation and receipt from the SOEs. In addition to the information prepared and published by the SPMC, the MoF receives information on respective SOEs from responsible line ministries.⁵ This data is not made publicly available. MoF utilizes the SPMC aggregated data and individual financial statements of the SOEs (when available) to produce the semi-annual Fiscal Risk Monitoring Report.

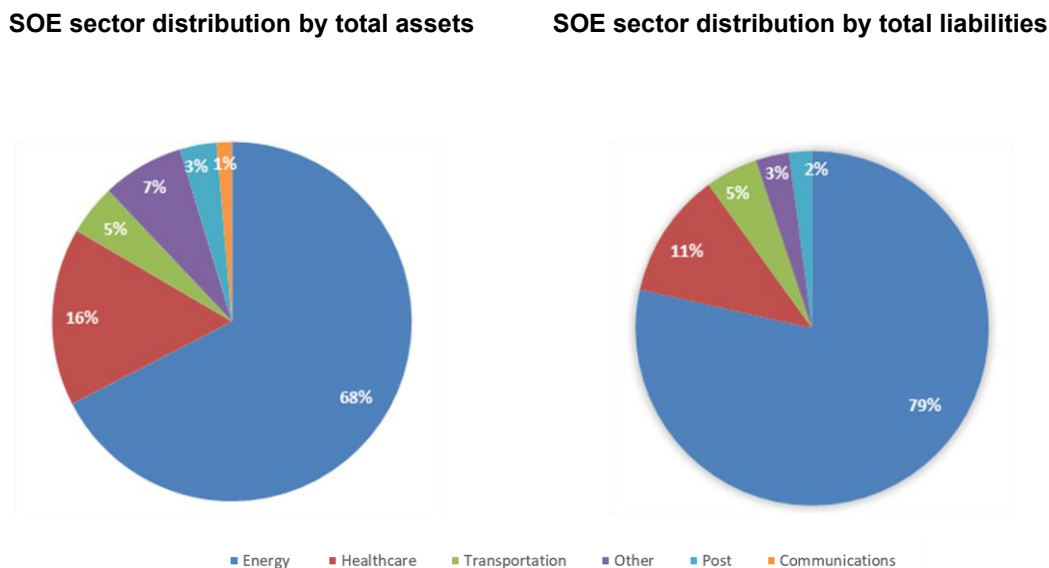


⁴ SOE is normally transferred from a central government agency to SPMC when such an SOE is slated for privatization (i.e., listed in the Law on the Privatization Program), but this mission established exceptions to that. There is at least one SOEs that is held by SPMC but not slated for privatization - Galaktika PB. Also, SPMC was not aware of the next actions related to the shares of Zangezur Copper Molybdenum Combine, which were transferred to SPMC from ANIF on December 22, 2022.

⁵ As per Government decree No. 202-N, dated March 03, 2011.

11. The majority of SOE assets are concentrated in a few entities in the energy sector, followed by companies in healthcare and other utility sub-sectors. As per the MoF Fiscal Risk Report, the largest SOEs by total assets, liabilities, and revenues belong to the energy sector – Armenian

Figure 2. SOE Sector Distribution by Total Assets and Total Liabilities (2021)



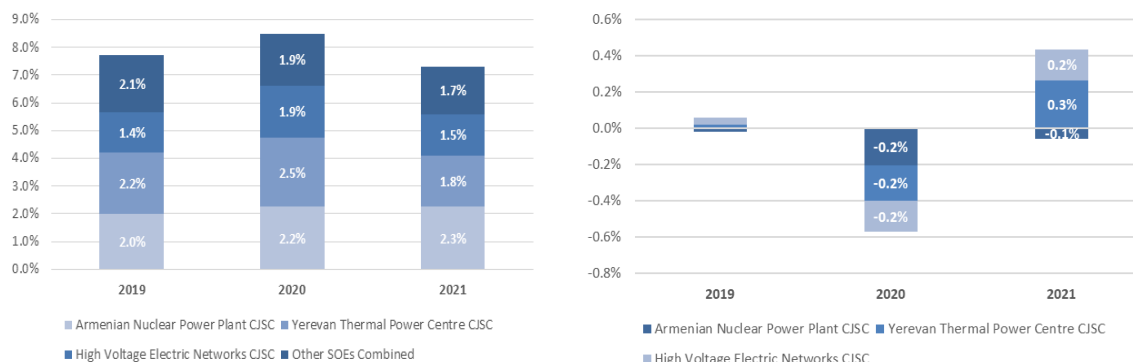
Source: Medium-Term Expenditure Plan 2023-2025, Fiscal risks analysis 2021 (MoF).

Nuclear Power Plant CJSC, Yerevan Thermal Power Center CJSC, High Voltage Electric Networks CJSC. Assets, liabilities, and revenues are highly concentrated in a small number of large SOEs (Figure 2 and Figure 3). The total assets of SOEs sector as a share of GDP accounted for around 10 percent at the end of 2021.⁶ The assets of the three largest SOEs account for more than half of total SOE assets in the country, reaching AMD 455.9 billion as of 2021, or 6.5 percent of GDP.⁷

C. Prioritization of SOEs

12. While further re-categorization is necessary, the Government should prioritize their efforts

Figure 3. SOE Sector Dynamics by Total Liabilities and Net Results



Source: Medium-Term Expenditure Plan 2023-2025, Fiscal risks analysis 2021 (MoF)

to improve corporate governance and strengthen oversight over the priority SOEs. Over the past decade, the Government has taken concrete steps to address SOE challenges, focusing on improving their financial transparency and fiscal viability. Despite these steps, progress is not evident. Therefore, focusing the legislative enforcement and implementation of good practices on the priority SOEs and improving their corporate governance, financial reporting, and transparency could bring tangible results and strengthen the fiscal risks oversight. This enforcement should be combined with further efforts to reduce the number of other SOEs—those that do not correspond to the Government strategic priorities and its ownership rationale.

13. Government oversight should prioritize macro-critical and high risk SOEs over the entire SOE portfolio. Presently, the Government exercises oversight over the entire SOE portfolio—by the line ministries, SPMC, and MoF. Some SOEs perform poorly, raising concerns about both public service delivery and fiscal risks for Armenia’s budget. SOEs may require equity injections, subsidies, and loans from the state budget or international financial institutions, while their service delivery to citizens remains sub-optimal, and their contribution to the Government in the form of taxes and dividends is insignificant.

14. Currently, the Government does not prioritize among the SOEs, thus diluting oversight focus among multiple SOEs in various sectors, which is not efficient. MoF and the SPMC analyze all SOEs equally, while their contribution and risk to the state budget vary considerably. Oversight can be prioritized based on the size and importance of each entity, as well as its financial performance and the size of its liabilities, assigning a priority and risk category for prudent risk management. The mission proposes a list of priority SOEs, as defined by their assets, net results, and critical public service delivery (Table 3).⁸ Should the Government accept the priority SOEs approach, their in-depth financial and fiscal

Table 3. Proposed Priority SOEs, as Defined by Assets and Net Result (2021)

	SOE	Total Assets AMD, million	Net Result AMD, million
1	Armenian Nuclear Power Plant CJSC	190,102	(4,085)
2	Yerevan Thermal Power Centre CJSC	137,083	18,568
3	High Voltage Electric Networks CJSC	128,873	11,620
4	Haypost CJSC	21,003	(238)
5	Karen Demirchyan Yerevan Metro CJSC	15,296	1,370
6	Electro Power System Operator CJSC	14,249	1,232
7	Nairit 2 CJSC	13,580	(1,078)
8	Yerevan Bus CJSC	13,215	(726)
9	Fanarjyan National Centre of Oncology CJSC	10,425	147
10	Armenian National Interests Fund CJSC	5,875	(797)

— Source: 2021 individual SOEs financial statements

⁸ Based on the mission analysis, the following threshold is proposed for priority SOEs: (i) total assets exceeding AMD 10 billion; or (ii) budget loans or guarantees exceeding AMD 1 billion; or (iii) net loss exceeding AMD 500 million.

risks analysis would cover largest SOEs by total assets (AMD 552.6 billion), or an equivalent of 7.9 percent of GDP.

15. Differentiated approach need be applied to monitor the priority SOEs operating in sectors bearing higher risk. The Armenian SOEs are dominated by the “legacy” companies inherited by RA with its independence in 1991 and operating in the infrastructure and utility sectors (energy, transport, water). One notable exception to this is ANIF—a recently established SOE with a broad investment mandate to generate additional income for RA. The mission could not determine or confirm the rationale for establishing the ANIF or identify any of its underlying investment and credit risk policies. The information on how the investment choices relate to the company’s mandate and strategy, the outcomes and financial performance of these investments, investment and risk policies are either lacking or are not publicly available. ANIF and its two subsidiaries are entirely funded from the state budget. As investment operations bear specific risks and do not guarantee a return, the mission recommends including ANIF into priority SOEs list and subject it to the same or higher scrutiny for fiscal impact and risk assessment.

D. Recommendations

Recommendation 1.1: Finalize the SOE categorization and clarification of all public sector entities into (i) SOEs; or (ii) Government Units. This will result in a complete, up-to-date, publicly available list of all SOEs, including at the regional government level.

Recommendation 1.2: Focus the MoF monitoring on the priority SOEs. The mission proposes a list (Table 3) based on the size of SOEs total assets, their net result and related risk to the public finances, as well as their importance in delivering critical public services.

II. Managing Risks from SOEs

A. Background

16. The authorities are increasingly concerned about the potential significance of different types of fiscal risks. To address such concerns, the MoF has made a commitment in the Memorandum on Economic and Financial Policies (MEFP) to conduct comprehensive monitoring, assessment, and management of fiscal risks, including SOE-related fiscal risks. It is creating a momentum to address the institutional and legal framework to manage such risks more efficiently.

17. The MoF has made steps to refresh and strengthen the fiscal risks management function and developed ambitious plan to steer these efforts. The Fiscal Risks Assessment Division has been operational in the Budget Block since 2014 tasked to prepare materials for fiscal risks disclosure from corporations with state ownership, regardless of the size of state ownership, providing regulated public services; receiving loans, guarantees, or subsidies from the state budget; and involved in PPP arrangements. In August 2022, the Ministry of Finance, as part of its broader restructure, established a Fiscal Risks Management Department (FRMD),⁹ on the basis of the Financial Market Analysis and Development Department and the Financial Statistics and Risks Department of the Ministry of Finance.¹⁰ Macroeconomic Policy Department and Public Debt Department prepare extensive analysis of macroeconomic and debt related risks, respectively. FRMD has set out the reform actions and measures

Box 1. 2022–23 Roadmap for Improvement of Fiscal Risks Management: Fiscal Risks Arising from the Activities of the State-owned Companies

- **Assessment:** Analysis of the financial state of the State-owned companies, sampling analysis of the special and systematic risks related to the State-owned companies.
- **Vetting Functions:** Studying the decision-making mechanisms for establishing companies, acquiring shareholding, replenishing capital by the state, as well as studying the large transactions concluded by the State-owned companies, and submission of recommendations.
- **Risk Monitoring:** Collection of financial indicators and monitoring are carried out for all selected major companies.
- **Mitigation Measures:** Stock-taking of risk mitigation measures and submission of preliminary recommendations for those measures".
- **Reporting:** Inclusion of fiscal risk statements in the MTEF and the State Budget, publication of intermediate fiscal risk report.

Source: The MoF

for risks arising from SOEs activities set out in the 2022-2023 Road Map (see Box 1).

⁹ Presently, FRMD consists of six staff organized around the thematic areas stated in the mandate.

¹⁰ The MoF RA order N 291-L, August 2022.

18. The implementation of these ambitious reforms will require dedicated resources and substantial enhancement of MoF capacity. The FRMD is mandated to assess the potential impact of unfavorable development on budgets related to SOEs, contingent liabilities from PPP contracts and other infrastructure projects, as well as from financial sector, environment, long term fiscal sustainability perspectives.¹¹ Present staff allocated to this important function is six people, which is not sufficient to cover such a wide spectrum of risks. To meaningfully implement their functions, the FRMD should be allocated additional resources, and their capacity be continuously strengthened.

19. Over the past six years, the MoF prepared a fiscal risks report focused primarily on large corporations and PPP arrangement in the energy, transport, and water sectors. The methodological guidelines¹² have been developed at the earlier stage of reforms with the support from the FAD¹³, as well as the capacity development support from the Asian Development Bank, including through hands-on training. The fiscal risks reports, until 2022, incorporated the financial ratio analysis¹⁴ to assess the likelihood of materialization of fiscal risks derived from SOEs and PPPs.

20. Presently, the MoF prepares and publishes fiscal risks reports twice a year. The Law on the Budget System of the Republic of Armenia requires this to include the information on major fiscal risks in the Medium-term Expenditure Framework (MTEF) and updated information in the Draft Budget. In 2022, the fiscal report on “Assessment of Fiscal Risks Associated with the Activities of Organizations Operating in Infrastructure and Other Areas” was published in June, as part of the 2023-2025 MTEF, and the updated report was published in December as part of the 2023 Budget Documentation. December 2022 report includes following:

- SOEs
- Private companies in the energy sector
- Review of budget lending
- Analysis of the contingent liabilities stemming from PPP contracts
- Fiscal risks stemming from natural and anthropogenic disasters
- Fiscal risks stemming from legal proceedings against the state
- Actions aimed at management of potential environmental risks and issues related to the assessment of liabilities
- Fiscal risks stemming from the financial sector.

¹¹ With the FAD support the MoF recently developed a framework for assessing the impact of climate change on budgets and long-term fiscal sustainability.

¹² Guidelines for fiscal risks assessment approved by the Order of the RA Minister of Finance N439-A on 14.09.2018; Methodology for Calculation and Assessment of the Contingent Liabilities of the Republic of Armenia approved by the RA Government decree N1785-L “On Approving the” dated on 06.11.2020.

¹³ Armenia: Strengthening Fiscal Risks Assessment. John Zohrab and Vladimir Krivenkov, 2017.

¹⁴ Cost recovery ratio, Net profit margin, Debt service ratio, Refinancing ratio, Z- score.

B. MoF's Mandate in Managing SOEs Fiscal Risks

21. The MoF currently has a limited role and no legal authority in controlling the fiscal implications from SOEs. The MoF's role in integrating SOE's financials into budget process is formalized on the revenue side, including on forecasting the amount of dividends to be received from SOEs. The role of the MoF, in the name of FRMD, in assessing proposals to provide loans, guarantees, equity injections and subsidies to SOEs is not institutionalized. As a general practice, budget transfers to SOEs are planned by responsible line ministries and are being allocated as part of the budget planning process. However, in the case of ANIF, the MoF received a decision to allocate budget to the Prime Minister's office during the budget year, which was implemented through within-year budget re-allocation, without a parliamentary vote.

22. To ensure the sustainability of public finances, it is critical for the MoF to be aware of and to have an ability to manage the fiscal implications of SOEs. MoF's ability to cope with fiscal risks depends on the quality of information about the potential likelihood and magnitude of impact of these risks, and the capacity to manage them. The MoF needs to have access to reliable and timely information on the financial situation of major SOEs and be in a position to analyze this information. To detect early signs of potential risks and their materialization, the MoF should consider requiring the SOEs to submit ex-ante information on significant risks to their financial and operational performance, including from their strategic plans.

23. The MoF needs to have the responsibility and the power to prevent or influence decisions related to SOE activities or support measures that are fiscally not affordable. There is a range of measures and techniques that can assist in mitigating fiscal risks arising from SOEs.¹⁵ For example, the Government could introduce controls to limit fiscal exposure by reducing the size of SOEs or by imposing caps on the liabilities that one SOE can accumulate. The Government may also request to reduce risky activities, or ensure the sharing of risks, for example, by introducing explicit no-bailout clauses. The latter, however, may not be applicable for SOEs that provide critical public services, which are typically expected to be bailed out (i.e., so called implicit guarantees), even if not directly guaranteed.

24. It is important to identify focus area and prioritize SOEs to be monitored by FRMD. Given the capacity and resource constraints, it is necessary to focus on the areas that are either macro critical and/or impose the highest risks. For the identification of major SOEs the size of the entity and its exposures for government, i.e., employment, liabilities, those that are loss making or receiving state support, and those that are of strategic importance or macro-relevance, should be considered (as discussed in Section I).

C. Analytical Approach

25. The present coverage of fiscal risk reports is comprehensive, but the analytical approach is limited. FRMD has collected and reviewed 2021 financial statements of all SOEs under their purview. The report gives the aggregate picture of financial positions and financial results of major SOEs and categorizes them by low, medium and substantial risks based on the analysis of the budget loans and

¹⁵ IMF (2016): How to improve the financial oversight of public corporations.

guarantees, accumulated losses and liabilities over the past three years. The MoF has discontinued applying the existing methodology and plans to develop new guidelines allowing more comprehensive analysis of SOEs performance.

26. A number of ready-to-use tools are available for the FRMD to employ, including those developed by the IMF (Figure 4). Fiscal Risks Toolkit was specifically designed to offer practical tools to identify, quantify and monitor fiscal risks, including from the SOEs sector, to strengthen SOEs oversight and fiscal risk management. Various tools included in the IMF Toolkit can allow the Armenian authorities to assess and monitor those priority SOEs that are more likely to pose fiscal risks and thereby help inform

Figure 4. IMF Fiscal Risk Toolkit

- **Fiscal Risk Assessment Tool (FRAT)** provides a high-level portfolio perspective on a wide range of fiscal risks.
- **Public Sector Balance Sheet (PSBS)** Assessment can identify fiscal vulnerabilities and opportunities, to inform better management of fiscal risks.
- **SOE Health Check Tool (SOE-HCT)** assesses the financial vulnerability and risks emerging from SOEs, to help identify and monitor high-risk SOEs.
- **SOE Stress Test Tool (SOE-ST)** provides a forward-looking assessment of the resilience of an SOE’s financial position under a range of alternative scenarios. It assesses an SOE’s financial position under a baseline and macroeconomic stress scenario and quantifies the potential impacts on public finances.



Source: <https://www.imf.org/en/Topics/fiscal-policies/Fiscal-Risks/Fiscal-Risks-Toolkit>Source: <https://www.imf.org/en/Topics/fiscal-policies/Fiscal-Risks/Fiscal-Risks-Toolkit>

early and targeted interventions or avoid crisis situations.

27. The SOE Health Check Tool (SOE-HCT),¹⁶ is designed to assess the financial health of non-financial SOEs based on their financial performance and financial position. The Tool allows to analyze a set of financial soundness indicators (e.g., profitability, solvency, and liquidity), which is important for assessing the likelihood of fiscal risk realization, as well as the potential impact of fiscal risks on public finances and can be used to categorize an SOE’s level of risk. In addition, transactions between the government and SOEs, including subsidies, loans, equity injections and contingent liabilities, are analyzed. The assessment uses historical financial data, as well as, forward-looking financial projections, where available, to assess how an SOE’s risk profile evolves over time. The Tool provides a starting point for SOE vulnerability assessment and can be complemented by more in-depth analysis of the underlying drivers of financial performance as well as the IMF’s SOE Stress Test Tool which examines the resiliency of an individual SOEs financial position.

¹⁶ IMF SOE Health Check Tool templates and guidelines are available here: <https://www.imf.org/en/Topics/fiscal-policies/Fiscal-Risks/Fiscal-Risks-Toolkit/Fiscal-Risks-Toolkit-SOE-HCT>

28. SOE HCT is useful to identify the SOEs experiencing financial difficulties and which may require fiscal support. It can also help the MoF to prioritize its monitoring effort by focusing on those entities which show a high or very high risk. The potential direct fiscal impact depends on the liabilities that would need to be taken over by the government or the transfers that the government would need to provide to cover the losses of an entity. Their potential indirect fiscal impact may, for example, stem from the cost of mitigating measures needed in case of any adverse social impact in case a SOE has to be restructuring or closed down. Given that Armenia's largest SOEs hold significant amount of debt and generate losses, the financial ratio analysis should focus on SOEs financial sustainability and debt levels. Section III provides considerations for introducing additional requirements for assessing the financial sustainability of priority SOEs.

29. Financial analysis should be complemented by assessment of qualitative indicators. Qualitative indicators can help strengthen understanding of underlying risk drivers, which can in turn help inform advice on appropriate mitigation measures. Box 2 provides guidance on some qualitative indicators that can be used to supplement financial ratio analysis, such as the entity's operating and regulatory environment, governance structures and presence of public service obligations. Some of the

Box 2. Qualitative Indicators for SOE Risk Analysis

Regulatory environment, including recent changes: Is the SOE subject to the same regulations and taxes as private firms in the industry? Are prices market based or regulated? In regulated sectors, is the tariff-setting regime compatible with the long-term sustainability (i.e., are prices informed by input costs or social objectives)?

Managerial Independence: Does the SOE have independence over operational decisions required to achieve its financial and other objectives, its wage remuneration and hiring decisions?

Management and Personnel: Does the SOE's strategic plan include clear financial and operational performance indicators which can be measured and are reported against? Does management have the requisite professional skills to deliver on its objectives? Does management of the SOE effectively identify, monitor, and manage risks?

Governance: Is there adequate separation between the government's regulatory and policy functions and its functions as owner of the SOE? Does the SOE have an effective supervisory board, selected based on transparent and professional criteria? Is the board comprised of non-executive and independent members? Does the SOE have effective internal control and audit arrangements?

Quasi-fiscal activities: Does the SOE have public service obligations or perform functions or absorbed costs which were not directly related to its business objective? Are these significant? Are they clearly defined in its agreement with the shareholder and fully compensated by the government?

Source: Adapted from IMF (2007) "Public Enterprises and Fiscal Risks — Lessons from Pilot II County Studies," SM/07/368 and IMF (2007).

qualitative indicators that can be used to supplement financial ratio analysis include the entity's operating and regulatory environment/any changes to regulations that may increase the potential impact on budgets, governance structures and presence of public service obligations. Assessment of these indicators will involve judgement and requires knowledge of the SOEs operating environment and internal governance and management structures and capabilities.

30. Qualitative indicators can be helpful for Armenia to enforce the SOEs' compliance with corporate governance and transparency requirements. For example, the Government may consider introducing the following qualitative indicators: (i) Corporate Governance code application; (ii)

appointment of professional independent members to SOE boards; (iii) timely publication of complete audited financial statements; etc. Such qualitative indicators could be instrumental in improving quality and compliance of SOEs with the existing governance and transparency requirements.

31. The IMF's SOE Stress Test Tool¹⁷ is a useful additional tool to supplement the SOE financial analysis by examining the impact of changes in macro-fiscal forecasts on SOE finances.

The SOE Stress Test Tool generates projections for an individual SOE's cash flow and balance sheet aggregates and calculates the net inflows or outflows from the budget under different macro-fiscal forecast scenarios. While other fiscal risk analysis tools typically focus on explicit or direct risks, stress testing also captures implicit and indirect risks (e.g., potential for reduced dividends or need for future recapitalization or assumption of liabilities). The Tool also provides support in benchmarking SOE performance against other SOEs operating in the same sector internationally.

32. The above analytical approaches can be used to develop internal reporting on fiscal risks.

It is useful for the MoF to produce a summary report of the SOE sector providing an overview of performance (as indicated by a limited subset of key indicators) and summary of the outcomes of the risk assessment based on the financial ratio analysis and degree of state support or accumulated liabilities. These reports and analyses should also be informed by discussions with the SPMC, relevant line ministries, and analyzed SOEs. Further information on underlying risk factors and interpretation of SOEs' financial indicators should be included in the report.

D. Resources and Capacity

33. The authorities are aware of the resource and capacity constraints that need to be addressed to meet their aspirations. Currently FRMD consists of six staff, out of whom only one staff is dedicated to conduct SOEs related administrative and analytical work. This compares low to peer countries in the region. For example, Georgia has four dedicated staff in the Fiscal Risks Division working on SOEs fiscal risks. Tajikistan has established a SOE Monitoring Department in the MoF specifically dedicated to SOEs fiscal risks. Building technical capacity of staff as well as adoption of analytical tools will be essential in establishing the MoF's leading role in managing fiscal risks from various sources.

34. It is encouraging that the authorities are engaged in active dialogue with the development partners to support their capacity development initiatives. Besides the targeted capacity development (CD), FAD has agreed to the secondment request from the MoF. Comprehensive CD support program from ADB is ongoing and aimed at strengthening analytical capacity to assess risk of materialization of the fiscal risks derived from SOEs and PPPs and developing the methodological guidelines. The SOEs fiscal risks analysis tools were not the focus of this mission, however, the team encouraged the authorities to familiarize with and apply the FAD fiscal risks management toolkit and offered further support if need be.

¹⁷ IMF SOE Stress Test Tool templates and guidelines are available here: <https://www.imf.org/en/Topics/fiscal-policies/Fiscal-Risks/Fiscal-Risks-Toolkit/Fiscal-Risks-Toolkit-SOE-ST>

E. Recommendations

Recommendation 2.1: Strengthen the MoFs mandate and capacity to monitor and manage SOE fiscal risks by:

- Defining the priority SOEs monitored by the MoF
- Formalizing the FRMD's role in assessing proposals to provide, loans, guarantees, equity injections and subsidies to the SOEs that it monitors.
- Ensure adequate resources – staffing and technical capacity – to perform the SOE fiscal risks monitoring.

Recommendation 2.2: Require SOEs to submit the ex-ante information to the MoF, including in their strategic plans, information on significant risks to financial and operational performance.

Recommendation 2.3: Strengthen the analytical approach by incorporating the SOE health check tool, which applies financial performance analysis and other indicators.

Recommendation 2.4: Build capacity of the FRMD to conduct stress tests using the SOE Stress Test tool of the projected financial performance of priority SOEs against variations in key indicators.

III. SOE Governance, Accountability, and Oversight

A. Rationale for State Ownership and Ownership Model

SOEs and national priorities

35. The Government of Armenia currently implements its five-year program (2021-2026) that identifies investment-driven growth and increased public spending on human capital and infrastructure, as its priorities. The program places great value on supporting growth in its private sector and utilizing relevant private public collaboration vehicles to develop its infrastructure and energy security. The Program prioritizes effective use of public resources, as well as targeted use of public investment funds for the creation and enhancement of quality infrastructure.

36. The role of SOEs and their contribution to the Government Program implementation need to be closely aligned. This can be achieved through: (i) revisiting the SOE presence across various sectors of the economy and keeping the state's presence only in priority sectors; (ii) improving performance of SOEs via enhanced corporate governance practices and management models aligned with SOE performance; (iii) implementing accountability mechanisms and transparency requirements; and (iv) taking measures to prevent the establishment of any new SOEs when no apparent rationale is present.

State ownership policy

37. The RA has no formulated state ownership policy. The Government Program deals with state property management as such, but it does not spell out the rationale for owning SOEs. The Program *does* set out national development priorities, which infer that Armenia's (implicit) rationale for owning SOEs is based not only on their profitability, but also suggests SOEs' contribution to achieving public policy objectives. The Program discusses state property management, focusing on improving the registration, monitoring, and use of state property, privatization of the more profitable SOEs and more liquid property. The Program also briefly states that the Government intends to *"use the existing property units in order to promote the implementation of investment programs in the Republic of Armenia that are integrated in international value chains and shape institutional knowledge."* However, there is not yet an explicit statement of the rationale for state ownership, based on the broader policy objectives.

38. The RA Government will benefit from formulating a state ownership policy. An effective state ownership policy is the foundation for streamlining the state's presence across economic sectors and prioritizing public investment. It defines the state's role in the governance of SOEs, establishes the accountability lines for the state, and outlines the respective roles and responsibilities of the public agencies involved in its implementation. It should also serve as a basis for streamlining the SOEs presence across the sectors and provide clear guidelines and criteria for establishing any new SOEs.

39. A formally defined rationale for owning SOEs enables the government to prioritize the presence of SOEs in key sectors and focus on policy objectives. Governments keep control of enterprises for several reasons: to maintain the operation of natural monopolies where market regulation is deemed infeasible or inefficient (e.g., energy generation); to support economic and strategic goals that

are of the national interest, or raise security concerns—for example, keeping certain sectors under national ownership, or shoring up failing companies of systemic importance (nuclear energy, weapons productions, oil and gas); or to sustain employment in times of crisis (see Annex I for an illustrative list).

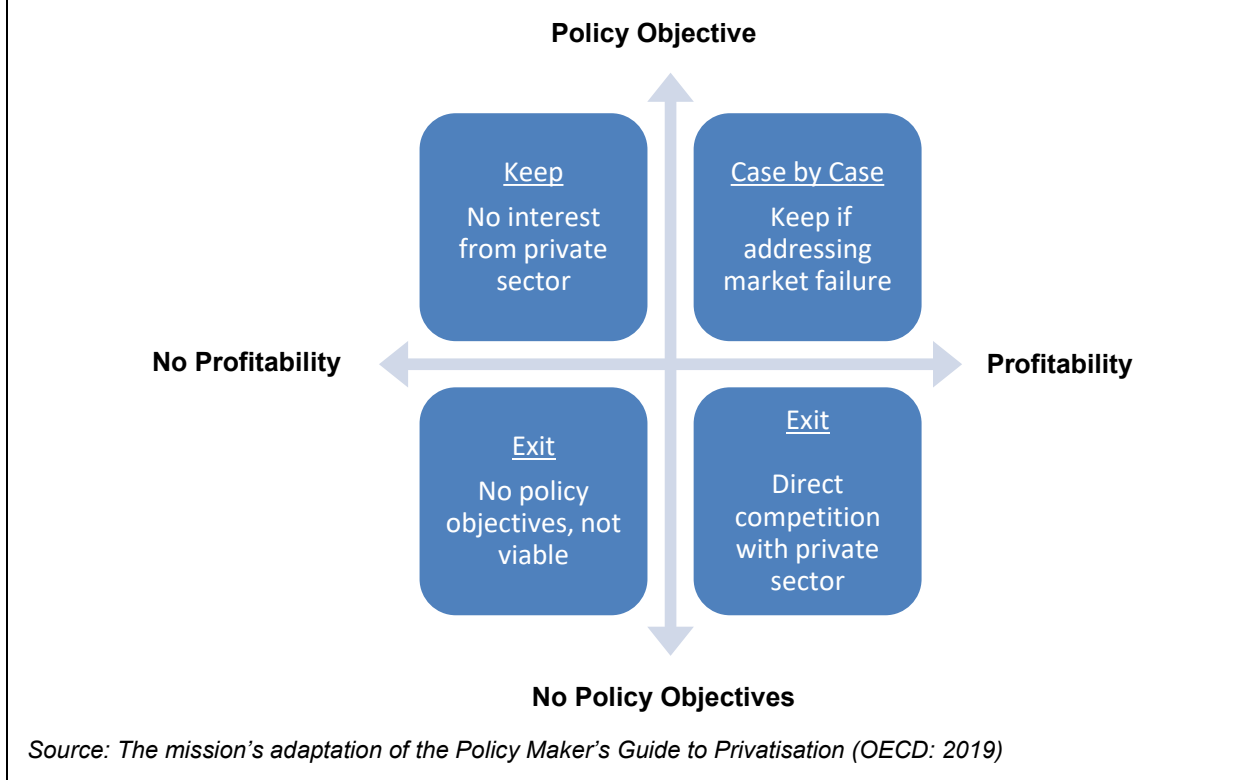
40. A well-formulated state ownership policy would typically cover the following issues: (see also Annex II for state ownership policies of selected countries):

- Rationale for state ownership: justification for state ownership with short-term and longer-term goals, such as addressing social problems, promoting social goals, correcting market dysfunctions, encouraging development where the private sector is absent, and economic diversification. Desired outcomes will indicate which enterprises should be state owned.
- Types of enterprises covered by the ownership policy: commercial enterprises providing a product or service, and enterprises with sectoral policy objectives that operate in a regulated environment.
- Criteria under which SOEs operate, including commercial sustainability of SOEs, importance of enterprise value, relative to social objectives, associated performance measures, and the calculation of (and compensation for) costs of noncommercial objectives.
- Effective and efficient delivery of public services for those SOE remaining in public ownership.
- Roles and responsibilities of specific institutions: the ownership entity (SOE Management Agency), SOE boards, SOE management, and independent regulators.
- Requirements for transparency and public disclosure, including financial reporting and public disclosure requirements.

41. Once the Government identifies the rationale for ownership in its SOEs, there are three potential scenarios. As Figure 5 shows, depending on the presence of policy objectives and profitability of each individual SOE, the Government should choose to: (i) exit if there is no clear or explicit rationale, particularly where there is direct competition with private sector participants; (ii) evaluate each SOE on a case-by-case basis and identify alternative mechanisms for private sector participation to achieve the relevant policy objectives; or (iii) keep SOEs if they are unprofitable but address a market failure with no alternative mechanisms. In the first and second scenarios, SOE participation is more likely to distort the private sector competition (Figure 5).

42. The Armenian state ownership policy should be closely aligned with the Government Program priorities, clearly defining the rationale for SOE ownership with explicit criteria and accountability lines for all parties involved. Specifically, the mission recommends that the Armenian state ownership policy should be based on the following rationales for the state to own an enterprise: (i) to make a specific contribution to the national development priorities and national security that cannot be made by the private sector; or (ii) to ensure the provision of critical services to the public when the private sector is not willing to provide such services. It should clearly allocate responsibilities among all key stakeholders, such as the SOE ownership entities (line ministries, public agencies, regional governments), MOF, SPMC, SOE boards and management, and independent regulators, thus helping to avoid overlap of roles and responsibilities.

Figure 5. Evaluating the Rational for SOEs



43. The state ownership policy should also clearly define the criteria for establishing and terminating state ownership. Establishment of any new SOEs must clearly follow the state ownership policy, directly contribute to the Government's policy priorities, and allowed only in cases when private sector participation is not possible. The resulting policy should be openly available and be subject to regular reviews.

44. After the rationale for owning SOEs is defined, such entities' mandate, governance arrangements and accountability requirements, as well as financial viability will need to be strengthened (as further proposed). Entities that do not correspond to the rationale in the state ownership policy could be put on a divestment path.

Ownership Model

45. A clear institutional basis is the foundation of a strong state ownership policy. One of the state's primary responsibilities toward SOEs is to act as an informed and active owner. In this role, the state should ensure that the governance of SOEs is carried out in an informed and accountable manner, with a high degree of professionalism and effectiveness.¹⁸ To carry out this important function, countries establish different models for exercising their ownership rights over SOEs.

46. In Armenia, various ownership entities are responsible for the exercise of the state ownership function, and the system is decentralized. Various line ministries, public agencies, and regional governments all make key ownership decisions for the SOEs within their mandate and sector.

¹⁸ OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015).

They vote in shareholder meetings, and thus approve capital increases and changes to SOEs charters, monitor and evaluate their financial performance. These agencies nominate or appoint board members and may appoint chief executives.

47. The decentralized model emerged from legacy systems. Historically, governments organized their activities under line ministries, which were responsible for all aspects of SOE management and oversight. State ownership arrangements have evolved over time as governments sought to reform SOEs, improve their efficiency, productivity, and accountability, while reducing the impact on private sector development. As per OECD, ownership models fall broadly into four models: decentralized, dual, advisory, or centralized. There are no bold lines separating ownership models; in fact, many countries may be categorized under one type of ownership model,¹⁹ but may also retain aspects of other models for some or all SOEs.

48. In Armenia, the regulatory and ownership functions of the state are duly separated, consistent with good practice. Strong sector regulations minimize an inherent conflict between the State's role as a market player (via SOE) and a market arbitrator. Establishing a strong and independent sector regulator is a fundamental prerequisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition. In Armenia, the Public Services Regulatory Commission (PSRC) carries out sector regulations for delivering services in such sectors as electricity, natural gas, district heating, water, wastewater, telecommunication, post, and railway. This way, the Government has a clear separation of functions between its ownership and sector regulation mandates.

49. While many countries are transitioning towards a more centralized SOE ownership model, this is not an urgent priority for Armenia given its progress in streamlining its SOE portfolio. The RA's SOE portfolio is rather contained with its largest and most strategic SOEs concentrated in the energy sector. At the same time, the existing SOE ownership arrangements must be significantly strengthened to achieve a more effective oversight system through:

- instilling robust corporate governance practices at SOEs,
- enforcing their financial reporting and disclosure requirements, and
- significantly strengthening the fiscal oversight mandate of the MoF.

50. Enforcement mechanisms by the fiscal oversight authority, such as MoF, are critical to enable SOEs accountability. In addition to the respective bodies in charge of SOEs, such as line ministries, public agencies, and regional governments, the MoF should be empowered with the clear authority to oversee the fiscal risks of the country's most important SOEs and advise the Government of the RA in case of risks to the public finances, particularly if these may lead to or result from SOEs' failure to deliver critical public services. Such capacity and authority must be supported by formal regulations and procedures that enable such a mandate (Figure 6).

¹⁹ For the purposes of this Report, the term "ownership model" does not refer to what entity is the legal owner of SOEs or their shares, but rather to the manner in which ownership rights are exercised.

Figure 6. Features of Strong SOE Oversight System



Source: IMF Mission

B. Corporate Governance of SOEs

51. Good corporate governance is the foundation for sustainable and financially healthy SOEs. Compared with private sector companies, SOEs face distinct governance challenges that directly affect their performance. These challenges include multiple ownership entities, competing goals and objectives, protection from competition, undue political interference, and low levels of transparency and accountability. Facing such challenges and considering their strategic role in providing key infrastructure and public services, it is vital to ensure that SOEs follow good corporate governance practices.

52. The OECD SOE Guidelines provide an international benchmark of best practices. Agreed between OECD member states in 2005 and further developed in 2015, the guidelines are recommendations to governments towards efficient, transparent, and accountable operation of SOEs. They aim at professionalizing the state as an owner, making SOEs operate with similar good practices as private enterprises, and ensuring competition between public and private firms at level playing field. Good SOE corporate governance practices are summarized in Table 4. Annex III presents the summary of the OECD guidelines on corporate governance of SOEs. Due to their general relevance, these SOE guidelines constitute useful aspirational benchmark for those countries that are aspiring to improve their SOE governance, accountability, and performance.

53. The basic legal framework in Armenia is largely conducive to proper corporate governance practices and financial reporting requirements by SOEs. In Armenia, state-owned enterprises are entities of private law as advised by good practices on level playing field among private and state-owned entities. Armenian SOEs are governed by the Law on Joint Stock Companies, Labor Code, the Law on Bankruptcy, and other laws applicable to private companies. In addition to general company legislation, SOEs are subject to the audit authority of the Audit Chamber of Armenia.

54. A national corporate governance code exists but is not implemented or enforced. The current Corporate Governance Code, approved by a Government Decree in 2010, applies to listed companies, banks, insurance companies, pension funds, and state-owned enterprises on a “comply or explain” basis. The Code is being presently revised, but its new version not yet approved by the Government. The Code forms an important part of secondary legislation and should be properly implemented by SOEs, with the respective public agencies enforcing its application.

Table 4. Summary of Good Corporate Governance Practices

Rationale for State Ownership	<ul style="list-style-type: none"> ▪ Governments exercise ownership of SOEs in the interest of the general public ▪ Ownership rationale developed based on country’s strategic priorities ▪ Ownership rationale should be disclosed and regularly reviewed to ensure maximization of the value for society, and efficient allocation of resources.
State’s Role as an Owner	<ul style="list-style-type: none"> ▪ Governments to act as informed and active owners ▪ Authorities should: (i) allow SOEs operational autonomy and refrain from intervening in SOE management; (ii) respect SOE boards independence and allow them to exercise their responsibilities ▪ SOE Boards, not government, to hold SOE management accountable to achieving the defined objectives
State-Owned Enterprises in the Market Place	<ul style="list-style-type: none"> ▪ Regulatory framework should promote a level playing field and fair competition in the marketplace for all participants – private and state-owned ▪ Clear separation needed between the state’s ownership function and other state functions (i.e., market regulation)
Equitable Treatment of Shareholders and Other Investors	<ul style="list-style-type: none"> ▪ Ensure equitable treatment for all shareholders, including minority ▪ State to require and enforce high degree of SOE transparency and accountability ▪ SOEs should be subject to national corporate governance codes to all listed and, where practical, unlisted SOEs
Stakeholder Relations and Responsible Business	<ul style="list-style-type: none"> ▪ SOEs’ should report on their relations with all stakeholders, including where relevant about labor, creditors and affected communities ▪ SOEs should not be used as vehicles for financing political activities, and refrain from making political campaign contributions
Disclosure and Transparency	<ul style="list-style-type: none"> ▪ SOEs should observe high standards of transparency, be subject to high quality accounting, disclosure, compliance, and auditing standards ▪ SOEs should report financial and non-financial information in line with internationally recognized standards ▪ SOEs’ annual financial statements should be subject to an independent external audit. State control procedures do not substitute for an independent external audit ▪ Authorities should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs

Responsibilities of the SOE Boards	<ul style="list-style-type: none"> ▪ SOE boards should have the necessary authority, competencies, and objectivity to carry out their functions ▪ SOE Boards should provide strategic guidance and monitoring of SOE management ▪ SOE board composition to allow the exercise of objective, professional and independent judgement ▪ All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities ▪ SOEs should develop efficient internal audit procedures and establish an internal audit function that reports directly to the board and its audit committee
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Source: Summarized from the OECD SOE Guidelines (2015)

55. The Armenian legislation does not define the role of a company board well, does not establish requirements for the board, its composition, or collective suitability requirements. The Law on Joint Stock Companies defines a set of rules defining structure, duties, and responsibilities of the board of directors and the management board of an enterprise. While large SOEs with more than 50 percent state ownership and lossmaking companies are required to establish boards of directors,²⁰ the Law does not assign to the board all the key functions (i.e., oversight over risk management and internal controls, management’s performance evaluation). Independent board members should constitute at least one third of a board for open joint-stock companies, while closed joint-stock companies (CJSCs) are not required to have independent members by the existing legislation (Article 85). In terms of board composition, the JSC Law allows executive managers of a company to be members of the board as long as they do not constitute a majority of the board.

56. Since 2013, Armenian SOEs are required to prepare an annual Corporate Governance Statement, but this reporting remains formalistic. In the Statement, companies are expected to clearly state whether they comply with the Code’s recommendations or explain why they have not followed the Code’s recommendations. Such reporting should be used to improve their compliance with the Code, as would be desirable in a good practice. Armenian SOEs do not regularly publish their Corporate Governance Statements.

57. Armenian SOEs struggle to demonstrate progress in implementing good corporate governance practices and improving their performance, and their accountability lines remain obscured. Most SOEs do not currently implement good corporate governance practices. While many important legislative improvements have been introduced over the past few years, SOE corporate governance practices remain weak, including low independence and engagement of boards, minimal presence of board committees, and underdeveloped control functions. This significantly reduces SOEs’ autonomy and effectiveness.

58. SOE boards’ role needs to be strengthened by a clear legislated mandate empowering the boards to carry out their strategic guidance role and holding SOE management accountable. This should be followed by merit-based SOE board nomination and appointment procedures, introducing a transparent and comprehensive system for selection of SOE board members, engaging independent parties in the selection process, and establishing a pool of potential board candidates. Steps that require

²⁰ Government of the RA Decree, N 474-N of April 29, 2010 on Coordination of State Property Management, Article 6.

attention include: (i) empower SOE boards —using further legislation if needed— to properly exercise their functions in terms of strategic SOE guidance, SOE management oversight, and financial supervision; (ii) establish board level committees for taking well-informed and considered decisions in key areas, such as audit, risk management, and remuneration; and (iii) implement SOE board training programs, peer exchanges, formal induction-orientation programs, and ongoing learning opportunities for potential candidates and existing SOE board members.

C. Transparency and Disclosure

59. Reliable and timely financial information is vital for efficient decision-making and for holding SOEs accountable for their performance. The OECD SOE Guidelines recommend that SOEs observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance, and auditing standards as listed companies. While each country chooses its own way in selecting financial reporting standards and transparency and disclosure requirements, globally there is a growing trend toward convergence of standards and increased requirements for information disclosure.

60. Armenia followed good practices by updating their accounting and audit legislation, adopting International Financial Reporting Standards (IFRS) based accounting, reporting, International Standards on Auditing (ISA) based auditing, and disclosure requirements. Accounting and financial reporting in Armenia is regulated by the Accounting Law—updated in 2019—that requires all entities, whether private or state-owned, report under the IFRS. Further, the Law introduces the tiered application thresholds based on the size of the entity. Such requirements are principally in line with the good practices.

61. Disclosure requirements apply to large and medium-sized companies, banks, and listed companies that are required to publish their audited annual financial reports. Such entities include public interest entities (i.e. banks, insurance organizations, stock exchange participants, investment companies and investment fund managers, and other financial institutions), large and medium-sized companies, and are required to disclose their complete set of audited financial statements or their publication links on the official website for public notifications of the RA at www.azdarar.am. Small-sized and micro-entities are not required to disclose their financials.

62. However, as the mission was informed, not all companies that are subject to the new Accounting Law’s requirements to publish their financial statements in fact publish them. It was not possible to ascertain how many SOEs do not follow this publication requirement, but SPMC and MoF indicated that they do not receive financial statements from all SOEs they oversee. The authorities consider that one of the reasons for low publication rate is the insignificant penalty for the failure to publish financial statements.²¹ If a company did not publish on time, it would pay a fine of around USD150 the first time. If it still did not publish, another fine of about USD1,000 would be imposed. However, it was not clear what would happen if a company did not publish after that. A second reason invoked is that the new publication requirements of the Accounting Law were relatively recent: It entered into force in 2020 requiring the publications for the reporting year 2020, meaning that the first publications were to be made

²¹ Code “On Administrative Offenses” (Article 169¹²).

in 2021. The mission was able to access financial statements of the largest SOEs that are made publicly available at their websites.²²

63. External audit requirements are stipulated in the Accounting Law and require that financial statements of public interest entities, large and medium-sized companies, including corresponding SOEs, are audited. The Law on Auditing Activity was revised in 2019, aligning the audit requirements with the entity size thresholds introduced by the Accounting Law, and introducing quality assurance over audit firms in the country. Presently, entities that must undergo an annual audit include public interest entities (i.e., banks, insurance organizations, stock exchange participants, investment companies, investment fund managers, and other financial institutions), and large and medium-sized companies. Present standards adopted by the Republic of Armenia are the ISA, as recommended by the good international practice.

D. Performance Planning and Evaluation

64. Historically, SOEs in most countries perform worse than their private sector peers. Even though the argument can be made that many SOEs operate in sectors that are not commercially viable as they aim to produce public services, performance in comparable environments is still in favor of private companies. This trend is similar across various jurisdictions and sectors of the economy. The reasons vary from country to country, but they can be summarized in three main weaknesses of a state as the owner of SOEs: (i) setting unclear or conflicting goals; (ii) appointing board members that lack commercial or industry expertise to SOE boards; and (iii) lack of strong monitoring of SOE performance and adherence to the set financial and non-financial objectives.

65. In Armenia, SOEs' ultimate performance evaluation is done by the ownership entities, and the evaluation framework is underdeveloped. SOEs report to their ownership entities—line ministries, public agencies, and regional governments—that monitor their performance by comparing the actual results with the annual targets planned a year in advance. Such reporting is performed regularly and is not publicly disclosed. Management bonuses are decided by the ownership entities, or by boards appointed by these entities., although the mission was not in a position to verify if such bonuses are linked (directly or indirectly) to SOEs' performance.

66. The SPMC conducts basic financial analysis and performance evaluation of SOEs semi-annually (annually, starting 2023). Such analytical report is published and available at SPMC website. The mission was informed that in addition to the summary analytical report, SPMC also carries out financial performance analysis that focuses primarily on SOEs' revenue targets, but also covers liquidity and debt indicators, and can be supported by other indicators that vary from company to company based on their sector and operational specifics.²³ However, the results of this analysis are only sent to the ownership entities as a recommendation and have no mandatory status in performance evaluation, including bonus decisions and dismissals.

²² Financial statements obtained by the mission: Yerevan Thermal Power Centre, High Voltage Electric Networks, Haypost, ANIF, National Centre of Oncology named after V.A. Fanarjyan.

²³ Government Decree #30 dated January 5, 2023, and #1262 dated October 5, 2017.

67. The MoF carries out two functions – monitoring dividends payment by SOEs and analyzing fiscal risks. The MoF verifies the accuracy of the dividends accrued and paid by the SOEs (majority owned and minority stakes) to the state budget, including any follow up with the shareholding ministries and agencies, in case needed. The MoF function related to fiscal risks monitoring is based on the SPMC reports, individual financial statements of the SOEs, and covers detailed analysis of SOEs' impact on public finances (see Section II).

68. Present performance evaluation of the SOEs seem to be rather mechanical with insufficient follow up mechanisms. Although the SPMC and the MoF reports are regularly communicated to the SOE ownership bodies and published, there seem to be a disconnect between their findings and the follow up measures. The mission did not identify linkages between the SOEs' performance and measures that incentivize the SOE management for good performance or take corrective actions in case targets are not met. For this mechanism to function, it is necessary not only to publish SOEs results, but also set objectives for SOEs and their management, regularly assess progress towards these performance objectives and hold respective managers accountable.

69. Armenia's SOEs paid about AMD 1.3 billion in dividends in 2022,²⁴ which makes up 0.06 percent of the state budget revenues in 2022. Note that this figure includes dividends from all SOEs—fully or partially owned by the Armenian state, as well as privately owned companies in which the Armenian state owns a minority stake (less than 50 percent). This number could be significantly increased should the government chose to implement an active performance management system that can aim for growth targets, reduce SOEs cost ratios, addressing the costs of public service obligations, and carefully monitoring the SOEs leverage, financial sustainability ratios.

70. The first step in setting up an SOE performance monitoring system is to formulate and document each SOE's ownership rationale (mandate) and strategy. This will serve as the foundation for formulating the SOE's policy and commercial targets. Non-commercial objectives of SOEs related to their social commitments or public service obligations should be clearly documented in the SOE's mandate, with their costs estimated, accounted for separately, and properly disclosed, indicating respective funding sources. This separation of objectives will provide the state and the public with an understanding of the cost of meeting social objectives.

71. Key performance indicators (KPIs) should stem directly from the SOE's mandate and strategy, focus on policy objectives, and be realistic and manageable. KPIs should be tailored to each SOE to capture the main dimensions of its performance and be tied to SOE strategy and objectives reflecting the nature of operations, as well as the government's policy priorities. Keeping to a manageable number of trackable indicators (around 5-7 is good practice) will allow SOEs to focus on key areas and minimize administrative resources needed for collecting and processing data. Requiring too many performance indicators places a burden on both the SOE to produce them and on the SOE ownership entity, which may have limited capacity to analyze them.

72. Presently, with Armenia's largest SOEs holding significant amount of debt and generating losses, the KPIs should focus on SOEs financial sustainability and debt levels. Armenia's largest

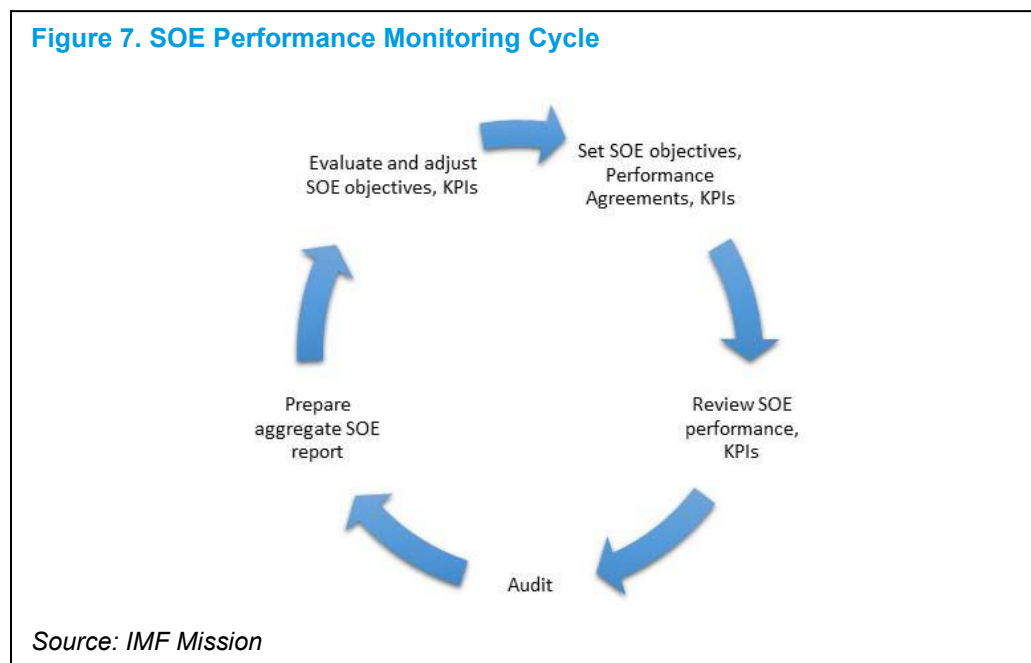
²⁴ Source: the mission interviews

energy SOEs hold significant liabilities in the form of debt to international financial institutions, commercial banks, and the budget. Moreover, largest SOEs generate losses undermining their ability to repay such debts or generate dividends for the budget. Therefore, it is crucial to monitor SOEs' health via respective debt and leverage ratios. This focus will help monitor potential fiscal risks stemming from SOEs and prioritize the needs in injecting funds into SOEs via either debt or equity. Scarcity of public funds demands that such funding is prioritized and provided only when needed and when it serves public policy objectives. Additional requirements for reporting and transparency for priority SOEs, therefore, can include additional and/or more frequent reporting on: (i) debt levels, changes in loan terms, such as interest rates or collateral requirements; (ii) significant increase (above certain threshold) of SOEs accounts payable, account receivable, respective provisions; (iii) monitoring of cash ratios; (iv) non-financial indicators, such as corporate governance improvements, timely disclosure of financial reports, achieving social obligations, climate change indicators etc.

73. MoF must have access to timely and relevant information to monitor SOEs performance and preempt unnecessary risks to public finances (as also discussed in Section II). Timely reporting by SOEs reduces a risk of unpleasant surprises and allows the government to take precautionary measures. Hence, it is important that SOE performance is analyzed timely—upon availability of annual financial statements, or completion of quarterly reports—to monitor their main KPIs, such as leverage ratios, losses within the year, cash/ liquidity shortages etc. It also enables the Government to understand the within-the-year performance dynamics and allows to adjust KPIs for the next reporting period (Figure 7).

74. To achieve results, performance assessment frameworks for SOEs management should be strengthened to align their incentives with SOEs performance and ensuring SOEs financial sustainability. This can be achieved by developing key performance indicators and targets directly linked to each SOEs' mandate and policy objective. This action will be stronger if reinforced with merit-based compensation and proper incentives for SOE management for achieving the indicators, which are linked

to entity-level SOEs performance indicators. Public disclosure of this information should be considered.



E. Recommendations

Recommendation 3.1: Develop a state ownership policy defining the rationale for owning SOEs based on policy objectives to be implemented by SOEs.

- The state ownership policy should be closely aligned with the Government Program priorities, define main strategic sectors, identify SOEs pursuing important public policy objectives; address market failures; and promote high-level government accountability mechanisms linked to SOE performance.
- Establishment of any new SOEs must clearly follow the state ownership policy, directly contribute to the government's policy priorities, and be allowed only in cases when private sector participation is not possible.

Recommendation 3.2: Define the rationales for owning each priority SOE and translate them into SOE-level policy objectives.

- This can be delivered by developing a Statement of Corporate Intent that defines each company's strategic objectives, its mandate, and contribution to the government policy priorities. It can also specify the financial and non-financial objectives of each SOEs, establishing its board and management's responsibility in achieving such objectives.

Recommendation 3.3: Mandate the adoption of the Corporate Governance Code (upcoming) for all priority SOEs, introduce compliance monitoring mechanisms with a respective enforcement mandate.

Recommendation 3.4: Strengthen priority SOEs' boards, appoint independent professionals with strong industry expertise.

- SOE board's role needs to be strengthened by a clear legislated mandate empowering the boards to carry out their strategic guidance role and holding SOE management accountable.
- This should be followed by merit-based and transparent SOE board nomination and appointment procedures, engaging independent parties in the selection process.

Recommendation 3.5: Define additional requirements for reporting and transparency for priority SOEs, considering (i) debt levels, changes in loan terms, such as interest rates or collateral requirements; (ii) significant increase (above certain threshold) of SOEs accounts payable, account receivable, respective provisions; (iii) monitoring of cash ratios; (iv) non-financial indicators, such as corporate governance improvements, timely disclosure of financial reports, achieving social obligations, climate change indicators etc.

Recommendation 3.6: Implement performance assessment for SOEs management aligning their incentives with SOEs performance and ensuring SOEs financial sustainability.

IV. Armenian National Interests Fund (ANIF)

A. ANIF's Mandate and Viability

Scope and mandate

75. ANIF, as a newly established SOE that operates in a high-risk investment business and wholly funded with the Government, poses a significant fiscal risk to the public finances. The Armenian SOE sector is dominated by companies inherited with the country's independence in 1991, all of which operate in the real sector and hold considerable tangible assets.²⁵ ANIF is a notable exception - it was established in 2019 with 100 percent ownership by the RA,²⁶ effectively with no tangible assets and broadly defined scope of operations. This section analyzes ANIF, its mandate, governance, reporting and viability requirements, with an aim to assist the authorities in meeting a structural benchmark under the current Stand-By-Arrangement with the IMF.

76. The rationale for founding ANIF is unstated, and its mission and purpose remain unclear. The ANIF Government Decree does not state the purpose for which the company was established, only instructing the Minister of Economic Development and Investments to form the executive body of ANIF (i.e., to appoint the CEO), approve the charter of the company, and ensure its state registration. These are purely mechanical steps that do not provide any rationale for establishing a new state-owned entity.

77. ANIF's mandate is essentially unlimited, allowing virtually any type of investment and using nearly any type of funding. ANIF's charter defines the company as a commercial organization pursuing the purpose of profit. According to the most recent version of the charter (approved on November 30, 2021, registered on December 9, 2021), the main objective of the company's activities is to promote the investment interests of the RA through the management of strategic investment programs, attracting investments in initiatives implemented in priority sectors of the economy, as well as participation in business enterprises with acceptable risks. The company's charter lists eleven types of activity, ranging from inward and outward investments, management of large investment programs and public-private partnership programs, support of the reform of SOEs, assistance to the government in policymaking, investment advisory, export promotion, and fighting the consequences of the Covid-19 crisis. For that purpose, the company has the right to invest in any assets not prohibited by the Armenian laws or other legal acts, establish any subsidiaries and representative offices, as well as receive loans, grants, or donations.

78. The company's reports resonate the above commercial purpose, rather broad objectives, and broadly varied business activities. ANIF's triennial report for 2019-2021 suggests that the company should both (a) generate additional income for the Republic of Armenia and (b) contribute to the economic development of Armenia. The report is *not* an annual report in a formal sense: It is not subject to legal requirements, implies no legal responsibility for the information provided, and does not include financial statements or other essential elements. Although ANIF disclosed its audited financial statements

²⁵ Such as Yerevan Thermal Power Plant, Armenian Nuclear Power Plant, High Voltage Electric Networks, or HayPost.

²⁶ Government Decree No. 513-N dated April 18, 2019.

for 2019-2021 on its website after this mission, they do not connect with the information reported on its investment activities in the triennial report.

Funding profile

79. ANIF and its two subsidiaries are 100 percent funded from the state budget. ANIF has two wholly owned subsidiaries: (i) ARFI, and (ii) Entrepreneurship + State Anti-Crisis Investments Manager CJSC (“E+SACI Manager”). E+SACI Manager was funded with capital injections from the state budget via the Government’s purchase of shares of the fund managed by this company—the “Entrepreneurship + State Anti-Crisis Investments” Investment Fund (“E+SACI Fund”). The E+SACI Fund, originally established to support local businesses during COVID-19 pandemic, received the government’s commitment of AMD 50 billion (about USD125 million at the current exchange rate) at the time of inception. This amount is significant for Armenia’s budget as can be compared to the current IMF program at about USD 171 million. This commitment is to be carried out in ten installments of AMD 5 billion annually via capital injections by the RA Government. The actual invested share capital at ANIF consolidated level stood at AMD 5.6 billion at end-2021.^{27, 28}

80. E+SACI Fund injections are approved outside of the normal budgeting process and do not undergo the scrutiny of parliamentary review and approval. The overall funding of AMD 50 billion was originally approved by a government decree as a response to Covid-19 pandemic, hence, was an inter-year funding reallocation.²⁹ After original approval, annual injection of each subsequent capital share should also be approved via a government decree, based on the results of the report submitted on the investment of the previous installment. It should be noted that such capital injections do not follow the standard budget process and are carried out using the within-the-year budget re-allocation. While this is allowed by the legislation, as re-allocations are made within the annual threshold,³⁰ they are not made known to or approved by parliament, which is not a good practice for such a high-visibility and high-risk SOE.

ANIF’s Investment Initiatives

81. The pattern of ANIF’s investment initiatives and projects, as reported by the company, suggests an unlimited mandate. As Annex IV shows, these initiatives relate to sectors ranging from hospitality to consumer finance to large infrastructure projects. Without knowing a convincing rationale or investment strategy, which this mission did not identify, the investment behavior of ANIF can be described as opportunistic.³¹ The mission could not identify ANIF’s or Government’s rationale for funding the investments with public funds (capital allocations to ANIF), and why such projects could not be financed with private capital. It is also not always clear how ANIF’s initiatives relate to the national

²⁷ Source: ANIF audited financial statements 2020-2021.

²⁸ Resolution No. 224-N of the Government of the RA February 24, 2021 on allocating AMD 5 billion for acquisition of domestic shares.

²⁹ Government Decree No. 771-L dated May 21, 2020.

³⁰ Reallocations are made by the Government decrees within the limits of 3% between the programs and measures of the programs defined by the RA Law “On the Budgetary System of the Republic of Armenia and within the framework of allocations approved by the law).

³¹ ANIF investments appear to emulate market behavior, investing into sectors that are typically funded by private capital (e.g., in a restaurant, an active leisure resort, or a mushroom growing factory).

development priorities (see “Armenia’s economic development priorities and implementation vehicles” below).

82. Project funding by ANIF at the parent company level has no investment mandate. In two investment projects, ANIF took a minority stake, with the co-investor getting the majority stake and operational control (management). In a third project, ANIF holds 100 percent ownership. Two of the below projects could be implemented by the Government directly, while there is no good rationale to launch the ARFI project with the public funding made available to ANIF.

- The size of the solar power construction project, Ayg-1, is USD 174 million, with 85% of the joint venture’s shares owned by Masdar and 15%, by ANIF (for which Masdar will provide an interest-free loan to ANIF), according to ANIF’s triennial report. Management of the joint venture (JV) will be appointed by Masdar, according to ANIF’s presentation. ANIF reported that Masdar signed a memorandum of understanding with ANIF in 2019 and won the tender in June 2021. Note that the Government Program was approved in August 2021. The Agreement on State Aid with Masdar was then signed in November 2021.
- Although the size of the FlyArna investment is not reported, ANIF told this mission that it was USD 20 million. The investment is undertaken via a JV, in which ANIF owns 49%; IBC, 49%; and IBC’s Armenian partner, the remaining 2%. In July 2021, ANIF and Air Arabia signed an agreement establishing a national airline of Armenia. The Government Program, approved in August 2021, states a national airline as one of the priorities.
- The ARFI investment company, 100% owned by ANIF, was licensed by the CBA in December 2022. The goal of the ARFI crowdfunding platform is to create new sources of funding for SMEs and startups based in Armenia and to enable investors to invest in non-listed SMEs and technology startups. The rationale for using the public funding and creating such a platform to be owned by the state is not identified or stated.

83. There appear to be no target size, co-investment obligations, rate of return requirements, or pre-set performance indicators for ANIF’s investments. ANIF informed the mission that there were no rate of return requirements, although the charter states that company’s purpose is to pursue profit and the triennial report states that its goal is to generate additional income for the Republic of Armenia. An internal rate of return of no less than 8% is required for the E+SACI Fund.

84. Project funding for the E+SACI Fund is governed by an investment mandate approved by Government Decree No. 771-L. This decree originally envisaged an investment agreement to be signed between the RA Government, represented by the Minister of Economy, and the fund manager (“E+SACI Manager”), with the following investment mandate:

- The size of an investment (i.e., “in one commercial organization, as well as in affiliated companies”) should be an AMD equivalent between USD1 million and USD2 million.
- The so-called “1 + 1 + 2” requirement, namely when the fund invests a certain amount (“1”) in a project, it should be matched by at least the same amount of investment (“+ 1”) from a private investor, made in cash. These investments should go into the equity capital of the investee. In addition, these equity investments should be matched by debt funding of at least the same size as the equity investment (“+ 2”).

- The E+SACI Fund should use the state's funding, as well as the interest income on bank deposits (i.e., when funds are not invested in projects), for the purpose of investment, and cover its current expenses from interest income.

85. The “1 + 1 + 2” requirement was subsequently abandoned and replaced with requirement of internal rate of return of 8%. Dropping the co-investment requirement was a step in a different direction from attracting investment, as it placed all the funding requirements and related investment risks on ANIF instead of mobilizing additional capital from alternative sources, including from the owner or the potential investee.

86. In addition, requirement on the investment size was relaxed, expanding the investment range to between USD 0.5 million to USD 4 million. Via the E+SACI Fund, ANIF invested USD 0.5 million in feedstock for existing farms of Yermeyan projects, USD 0.5 million in the opening of Hard Rock Café Yerevan, USD 0.6 million in the expansion of an existing mushroom growing and processing factory, USD 1.4 million in an existing logistics business, USD 1.6 million in a local hotel and active leisure club, and USD 4 million in the EU-Armenia SME Fund managed by a private investment firm, Amber Capital (also funded by the EU, EBRD, and FMO). It also appears to have invested in the expansion of an existing Clinic of Modern Surgery (amount not reported).

87. Most of the existing ANIF projects lack an apparent rationale for state ownership. By way of example, a Hard Rock Café is very difficult to defend as a state investment – Yerevan’s hospitality and catering market offers an abundant choice of restaurants, and it is difficult to imagine how yet another restaurant contributes to the achievement of national development objectives. Moreover, the investment took place during the Covid-19 pandemic, possibly distorting the competition in favor of the Hard Rock Café. In fact, if the state should have considered this as a supporting measure to the suffering hospitality market via an anti-crisis fund, such as E+SACI, then it should have considered supporting the existing businesses on equal footing rather than setting up a new one.

88. Due to very limited disclosure, it is impossible to assess the viability of ANIF’s investment initiatives and assessment of their risk profile. The information on how the investment choices relate to the mandate/strategy, the outcomes and financial performance of these investments, or risk appetite and risk management is either lacking or is not publicly available. From the public available data, investment track record is short and patchy, with five out of fifteen initiatives appear to have no reporting on outcomes, with some of them already abandoned, such as the Russian Direct Investment Fund or Smart Technologies Systems JSC (Annex IV).

Armenia’s economic development priorities and implementation vehicles

89. It is not clear how ANIF’s initiatives relate to the national development priorities. Specifically, the Government’s five-year program (2021-2026) comprises six priority areas: (i) security and foreign policy, (ii) economy, (iii) infrastructure development, (iv) human capital development, (v) law and justice, and (vi) institutional development. In terms of using public funds, the Program prioritizes the effective use public investment funds for the creation and enhancement of quality infrastructures. While some of ANIF’s investment can technically be aligned with these priorities, others cannot and seem to be competing with private sector actors. Annex IV offers some details and the profile of ANIF investments.

90. ANIF’s specific role in the implementation of the national priorities is not formulated, although its activities may be seen to reflect some of the priorities under the second area, economy. Such a role may conflict with the role of line ministries and government agencies. This priority area states an ambition to pursue a knowledge-based, export-oriented, investment-driven growth strategy, aimed at reducing poverty. This includes, among other things, the objectives to achieve an annual GDP growth of at least 7%, raise the investment/GDP ratio to at least 25% (with FDI/GDP ratio of 6%), increase productivity growth to at least 5%, reduce the unemployment rate from 17-18% to 10%,

and increase the share of SMEs in GDP from 27% to 55%. For that purpose, among other things, the government aims to boost the manufacturing, tourism, and agriculture sectors (through land acquisition and water management reforms); diversify the export base and markets; expand economic opportunities through SME support; and modernize infrastructure and urban planning policies. To improve the business environment, policy options include capital market development and improved access to finance and quality infrastructure investment, among other things.

91. ANIF's investments also appear to reflect some of the policy goals under a third priority area, infrastructure development. Infrastructure priorities focus on (a) road, air, rail, and water transportation, (b) road construction, (c) water management, and (d) energy independence and security. Thus, FlyArna project is in line with the policy goal of developing air transportation, while the Ayg-1 solar power construction project is in line with the policy goal of achieving energy independence and security. However, it is remarkable that both investment projects were decided (a memorandum with Masdar was signed and FlyArna was established) *before* the Government Program was approved, which suggests that the Program may *not* have determined the choice of these projects by ANIF, but both projects may have influenced the Program.

92. The role of ANIF in supporting and, possibly, influencing the setting of Armenia's economic development priorities may conflict or overlap with that of the Ministry of Economy. It is the mandate of the Ministry of Economy to formulate the priorities for economic development of the country and to monitor the Program's implementation. One example of such overlap is ANIF's USD 4 million investment in the EU-Armenia SME Fund managed by Amber Capital. The government invested a total of USD 7 million in this fund, of which USD 4 million was invested by ANIF and another USD 3 million directly by the Ministry of Economy that is tasked with developing the SME sector. Moreover, it is the investment by the EU, the EBRD, the FMO and Amber Capital that attracted the government's funding rather than vice versa. If the purpose of the state funding was to catalyze private sector investment, then a successful example would be rather the opposite—an investment fund set up by ANIF to attract private investment. Otherwise, public funding seems to be crowding out private investors, while this funding could be employed at more urgent national development priorities of the Government.

93. The objectives and mandate of ANIF are out of step with good international practice. ANIF mandate and role should be defined, once the rationale for its existence is defined, and it should outline its purpose, mission, and objectives. At this time, ANIF's model and mandate poorly correspond to the existing range of best-practice models worldwide. The following structures were considered by the mission and outlined below: (i) managing the nation's reserves (the role of a sovereign wealth fund), (ii) managing the SOE portfolio (the role of a national wealth fund, holding company, or a centralized ownership entity), (iii) administering development aid, and (iv) investment and export promotion. These are considered seriatim in the following subsection.

Considerations for ANIF's role

Managing the nation's reserves

94. ANIF has declared an aspiration to become a sovereign wealth fund (SWF). ANIF has obtained an associate membership with the International Forum of Sovereign Wealth Funds (IFSWF), in particular to be able to accede to the Generally Accepted Principles and Practices for Sovereign Wealth Funds (commonly referred to as the "Santiago Principles"). In communication with this mission, ANIF officials shared that the process of obtaining full IFSWF membership would normally take three years, but ANIF's intention was to obtain full membership earlier.

95. A rationale for ANIF's role as an SWF is lacking, as Armenia does not possess the excess wealth requiring active management. SWFs are commonly established for the purpose of managing the nation's reserves resulting either from resource endowments (such as oil in the case of Norway) or income generated by the country's assets (such as long-standing exemplary performance of government-owned assets in the case of Singapore). Neither of these conditions is present in Armenia. The country does not have abundant natural resources that generate windfall profits, and its revenues from public assets are almost negligible. At the same time, the fiscal risks of public assets appear to be high. Moreover, Armenia has a persistent fiscal deficit, meaning that it has no reserve liquidity to manage. In fact, the government would be effectively borrowing to fund an SWF, which is opposed to the very idea of an SWF.

96. Successful SWFs are characterized by exemplary corporate governance, which is not the case of ANIF. Having abundant natural resources or reserve liquidity is not a sufficient condition for a successful SWF. Both Norway and Venezuela had vast reserves of oil; yet, the Norwegian fund has demonstrated overwhelming success, while the Venezuelan fund plummeted due to governance failures. Another good practice example is GIC of Singapore, which was established to manage Singapore's reserves in financial assets – such as those resulting from profits made by companies with state ownership. Its success is largely attributed to the exceptional governance (See Box 3). ANIF has not yet established a strong corporate governance framework.

Box 3. Sovereign Wealth Funds

A sovereign wealth fund (SWF) is primarily a fund manager, concerned with managing reserve liquidity, typically investing in securities traded on major mature markets. SWFs are designed to optimize a portfolio through continual securities trading to achieve balance between risk and returns.

Government Pension Fund Global (GPF, Norway) was established in 1990, after Norway discovered oil in the North Sea, in order to smooth fluctuations in oil revenues and to safeguard and build financial wealth for future generations, benefitting from windfalls from Norway's oil and gas. As the name suggests, it was decided that the fund should only be invested abroad. Today, it is one of the largest SWFs in the world, with a market value of over NOK 13 billion (around USD1.33 trillion), owning almost 1.5 percent of all shares in the world's listed companies. The fund's governance model builds on a clear delegation of duties and effective systems for control and supervision. Norwegian parliament has set the formal framework for the fund in law. The Ministry of Finance has the overall responsibility for the fund's management and issues guidelines for its management. Norway's Central Bank is tasked with the management of the fund. Its Executive Board has delegated the operational management to Norges Bank Investment Management, whose CEO has the overall responsibility for implementing requirements defined by the Executive Board.

Government of Singapore Investment Corporation (GIC) is a global long-term investor established in 1981 to manage Singapore's foreign reserves. The fund is invested in more than 40 countries. However, GIC manages the Government's reserves in financial assets – such as those resulting from profits made by companies in which it has ownership (rather than natural resources). GIC boasts exceptional governance. Its board and management are accountable to the Government of Singapore for portfolio performance. The GIC board is responsible for long-term asset allocation and overall performance; management formulates and executes investment strategies. The fund acts autonomously on individual investments, without influence from the Government or the board. GIC does not own the assets under its management – it is a fund manager for the government. The government gives GIC an investment mandate that stipulates the terms of appointment, investment objectives, risk parameters, investment horizon, and guidelines for managing the reserves. Underpinned by Singapore's strong public governance, GIC's governance relies on a clear investment mandate, a strong board of directors (including five committees), a robust audit and risk management framework, and transparent disclosure.

FIEM (Fondo de Inversión y Estabilización Macroeconómica, or “Fund for Investment and Macroeconomic Stabilization”) of Venezuela was established in 1998 to smooth fluctuations in revenues resulting from oil price volatility. FIEM was placed under the mandate of the Central Bank of Venezuela (CVB). FIEM’s value was as high as USD 7 billion in 2001, just four few years after it was established. However, the fund quickly came under political meddling of the Chavez administration, along with frequent changes to the broader fiscal policies. Unlike in GPFG’s case, FIEM rules were constantly changed to reflect Venezuela’s budget priorities, turning FIEM into a spending vehicle rather than a fund, pursuing a consumption-based rather than wealth-preserving strategy. In particular, its saving and spending rules were made discretionary, and researchers have argued that FIEM introduced more macroeconomic volatility instead of smoothing out fiscal fluctuations at the central and local government levels, for which it was originally designed. The fund’s poor governance and accountability also resulted in poor investment.

Fondo para la Estabilización Macroeconómica (FEM) replaced the failed FIEM in 2003. In few years, FEM fell victim to similar political influences - its value plunged to USD 1 billion as soon as 2004, further plummeting to USD 3 *million* in 2021-2022. Like its predecessor, FEM was unable to save extraordinary oil rents during oil booms and set them aside for later use – a direct contradiction to its policy objectives. Despite high oil prices in 2005-2008, the FEM only held USD 732 million at the end of 2005 and \$828 million at the end of December 2008, which was 2% of oil exports in 2005 and 1% in 2008, respectively.

Sources: see Annex V.

Managing the SOE portfolio

97. ANIF does not currently perform management or oversight of the strategic SOEs, as opposed to some of the initial intentions. The mission learned from ANIF presentation that ANIF was established, among other tasks, to consolidate and effectively manage a portfolio of Armenian SOEs with assets that are strategically important for national economic development. However, this intention was not realized, perhaps because ANIF has no mandate, mechanisms, or capacity to carry out such task that embeds significant regulatory constraints and bears fiscal risks to public finances. Oversight of SOEs is currently performed by other central government agencies and local governments.

98. ANIF is a newly established entity that already owns two other financial SOEs with a primary purpose of maximizing returns, a short track record, and lagging corporate governance practices. ANIF owns 100% of shares in both ARFI and E+SACI Manager, each managing a respective investment fund established with the purpose of generating returns. In addition, this is also one of ANIF’s own major purposes for the large assets that it owns, including the shares in Masdar Armenia and FlyArna. ANIF can briefly become an owner of state-owned shares, such was the case of Zangezur Copper Molybdenum Combine.³² However, the SOE ownership function is not presently allocated to ANIF.

99. ANIF’s role as an SOE holding entity would not be beneficial for Armenia. First, with a relatively small SOE portfolio, centralizing ownership in Armenia is not an immediate priority. The overall corporate governance in Armenia needs to be significantly strengthened, and a state ownership policy designed, before appropriate ownership agencies are contemplated. As Box 4 shows, the international experience of state holding companies varies. In the Temasek case, the clear separation of the ownership function from the policymaking function, as well as strong corporate governance, have been among the success factors. In Turkey or Georgia, instead, the policymaking and ownership functions remained intertwined, and the susceptibility of these countries NWFs’ to political influence have

³² ANIF briefly held 21.87% of the shares in CJSC Zangezur Copper Molybdenum Combine during 2022. The government decided to allocate these shares to the SPMC (Government Decree No. 2010-A, dated December 22, 2022). At the time of this writing, the SPMC had not yet formally accepted these shares, or was aware of whether these shares would be offered for privatization or remain held by the SPMC.

undermined their roles, redirected their purposes, and eventually resulted in a loss of value and public funds.

Box 4. National Wealth Funds and Centralized SOE Holding Companies

A national wealth fund (NWF) is an asset manager, concerned with active management of operational assets as a portfolio. Its purpose is to maximize the portfolio value through active management including the development, restructuring, and monetization of the individual assets (Detter & Fölster, 2015).

Temasek of Singapore,³³ a pioneering wealth fund that has demonstrated a 14% total shareholder return since its establishment in 1974. It has become a role model for many countries that have tried to model their NWFs after Temasek – ranging from Malaysia to Finland. Temasek was incorporated under Singapore’s company law to hold and manage the assets that were previously held directly by the Singapore government. Temasek would own and manage these investments based on commercial principles, which allowed the ministries to focus on policymaking. With time, the span of Temasek has grown, and it evolved into an investment company owning and managing almost USD 0.5 trillion in assets in 2022. Temasek promotes sound corporate governance in its portfolio companies, including strong boards. Its portfolio companies are guided and managed by their respective boards and management, and Temasek does not intervene in their business operations. Temasek’s own investment, divestment, and other business decisions are also directed by its board and management, and the Government of Singapore is not involved in these business decisions. Temasek’s Board of Directors, including its four committees, has a clear mandate and powers, and it provides overall guidance and policy directions to the company’s management. Temasek boasts extended disclosure and well-defined risk management.

Türkiye Wealth Fund (TVF) was established in 2016 as a centralized holding with a company status for SOEs that had previously been overseen by the Privatization Administration and the Treasury. TVF’s purpose was to: (i) enhance the value of the Fund’s assets, (ii) provide equity to strategic investments in Türkiye, (iii) support Türkiye’s international economic objectives via equity investments, and (iv) develop financial markets. In 2021, TVF was responsible for managing assets worth around USD 33.5 billion, a figure equal to 40% of Türkiye’s central budget. However, there have been numerous governance issues around TVF, including its purpose, mandate/scope, fiscal discipline, transparency, and accountability. Originally, TVF was established with the ambition to finance strategic projects, targeting an additional annual growth of GDP of 1.5%, as well to promote the development of Türkiye’s capital markets. With the macroeconomic shocks resulting from the Covid-19 pandemic, the depreciation of the lira, and the Russian invasion of Ukraine, TVF switched its role to supporting strategic sectors, aiming at their long-term stability.

Georgia’s Partnership Fund (PF) was established in 2011 as a joint-stock company, with the objective to support private investment in energy, agriculture, real estate (including tourism infrastructure), and manufacturing through minority equity participation, debt financing, and guarantees. PF was assigned the 100% shareholding of 13 SOEs deemed strategically important, with a combined annual turnover of over USD 717 million (2018). Its portfolio included 100% ownership in five of the largest SOEs: Georgian Railway, Georgian Oil and Gas Corporation (GOGC), Georgian State Electrosystem (GSE), Electricity System Commercial Operator, and 24.5% of shares in JSC Telasi. In addition, according to a 2016 report on industrial policy in Georgia, PF invested too little in the manufacturing sector, and it did not pay enough attention to production diversification, innovation, investment in high-added value or job-creating sectors, export orientation, or import substitution – all suggesting that the Fund barely had a mission that supported national development priorities. In 2015-2020, PF took a loss of a loss of GEL 1.34 billion. In a commercial environment with an unclear legal and governance framework, PF’s operations suffered from inconsistencies between its commercial objectives and the government’s public policy goals, as well as a lack of clarity in the relationship between the PF, the government and its ministries. In 2020, Fitch withdrew the Partnership Fund’s ratings “due to incorrect or insufficient information provided”.

³³ Temasek’s website (<https://www.temasek.com.sg/>), last accessed on January 19, 2023.

ANIF's other options and the dissolution option

100. ANIF might play a different role in implementing the development priorities of the Government Program. Such roles could include administering development aid, or investment and export promotion, in which case these tasks will need to be coordinated with the Ministry of Economy and other agencies to avoid overlaps:

- The Ministry of Economy addresses the SME support via its Investment Support Center, which serves as a “one-stop shop for investors.” In addition, Enterprise Armenia is a specifically designated agency for investment promotion.
- The Development and Investment Corporation of Armenia (DICA) is 51% owned by the Ministry of Economy (via its Investment Support Center), with another 49% held by the Ministry of Finance. DICA provides loans, leasing services, and guarantees to SMEs, mainly in agriculture and the agri-food sector.
- The Export Insurance Agency of Armenia, under the Ministry of Economy, plays a role in promoting exports.
- The Ministry of Economy invested in Amber Capital's EU-Armenia SME Fund for the purpose of further supporting SME development.

101. ANIF differs from other agencies in that it makes equity investments rather than offers loans or grants as other support vehicles do. Although some of ANIF's transactions are much larger than the Ministry of Economy and other agencies focus on, it is worth consolidating ANIF's smaller initiatives with the existing programs run by the Ministry of Economy and other institutions. One possibility is to devise an exit strategy to divest from the SME investment portfolio, possibly transferring it under management of a private equity fund manager. Another is to subordinate ANIF to the Ministry of Economy as the central body responsible for economic development. One more option is to distill ANIF's role to be clearly distinct from that of the Ministry of Economy and specialized agencies, and establish stringent requirements as to its corporate governance, reporting transparency, and financial viability.

102. The Government should consider a dissolution or divestiture from ANIF, in case no distinct role and rationale for continued public funding of ANIF activities are identified. As the cases of Sweden and Brazil show (Box 5), the dissolution or divestiture from similar structures are not exceptional. The reasons for dissolution or divestiture may usually be the following: (i) the government wants to decrease the state's role in the economy; (ii) the state is in need of funding; (iii) the established structure does not fulfill its functions and failed on its objectives; or (iv) the governments opts for a divestment for strategic reasons, for example, to divest from extraction of fossil fuels.

Box 5. Examples of Dissolution

Statsföretag (Sweden). Originally established in the 1970s with the aim of centralizing state ownership over the state's assets in shipbuilding, steel industry, and forestry, Statsföretag expanded its coverage to other industries when several industrial companies were nationalized as a result of the 1970s economic crisis. Statsföretag suffered bad losses after that, leading to its reorganization and transfer of the key steelmaking and mining companies to the Ministry of Industry in the 1980s. It also changed its name from Statsföretag to Procordia. In the late 1980s, some 20% of Procordia were privatized, with shares listed on the Stockholm Stock Exchange. The government's share was further reduced following Procordia's merger with private pharmaceutical and food companies, and the government's shareholding further managed via a new state holding company, Statum. Ultimately, the Swedish government divested from Procordia, with both the pharma and food business ending up in private hands.

Fundo Soberano do Brasil (Brazil). Much like ANIF, the FSB was established in 2008 to support Brazil's economic development by financing projects of strategic importance for the country and assisting Brazilian business to expand abroad (particularly, by promoting exports), as well as promoting investment in the Brazilian economy. Much like other SWFs, the FSB was funded with Brazil's surplus reserves, largely channeled via the Brazilian Treasury and government bonds from the state-owned bank (Banco do Brasil) and the national oil champion (Petrobras). The FSB was directed and overseen by an advisory board composed of ministers and the central bank governor whose tasks included deciding on the FSB's investments and making sure that these reflected the fund's objectives. However, in 2018, the Brazilian government withdrew most of the FSB's funds (BRL 3.5 billion out of BRL 4 billion) to pay off its national debt. In 2019, the fund was dissolved because it was depleted.

Source: see Annex V.

ANIF's financial viability and fiscal risks

103. ANIF poses several types of risks for the Armenian Government, including but not limited to fiscal, investment, and litigation risks. These risks may not all be quantified, and can be broadly put into the following categories:

- Investment or market risk (quantifiable) related to complete loss or significant impairment of the government's capital injections into ANIF itself, stemming from poor investment choices or market conditions. Presently, this risk is limited to ANIF's first capital injection of AMD 5 billion but can be as large as AMD 50 billion, as per total Government's commitment to inject capital. Due to absence of a clear mandate for its investments, rather low level of oversight over ANIF, and lack of investment and risk policies, this risk is rather high.
- Litigation risk (un-quantifiable) related to possible materialization of contractual liabilities resulting from ANIF's investments and joint ventures. Such liabilities are distinct from ANIF's own obligations, as they may relate to policy or regulatory obligations, contingent fee arrangements to compensate for underutilization of infrastructure projects, minimum revenue, exchange rate guarantees, etc. In case such contractual liabilities materialize, they may require the Armenian Government's intervention. The mission did not analyze ANIF's (and subsidiaries') investment agreements, therefore, cannot quantify this risk or its probability.
- Other risks related to ANIF operations include: litigation risks from activities other than contractual obligations; default risk; reputational risks stemming from ANIF investment decisions; risk of replicating ANIF structure with other new entities, leading to the same risks as described above. There may be other types of risk associated with ANIF, which could be identified should the detailed assessment of the company take place.

104. To cap the fiscal risks until the decision on ANIF role and mandate is reached, the Government of RA should refrain from any further ANIF capital injections. It is imperative to complete the recommended steps on identifying ANIF mandate and deciding on its role before making any corporate decisions on restructuring, or governance improvements. Until the above steps have been completed, the Government should consider introducing a moratorium on ANIF's new capital injections.

105. Should the Government choose to keep ANIF and streamline its mandate, actions must be taken to ensure its financial viability and transparent governance. For this, ANIF will require strong and transparent corporate governance practices, enforced reporting requirements, strict accountability lines, and importantly—clear criteria for ANIF financial viability. For this, good practices must be imposed in investment selection, their risk assessment and alignment with the Government development priorities. This should ensure that investments will be made in a responsible, efficient, and monitorable manner, with clear viability requirements that should be specified and enforced.

106. To ensure ANIF's financial viability, the Government should implement urgent measures that address fiscal and investment risks and require that co-investments are made along with ANIF that invests public funds.³⁴ To ensure ANIF's financial viability, the mission advises introducing the following measures:

- introduce a requirement that ANIF investments should be matched by co-investment by reputable investors, such as investment grade funds or entities rated by international rating agencies,
- establish a requirement for all investments (ANIF and its subsidiaries) to produce a rate of return no lower than the cost of capital, on a project basis,
- in case such investments are expected to have a lower rate of return—effectively, implementing a public policy objective—then a requirement to state a clear rationale for such investment, explaining: (i) quantifiable development benefits following from ANIF's ownership policy and contributing to the government's public policy goals; (ii) how such benefits outweigh the costs, on a project basis; (iii) why these development benefits are better achieved via ANIF or its subsidiaries than other policy measures; and (iv) information on other support measures for such investments (for example, targeted grants from the budget).

³⁴ While ANIF operates its share capital, it is public funds that are allocated to the capital of ANIF and its subsidiaries. Such funds should be evaluated by the Government in their entirety from the point of view of alternative use for other, more pressing spending priorities.

B. Corporate Governance of ANIF

Legal form and organizational structure

107. ANIF was established as a closed joint-stock company (CJSC) and falls under the general company law. ANIF is a parent company to two subsidiaries: (i) "Armenia Financed", which manages the crowdfunding platform ARFI, and (ii) "Entrepreneurship + State Anti-Crisis Investments Manager" CJSC ("E+SACI Manager"), which manages the "Entrepreneurship + State Anti-Crisis Investments" Investment Fund ("E+SACI Fund"). In general, ANIF follows the established legislation and has an appropriate set of governing bodies for a JSC: (a) general shareholders meeting ("GSM"), (b) board of directors, and (c) a single-person executive body, the Director (henceforth referred to as the "CEO"). This is established by ANIF's charter.

General shareholders meeting

108. Established by the law and ANIF's Charter, ANIF's general shareholders meeting (GSM) has the powers that are common for this body in similar companies. The exception is that, unlike at ANIF, it is usually the board who decides on the remuneration of the CEO. Otherwise, these powers include, among other things, the powers to approve the charter, to appoint members of the board of directors, to reorganize and liquidate the company, to approve the auditor, to approve the annual report and financial statements, to decide on the distribution of profits and losses, to decide on major transactions, to decide on the remuneration of both the board members and the CEO.

109. All decisions of the GSM are made in the form of Government Decrees since the only shareholder of ANIF is the Prime Minister's Office. Although the mission has not been able to confirm this with the Prime Minister's office, based on the mission interviews, the Prime Minister's Office does not appear to have dedicated capacity or necessary expertise to efficiently oversee ANIF. In practice, it is the Chief of Staff of the Prime Minister's Office and his deputy that interact with ANIF on behalf of the ownership entity. The Prime Minister's Office may involve the Office's staff in interactions with ANIF and engage other government agencies in developing the Government Decrees that formalize the decisions of the ANIF GSM.

110. Although ANIF's board is the key governing body that is supposed to scrutinize all key decisions, the mission has not identified much of an interaction between ANIF's board and the Prime Minister's Office. Coupled with the board's minimal support infrastructure and ANIF's basic internal controls (both discussed below), this suggests that ANIF lacks the necessary capacity for informed decisions, effective execution monitoring, and efficient oversight.

Board of directors

111. Independence of the board can be undermined by the GSM's power to dismiss any board member at any time. According to ANIF's charter, the GSM decides on the size of the board of directors, election, and dismissal of board members, essentially on any grounds, implying that whenever the shareholder dislikes the opinion of a board member, it may replace him/her with another candidate. In good practice, and according to OECD Guidelines, the state should let SOE boards exercise their responsibilities and should respect their independence.

112. ANIF board independence is difficult to ensure. The Law on Joint-Stock Companies (the "JSC Law") appears to allow dismissing board members at any time. In principle, ANIF could specify in its charter a limited, exhaustive list of grounds on which a board member may be dismissed. (Note that the shareholder must always have the right to dismiss the entire board, if it wishes to do so.) However, since the charter is approved by the shareholder, this may be reversed at any time, unless changes to the Charter are protected by loan covenants or other obligations. In addition, the company law only requires

that independent members make up at least a third of the board in open joint-stock companies, but not in CJSCs, such as ANIF.

113. It is difficult to make conclusions on the board powers since this mission has no evidence of board's approvals of the ANIF's strategy or significant transactions that are within the board's remit. No evidence of preliminary consideration of major deals by the board have been shared either, such as the Masdar project, FlyArna project, or the Zangezur Copper Molybdenum Combine. In good practice, such approvals are publicly disclosed in ongoing and annual reporting, which is not the case with ANIF.

114. ANIF board size and composition are unclear. According to ANIF's charter, the board shall consist of no less than three and no more than nine members. According to ANIF's website,³⁵ triennial report, and presentation, the company's board consists of three people.³⁶ The mission did not see the documents by which these board members were appointed. At the same time, the mission is aware of at least one Order of the Minister of the Economy (No. 733, dated June 30, 2020), which appointed five people to ANIF's board.³⁷ ANIF's website or triennial report contain no mention of these appointments or re-appointments, suggesting that there may have been other similar appointments. More importantly, it has no information on the two members.

115. ANIF's board profile is unclear. Despite the fact that ANIF board consists of high-caliber individuals, it appears to lack professional expertise for reviewing and making professional investment decisions. The board is also too small to be able to evaluate investment projects properly. According to ANIF's charter, any legally capable natural person of any citizenship may be ANIF's board member. The mission has not identified any further qualification requirements for individual board members or collective suitability requirements, which is expected in good-practice SOEs. Such qualification/collective suitability requirements will typically ensure that the board profile reflects the company's mission and business, making it possible for the board to both advise and monitor/scrutinize management.

116. The selection and nomination process of board members is unclear, and there seems to be no nomination procedures ensuring a competitive, transparent, and merit-based process. Although ANIF's website has several news releases that announce new board appointments, it is not possible to infer from these releases how the board members were selected. There is no information on the selection and nomination procedure. Limited corporate governance information on the website or in ANIF's triennial report do not discuss the selection process or the board's collective set of skills.

117. The powers to set the board's remuneration (including possible bonuses and reimbursable expenses) are vested in the GSM, and their adequacy is impossible to evaluate as they are not disclosed. The mission could not identify a remuneration policy for ANIF board members or a reference to such policy. The OECD SOE Guidelines and good practice suggest that the board remuneration is decided by the GSM. However, they also recommend that remuneration should be set according to a clear remuneration policy, and that both the policy and the size of remuneration are publicly disclosed. The OECD SOE Guidelines recommend that board remuneration should be adequate to attract and retain skilled candidates, i.e., at par with peer companies, so that SOEs are on a level playing field with their private competitors. The Armenian law does not require ANIF to disclose its board or management remuneration, and the company chooses not to.

³⁵ <https://anif.am/>. Last accessed on January 17, 2023.

³⁶ Tigran Avinyan (Board Chairman, currently a deputy mayor of Yerevan), Dominique de Villepin (independent member, appointed on 23/07/2019), and Isidoro Lucciola (independent member, appointed on 08/11/2019).

³⁷ Above mentioned three members plus Aneta Babayan (Adviser to Deputy Prime Minister Avinyan at that time), Sona Tevanyan.

118. Information on the boards of ANIF and its subsidiaries is not clearly presented. ANIF website, triennial report, and presentation indicate that ANIF has an investment committee of three members, two of whom are independent. However, (a) none of these individuals is a member of ANIF's board, and (b) ANIF's charter does not envisage an investment committee, whether as a board committee or a standalone committee. In communication with this mission, ANIF clarified that ANIF's board also serves in the capacity of the company's investment committee. The "investment committee" as presented in the triennial reports and presentation are not ANIF's board committee. In fact, these three individuals are member of the board of ARFI, an ANIF subsidiary. They also serve as an investment committee of ARFI.

119. ANIF's board has no board committees, while good practice calls for establishing at least an audit committee and a nomination and remuneration committee. In good practice, these committees should be chaired by an independent board member, the remuneration and nomination committee should consist of a majority of independent members, and the audit committee fully composed on independent members – with appropriate expertise. The good practice also suggests that membership overlaps across board committees should be kept to a minimum. In case of ANIF, this can only be realistic with a larger board that will attract members with appropriate expertise.

CEO and management

120. ANIF's charter states that the board decides on the appointment and dismissal of the CEO, while the current CEO was appointed directly by the Government. Specifically, the Government Decree that established ANIF instructed the Economy Minister to form the executive body of ANIF (i.e., to appoint the CEO), among other things. Based on this evidence, the mission assumes that the CEO was appointed by an Order of the Economy Minister, and that ANIF is likely to have had no board at that time. ANIF's press releases also refer to board appointments were made after the CEO was appointed directly by the Government.

121. ANIF board decides on the remuneration policy, but it seems that the GSM decides on the CEO's remuneration, which is not in line with good practice. In best corporate governance practices, both - the CEO's remuneration size and remuneration policy - are set by the board. Moreover, since it is ANIF's board that decides on the appointment and dismissal of the CEO, it should be within the board's powers to decide on the CEO's remuneration.

122. Selection, nomination, remuneration, and evaluation of ANIF's CEO do not appear to be governed by any formal procedures, as the OECD SOE Guidelines recommend. In best practice, the board should develop a nomination and a succession policy, set objectives and performance indicators for the CEO that reflect company's strategic objectives, and evaluate his/her performance. The CEO's remuneration, with appropriate explanation for which achievements he/she was rewarded based on the remuneration policy and the pre-set objectives or performance indicators, should also be publicly disclosed.

123. It is unclear if ANIF management is evaluated and rewarded for good performance or sanctioned for poor performance. This would be difficult, if not impossible to achieve, as ANIF strategic objectives are not defined. In good practice, the evaluation is based on clearly set targets distilled from the company's strategic objectives. Without such targets, performance evaluation becomes discretionary or arbitrary. It appears from ANIF's charter that the decisions relating to the appointment, dismissal, performance evaluation, and remuneration of all ANIF employees, including the management team, are all within the remit of the CEO.

Control Environment

124. ANIF's financial statements are prepared according to the IFRS and regularly audited. Since the Company's inception in 2019, ANIF audit is performed by a major audit firm - KPMG. While

ANIF is not required by the local legislation to do so, good practice calls that the public companies disclose their complete financial statements along with the auditors' opinion so that the public can form an opinion of the company's performance. ANIF has disclosed its financial statements for 2019-2021 publicly after this mission, in February 2023. This is a welcome voluntary step towards good practice. However, this mission acknowledges that there is no legal requirement or a contractual obligation for ANIF to make such disclosure, it is suggested that accurate and timely disclosure of financial statements will be maintained.

125. ANIF's subsidiaries seem to have adopted risk management requirements, as required by the CBA's relatively liberal regulations for investment funds, but are unclear in case of ANIF. No evidence of an organized risk management function at the level of ANIF, stating ANIF's risk appetite, risk management policies, and description of a risk management function, was made available to the mission. In principle, based on ANIF's undefined mandate and investment pattern, it may be difficult to devise an effective risk appetite statement. Similarly, little or no evidence was available that a compliance function is in place.

126. The mission did not identify a system of internal controls or an internal audit function at ANIF. Neither ANIF's charter, the board practices, nor the composition of the top and middle management teams indicate that ANIF has an established internal audit function.

127. In absence of a developed internal control system and limited oversight, ANIF will benefit from a state audit. In principle, ANIF is a subject to state audit by the Chamber of Audit. However, the Chamber has not yet audited ANIF since its establishment in 2019. Subjecting ANIF to the state audit is particularly important because the Chamber's audits are not limited to financial audits, but also cover performance audits and compliance audits. ANIF can be audited as part of the audits of Prime Minister's Office's spending of state budget funds.³⁸

C. Transparency and Disclosure

128. ANIF's primary sources of public disclosure are the company's website, its informal triennial report, and impact report. Although ANIF triennial report resembles a standard annual report of a public company, and the impact report resembles an ESG report, they do not perform these functions yet. First, they are not governed by any legal provisions or obligations, and the mission could not establish any legal requirements regarding the accountability of ANIF's officials for (possibly, incorrect or erroneous) disclosure in these reports. Second, the reports are not organized in a systematic way, and do not contain the information required to form an opinion of ANIF's performance or project impact – because ANIF objectives are loosely defined, making it impossible to evaluate that impact without understanding ANIF's mandate.

129. Although ANIF has disclosed its 2020–21 financial statements recently, it is still difficult to make sense of the company's investments or their performance. In February 2023, ANIF has disclosed its audited IFRS financial statements for 2019-2021 for the first time. Such disclosure is consistent with good practice. However, the informativeness of these statements is limited at this time for the following reasons:

³⁸ As part of the feedback to the draft mission report, the mission team was informed that on October 25-28, 2022, the MoF Department of Financial and Budgetary Control conducted an audit in the ANIF, covering the verification of the authenticity, purposefulness and effectiveness of the budget funds execution and the accuracy of the calculation of dividends. The audit report has been submitted to the staff of the RA Prime Minister. The mission team has not discussed this information with the authorities.

- The statements are disclosed as a standalone document, not as part of an annual report which would typically include a management analysis and discussion (MD&A) section that helps the user to interpret the financials and the company's performance, relating them to key developments.
- ANIF's triennial report could serve as such MD&A, as it covers the same period as disclosed financial statements (2019-2021). However, there is no connection between company's developments and investment initiatives discussed in the triennial report and the financial statements, making it difficult to interpret either of these two documents. For example, 2021 financial statement do not have any investments reflected at ANIF's balance sheet or cash flows – out of ANIF's total assets of AMD 5.9 billion, AMD 4.2 billion (or 71%) was deposited in banks. This suggests that no investment activity took place as of end-2021. The mission acknowledges that such investments may have been made in 2022 and may not be reflected in the 2019-2021 statements. However, if that is the case, one would expect the triennial report to (a) explain this clearly, and (b) to offer a substantive discussion of the developments and performance that is in fact based on the company's 2019-2021 financial statements.
- As mentioned earlier, there is no legal requirement or contractual obligation that ANIF discloses its audited financial statements, implying that such disclosure could be discontinued at any time.

130. ANIF appears to be in regular contact with the Prime Minister's Office and reports to the Government on a quarterly basis. The Government also receives ANIF's audited annual financial statements, which it must receive by law as the entity exercising the shareholder rights in ANIF. Note that ANIF is not mandated to disclose the IFRS statements since reporting year 2020, after the new version of the Accounting Law became effective, because it only falls under one of the three criteria of a large or medium enterprise necessary for such disclosure (assets, revenues, and workforce), while the law requires two criteria to be met to be considered a large or a medium enterprise.

131. Should ANIF be maintained by the Government, it should be subjected to the high standards of accounting, disclosure, compliance, and auditing, as per the OECD SOE Guidelines. Given the Government's sizable commitment to inject equity into ANIF, its growing role in government's spending and related fiscal risks, the mission believes the following public disclosures should be introduced and enforced for ANIF to bring it in line good practices:

- clear rationale for the state to own ANIF to be formulated by the Government, ANIF mandate;
- ANIF charter;
- ANIF strategy, its financial and public policy objectives;
- audited annual IFRS financial statements, complete set of notes and the auditors' opinion;
- an international-standard annual report that includes: (i) meaningful MD&A, sufficient to interpretate financial results, material developments, and company's performance on non-financial goals; (ii) corporate governance statement, including board and management composition, changes therein during the year, board and management's bios, information about board meetings, remuneration policy for the supervisory board with the disclosed actual amounts paid to each board member, remuneration policy for management with the disclosed actual amounts paid to the CEO and key executives, and compliance with corporate governance rules, such as the national corporate governance code; (iii) summary information on all transactions that involve conflicts of interest and related parties, all material procurement contracts, audit fees paid to the external auditors; (iv) issues regarding employees and other stakeholders; and (v) risk policy and foreseeable risk factors.

132. Before developing or updating ANIF's Decree, the Government should determine and formulate a clear rationale for owning ANIF and its mandate – this is a pre-requisite before proceeding to any further corporate governance changes. In particular, the rationale for owning ANIF should be distilled from the state ownership policy and clearly reflect specific national economic

development priorities, such those in the Government Program. While all the corporate governance elements discussed above in this subsection are essential, they will not address the fundamental question on why the Government should own ANIF. Without a clear rationale and mandate, such changes are likely to be nominal or inefficient at best. They will only be meaningful if based on a clear ownership rationale and mandate to guide ANIF operations.

D. Recommendations

Recommendation 4.1: From the state ownership policy, distill a clear rationale for owning ANIF and, based on that, define the scope of ANIF, considering the following:

- The rationale for owning ANIF should reflect the national economic development priorities, and the scope should state (a) the policy objectives that ANIF is required to (help) achieve, (b) in which sectors ANIF will be involved, and (c) its role in these sectors.
- To ensure that ANIF investments are made in a responsible, efficient, and monitorable manner, a requirement should be established that ANIF investments should be matched by co-investment by reputable investors, such as investment grade funds or companies as rated by international rating agencies.
- ANIF investments should be required a rate of return no lower than the cost of capital, on a project basis.
- Consider ANIF dissolution if rationale for its ownership is not determined and lacks links to the Government public policy objectives.

Recommendation 4.2: Only after establishing the rationale for owning ANIF and defining its scope, the Government of RA should establish proper corporate governance at ANIF, including at a minimum: a competent, empowered, and independent board; a management team that reflects ANIF's strategy and is evaluated based on performance; an effective internal control system; and transparency and disclosure consistent with the OECD standards.

Recommendation 4.3: The Government of RA should refrain from any further capital injections into ANIF until the above steps have been completed. For that purpose, it should consider introducing a moratorium on new ANIF capital allocations and/ or its new investments, until reporting, transparency, and viability requirements for ANIF are clarified and legislated via a dedicated ANIF Decree.

Annex I. Illustrative List of Rationales for State Ownership

The list is developed based on both OECD research results and available working materials taking into account the specifics of the SOE reform progress in the republic of Armenia.

As per OECD “*Ownership and Governance of State-Owned Enterprises – A Compendium of National Practices*”, the overall objectives for state enterprise ownership generally fall into the following categories:

- a. supporting national economic and strategic interests;
- b. ensuring continued national ownership of enterprises;
- c. supplying specific public goods or services (if the market cannot supply the same goods or services);
- d. performing business operations in a “natural” monopoly situation; and
- e. creating or maintaining a state-owned monopoly (or oligopoly) where market regulation is deemed infeasible or inefficient.

The proposed extended list of justifications/rationales for state ownership

For enterprises with 100 percent state ownership aimed to serve strategic state interests:

- Infrastructure of national interest
- Natural monopolies
- State-owned monopoly (or oligopoly) where market regulation is deemed infeasible or inefficient
- Correction of market failure
- Resolving social issues
- Achieving social goals
- Production of goods and services of the strategic importance
- Support development of the sub-sectors where the private sector is not present
- Economic diversification
- Achieving specific sector policy targets
- Temporary support to loss making companies where collapse may produce multiple negative effects (i.e., in crisis times)

For enterprises with majority state ownership aimed to serve specific strategic interests

- Need for significant investments that could be provided by a third party, when the state ownership structure reduces the cost for the budget
- Need for specific expertise that could be provided externally at minimal or no additional cost to the budget or SOE

Potential exit scenarios for the enterprises in the divestment pipeline

- Divesture through direct auction privatization
- Divesture through direct tender privatization
- Divesture through auction privatization with prior restructuring
- Divesture through tender privatization with prior restructuring
- Divesture through concessions
- Divesture through PPP

Annex II. Selected State Ownership Policies

Sweden: The Swedish Government has a mandate from the Parliament to actively manage SOEs to ensure optimal long-term value performance and, where applicable, to ensure that specifically adopted public policy assignments are performed well. The Government sets out mandates and objectives, applicable frameworks and important matters of principle relating to the governance of the SOEs. The Government is responsible for (i) developing a state ownership policy and other guidelines; (ii) setting SOEs' financial targets; (iii) setting the public policy targets for SOEs that have specific public policy objectives; (iv) appointing Boards of Directors; and (v) deciding on dividends.

Sweden's State Ownership Policy is updated regularly, its 2020 edition is available here:

<https://www.government.se/49eb29/contentassets/aef85fbd7beb4319a70af9a30d6723a1/state-ownership-policy-2020.pdf>

Germany: The state ownership policy is established at the legislative level. Its main principle - participation in or creation of a commercial enterprise (SOE) only if the State has a strategic interest, and a goal that cannot be achieved in a more efficient way. The Policy is being reviewed every two years. The Ministry of Finance publishes an annual report on state ownership of the state and a biennial Report on Reducing SOEs.

The specific objectives of the SOE should be included in the charters and regulations of each SOE. The goals are clearly defined, and each enterprise with direct state ownership is published in the annual report of the Ministry of Finance: <https://www.bundesfinanzministerium.de>

France: The recently revised ownership priorities were re-focused to take a more selective role for the French Government's participation in SOEs to clarify its policy for intervention based on three key priorities:

- Companies of strategic interest and contribution to France's national sovereignty (defence and nuclear power)
- Public service companies and companies of local or national public interest that the Government cannot adequately influence to uphold these interests using regulation alone
- Companies encountering difficulties and of a systemic risk

To supplement the above, the French Government places additional four priority factors for SOEs to contribute to the national priorities: (i) the need to continue supporting SOEs hard hit by the crises; (ii) economic sovereignty and requirements concerning France's re-industrialization; (iii) environmental requirements that speed up the transformation of business models; and (iv) digital and technological changes.

The policies and detailed report on SOEs governance and performance are published by the French SOE ownership authority - Agence des participations de l'État (APE):

<https://www.economie.gouv.fr/agence-participations-etat/ressources-documentaires-1>

The Netherlands: The state property policy is published by the Government of the Netherlands, and includes the following basic principles of state ownership - the State owns shares of a company, if it serves the public interest:

- carries out major infrastructure projects in the national interest, such as Schiphol or share in the port of Rotterdam; or

- a private company is in crisis and is nationalized in the public interest, such as nationalization of ABN AMRO and SNS Reaal during the financial crisis.

The Government of the Netherlands divides the SOE portfolio into three categories:

- i. Permanent: SOEs over which the government controls strategic majority control (e.g., Schiphol Airport, NS (Dutch railway operator), Rotterdam port, as these companies manage vital infrastructure and are important for the Dutch economy)
- ii. Not permanent: The government has announced plans to sell some SOEs (e.g., Staatsloterij and Holland Casino)
- iii. Temporary: SOEs nationalized to stabilize the market and that will be returned to the private sector if market conditions improve (e.g., financial institutions ABN AMRO, ASR and SNS Reaal)

The Government portal: <https://www.rijksoverheid.nl/onderwerpen/staatsdeelnemingen/waarom-staatsdeelnemingen>

Annex III. Summary of the OECD Guidelines on Corporate Governance of State-Owned Enterprises

The OECD SOE Guidelines were updated in 2015 and include recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. Detailed Guidelines can be accessed on the OECD website.³⁹

I: RATIONALES FOR STATE OWNERSHIP

The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

- A. The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources.
- B. The government should develop an ownership policy. The policy should *inter alia* define the overall rationales for state ownership, the state's role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.
- C. The ownership policy should be subject to appropriate procedures of political accountability and disclosed to the general public. The government should review at regular intervals its ownership policy.
- D. The state should define the rationales for owning individual SOEs and subject these to recurrent review. Any public policy objectives that individual SOEs, or groups of SOEs, are required to achieve should be clearly mandated by the relevant authorities and disclosed.

II: THE STATE'S ROLE AS AN OWNER

The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

- A. Governments should simplify and standardize the legal forms under which SOEs operate. Their operational practices should follow commonly accepted corporate norms.
- B. The government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management. The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner.
- C. The state should let SOE boards exercise their responsibilities and should respect their independence.
- D. The exercise of ownership rights should be clearly identified within the state administration. The exercise of ownership rights should be centralized in a single ownership entity, or, if this is not possible, carried out by a coordinating body. This "ownership entity" should have the capacity and competencies to effectively carry out its duties.

³⁹ <https://www.oecd.org/corporate/guidelines-corporate-governance-soes.htm>

E. The ownership entity should be held accountable to the relevant representative bodies and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

F. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Its prime responsibilities include:

1. Being represented at the general shareholders meetings and effectively exercising voting rights;
2. Establishing well-structured, merit-based and transparent board nomination processes in fully- or majority-owned SOEs, actively participating in the nomination of all SOEs' boards and contributing to board diversity;
3. Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;
4. Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;
5. Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;
6. When appropriate and permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;
7. Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

III: STATE-OWNED ENTERPRISES IN THE MARKETPLACE

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

B. Stakeholders and other interested parties, including creditors and competitors, should have access to efficient redress through unbiased legal or arbitration processes when they consider that their rights have been violated.

C. Where SOEs combine economic activities and public policy objectives, high standards of transparency and disclosure regarding their cost and revenue structures must be maintained, allowing for an attribution to main activity areas.

D. Costs related to public policy objectives should be funded by the state and disclosed.

E. As a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations. Laws and regulations should not unduly discriminate between SOEs and their market competitors. SOEs' legal form should allow creditors to press their claims and to initiate insolvency procedures.

F. SOEs' economic activities should face market consistent conditions regarding access to debt and equity finance. In particular:

1. SOEs' relations with all financial institutions, as well as non-financial SOEs, should be based on purely commercial grounds.
2. SOEs' economic activities should not benefit from any indirect financial support that confers an advantage over private competitors, such as preferential financing, tax arrears or preferential trade credits from other SOEs. SOEs' economic activities should not receive inputs (such as

energy, water or land) at prices or conditions more favorable than those available to private competitors.

3. SOEs' economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

G. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

IV: EQUITABLE TREATMENT OF SHAREHOLDERS AND OTHER INVESTORS

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

A. The state should strive toward full implementation of the *OECD Principles of Corporate Governance* when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:

1. The state and SOEs should ensure that all shareholders are treated equitably.
2. SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.
3. SOEs should develop an active policy of communication and consultation with all shareholders.
4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.
5. Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.

B. National corporate governance codes should be adhered to by all listed and, where practical, unlisted SOEs.

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

D. When SOEs engage in co-operative projects such as joint ventures and public-private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner.

V: STAKEHOLDER RELATIONS AND RESPONSIBLE BUSINESS

The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

A. Governments, the state ownership entities and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements.

B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labor, creditors and affected communities.

C. The boards of SOEs should develop, implement, monitor, and communicate internal controls, ethics and compliance programmes or measures, including those which contribute to preventing fraud and corruption. They should be based on country norms, in conformity with international commitments and apply to the SOE and its subsidiaries.

D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.

E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions.

VI: DISCLOSURE AND TRANSPARENCY

State-owned enterprises should observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance and auditing standards as listed companies.

A. SOEs should report material financial and non-financial information on the enterprise in line with high quality internationally recognised standards of corporate disclosure and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. With due regard to enterprise capacity and size, examples of such information include:

1. A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity);
2. Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives;
3. The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes;
4. The remuneration of board members and key executives;
5. Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board;
6. Any material foreseeable risk factors and measures taken to manage such risks;
7. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships;
8. Any material transactions with the state and other related entities;
9. Any relevant issues relating to employees and other stakeholders.

B. SOEs' annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit.

C. The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

VII: THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of SOEs should have the necessary authority, competencies, and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably.

B. SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government. They should have the power to appoint and remove the CEO. They should set executive remuneration levels that are in the long-term interest of the enterprise.

C. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.

D. Independent board members, where applicable, should be free of any material interests or relationships with the enterprise, its management, other major shareholders, and the ownership entity that could jeopardise their exercise of objective judgement.

E. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.

F. The Chair should assume responsibility for boardroom efficiency and, when necessary, in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.

G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information, and independence.

H. SOE boards should consider setting up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

I. SOE boards should, under the Chair's oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

J. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

Annex IV. An overview of ANIF's Initiatives and Investments

Initiative	Date	Sector	Topic	Reflects national development priorities?	Information on outcomes
Russian Direct Investment Fund	June 2019	Various (undefined)	It appears that no investment came out of this initiative, and ANIF's representative office in Moscow was closed in 2022.	Unlikely	Not available
Masdar	July 2019	Renewable energy (including solar photovoltaic, wind, and floating solar energy)	Solar power construction project, Ayg-1. Masdar signed a memorandum with ANIF in 2019 and a deal was announced in June 2021. Agreement on State Support signed in November 2021. The project's total investment is USD174 million via a JV. 85% of JV is owned by Masdar and 15%, by ANIF.	Yes, but the development priority was set <i>after</i> the Ayg-1 project was approved	Triennial report
A2A broad S.p.A. – ABD	February 2020	Advisory (waste management)	Consulting services for industrial initiatives in waste management	Unlikely	Not available
Young Sun Business Group	February 2020	Manufacturing	Bus-producing factory in Armenia	Unlikely (also unclear why another JV to produce buses, with Tekne, was contemplated)	Not available
Smart Technologies Systems JSC	April 2020 July 2020	Manufacturing	Metal oxide production in Armenia. Memorandum terminated in September 2020. Reasons not reported.	Unclear	Not available
Armenian Leasing Company	August 2020	Finance	Universal credit organization	Unlikely	Not available
Customs Card	April 2021	Digital services	A project to assist Armenian exporters in exporting to Russia by simplifying customs processes	Unclear	Not available
IBC	April 2021	Air	FlyArna Airline. The project's total investment is	Yes, but the	Triennial

		transportation	USD20 million via a JV. 49+2% of JV is owned by IBC, and 49%, by ANIF.	development priority was set <i>after</i> the FlyArna project was approved	report
Intesa – Sanpaolo	October 2021	Various (undefined)	Purpose and essence of the (intended) cooperation unclear	Unlikely	Not available
Tekne	November 2021	Manufacturing Other – various (undefined)	Intended JV to produce buses, as well as various cooperation within the E+SACI Fund	Unlikely (also unclear why another JV to produce buses, with Young Sun, was contemplated)	Not available
E20 Investments	December 2021	Agriculture	Livestock, crop, sheep, fodder, and meat production	Unlikely	Not available
Khachen	December 2021	Various (undefined)	Increasing exports, co-financing large projects, and developing a crowdfunding platform	Unlikely	Not available
ARFI	2022 (plan)	Finance	Crowdfunding investment platform. Appears to be an own initiative of ANIF.	Unlikely	Triennial report
Im Toon	n/a	Manufacturing	Wooden modular house factory. VIA ARFI, based on the principle: “ANIF + private investor”	Unlikely	Triennial report
E+SACI Fund	May 2020	Various	A fund to help the Armenian economy recover from Covid-19 pandemic – in reality, 7 investment projects in all sorts of business	Most investment are not likely to reflect national development priorities	Triennial report

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