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**European Bank**  
for Reconstruction and Development

## **Corporate Governance in Transition Economies**

### **Azerbaijan Country Report**

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If you believe that the information has changed or is incorrect, please contact Gian Piero Cigna at [cignag@ebrd.com](mailto:cignag@ebrd.com)

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## **Foreword**

As part of its Legal Transition Programme, the European Bank for Reconstruction and Development (“EBRD”) has been assessing the state of legal transition in its countries of operations. These assessments provide an analysis of the progress of reform and identify gaps and future reform needs, as well as strengths and opportunities.

In 2012, the Legal Transition team within the EBRD Office of the General Counsel (LTT) developed with the Assistance of Nestor Advisors a methodology for assessing corporate governance frameworks and the governance practices in the EBRD countries of operations. This assessment was implemented in 2014-2015 (the “Assessment”).

The Assessment aims at measuring the state of play (status, gaps between local laws/regulations and international standards, effectiveness of implementation) in the area of corporate governance

The Assessment is meant to provide for (i) a comparative analysis of both the quality and effectiveness of national corporate governance legislation (including voluntary codes); (ii) a basis to assess key corporate governance practices of companies against the national legislation; (iii) an understanding whether the legal framework is coupled with proper enforcement mechanisms (e.g., sanctions) and/or with authorities able to ensure proper implementation; (iv) a support to highlight which are the major weaknesses that should be tackled by companies and legislators for improving the national corporate governance framework; and (v) a tool which will enable the EBRD to establish “reference points” enabling comparison across countries.

This country report is part of a series of 34 country reports. A general report synthesising all countries will close the Assessment.

## Methodology

This Assessment is based on a methodology designed to measure the quality of legislation in relation to best practices requirements and the effectiveness of its implementation as evidenced by companies' disclosure, also taking into consideration the capacity of the institutional framework (e.g., courts, regulators) to sustain quality governance. The analytical grid developed for assessing the governance framework is based on international recognised best-practice benchmarks (e.g., OECD Corporate Governance Principles, Development Financial Institutions, EBRD, IFC and World Bank ROSC governance methodologies). The methodology is applied identically across all the countries reviewed. The process for gathering, analysing and reporting information is applied identically for each of the countries assessed, which allows comparing countries to each other across a long a set of benchmarking points.

For the purpose of the Assessment, the corporate governance framework and the practices were divided in five key areas: (i) Structure and Functioning of the Board; (ii) Transparency and Disclosure of company information; (iii) Internal Control; (iv) Rights of Shareholders; and (v) Stakeholders and Institutions. Each of these key areas is further divided in sections (for instance, the area "Structure and Functioning of the Board" is divided in five sections: Board composition; Gender diversity at the board; Independent directors; Board effectiveness; and Responsibilities of the board). Each section is further divided in subsections (for instance, the section "Independent Directors" is divided in three subsections: "Requirement to have independent directors"; "Definition of Independence"; and "Disclosed practices").

The assessment started by sending a questionnaire to law firms, audit firms, national regulator(s), ten largest (listed) companies, and stock exchange(s) in each country. Questions were different according to the respondents, which were asked to provide information on the legislation and on how they believe the legislation is implemented.

Responses were assigned to the corresponding subsection(s) and validated by the EBRD corporate governance specialists by looking at the applicable framework and at the disclosure offered by the ten largest (listed) companies in each country. In this respect, the working hypothesis was that the ten largest listed companies are those offering the best disclosure in each country. As such, we presumed that when certain practices were not disclosed by them, they were unlikely to be disclosed by smaller or unlisted companies. The ten largest companies were identified according to their market capitalisation. When a country did not have a stock exchange, there were less than ten listed issuers or there were no data on capitalisation of issuers, the ten largest companies were identified according to their revenues and size of the labour force. In case the largest companies were mostly of one sector (e.g., financial institutions), then the sample of ten companies was corrected to reflect other sectors of the economy.

The validation of responses was undertaken by the corporate governance specialists within the Legal Transition Team through desktop research. This research was conducted both on legislation and on the practices disclosed by the largest (listed) companies (e.g., companies' websites, annual reports, stock exchanges database etc.). In addition, the relevant reports by international financial institutions (e.g., IMF, World Bank, IFC, Transparency International, etc.) were analysed and taken into consideration. Answers received by respondents that were not grounded by specific references to legislation or consistent with the disclosed practices were not taken into consideration.

Following the validation process, each subsection was compiled by adding specific references to legislation and practices. Conclusions were then formulated for each subsection, each rated as per their adherence to international governance standards. The score ranges from 1 (very weak) to 5 (strong). The rating for each section was then calculated by averaging the ratings of the subsections.

Because understanding corporate governance requires a "holistic perspective", where each component needs to have a place in the overall picture – pretty much like a puzzle - in case one of the subsection was rated "weak" or "very weak", the resulting average was decreased by 0.2; in case

more than one subsection was rated “weak” or “very weak”, the resulting average was decreased by 0.5. This is because if just one component is not fitting well with the others, then all others are weakened. Similarly, the overall strength diminishes if there are more weak components.

Conversely, in order for the framework to be strong, all components need to be well fitting with each other. Hence, in case all subsections were scored “moderately strong” or “strong”, then the resulting average was increased by 0.5. However, this “positive” adjustment was used with some care as the assessment looked at the top ten largest companies in the country, hence findings tended to be often overly optimistic.

Key areas were then rated according to the same criteria.

The ratings are presented through the colours detailed in the box below and they demonstrate the adequacy or need of reform in respect to each governance area and section.

**Rating:**

**“Strong to very strong” (DARK GREEN)** - The corporate governance framework / related practices of companies are fit-for-purpose and consistent with best practice.

**“Moderately strong” (LIGHT GREEN)** - Most of the corporate governance framework / related practices of companies are fit-for-purpose but further reform is needed on some aspects.

**“Fair” (YELLOW)** - The corporate governance framework / related practices of companies present some elements of good practice, but there are a few critical issues suggesting that overall the system should be assessed with a view of reform.

**“Weak” (ORANGE)** - The corporate governance framework / related practices of companies may present few elements of good practice, but overall the system is in need of reform.

**“Very weak” (RED)** - The corporate governance framework / related practices of companies present significant risks and the system is in need of significant reform.

We believe corporate governance cannot be captured and measured simply by numerical values. Hence, alongside the “quantitative” assessment obtained according to the methodology described above, a “qualitative” assessment was also undertaken, by classifying our findings for each section as “strengths” and “weaknesses”. Because understanding corporate governance requires a “holistic perspective”, when the “quantitative” assessment was finalised, the assessment team compared it with the “qualitative” assessment, and when any inconsistency (i.e. material weaknesses or strengths) was noticed, the average scores of the sections were adjusted by up to  $\pm 0.5$ .

A preliminary version of the Assessment was made public for consultation. The comments and corrections received during the process were analysed by the corporate governance specialists. When confirmed, the corrections were reflected in the final ratings and in this Assessment.

## Overview

### ***Legislative framework***

In Azerbaijan, the corporate governance framework is mainly included in the Civil Code, the Law on Banks the Law on Insurance Activity, Law on Securities Market,<sup>1</sup> the Law on Accounting, and the Law on Internal Audit. In addition, Corporate Governance Standards for Banks and regulations of the Central Bank of Azerbaijan on the external and internal audit and on risk management set out a number of corporate governance requirements which the banks must adhere to.

The Azerbaijan Corporate Governance Standards were adopted in 2011. In 2012, the Ministry of Economy issued a methodology for assessing compliance with the Standards and in 2013 performed a review over 33 selected companies. In 2014, the Standards become mandatory for the companies where the Azerbaijani Investment Company has made equity investment. For all other companies, the Standards are voluntary; overall, there is no evidence that they are taken as a reference.

### ***Structure and Functioning of the Board***

Companies with more than fifty shareholders are organised under a two-tier board system where the CEO cannot be chair of the board. Boards seem to have very little authority over the company's strategic functions, and they are not entitled by law to appoint or dismiss executives. Boards are generally small, while gender diversity at the board appears to be very limited. Since only one company disclosed the board members' qualifications, we could not assess whether boards have a diversified mix of skills. Insurance companies and companies listed on the exchange's Premium Segment are required to have independent directors. The Corporate Governance Standards recommend all companies to do so, but they do not seem to be well implemented as none of the companies in our sample disclose having any independent directors. Public interest entities are required to have an "audit committee" appointed by the general shareholders' meeting (GSM). This body is not a board committee. The Standards recommend the establishment of audit, nomination, remuneration and risk management committees. These committees may be comprised of a minority of non-board members (outsiders), which is not in line with best practices. There is no practice of performing board evaluations or appointing corporate secretaries. The law awards board members with liability and fiduciary duties; however, there is no evidence that the law is well implemented. No case law on these issues seems to exist. We could not determine how boards and committees work in practice, since there is no disclosure on the number of board and committee meetings and activities.

### ***Transparency and Disclosure***

Public interest entities, including banks and listed companies, are required to prepare their financial statements in accordance with international standards, and most companies seem to comply with this requirement. Joint stock companies are further required to prepare and disclose their annual reports; however, as of recently this obligation does not seem to include any non-financial information, however, there is no guidance on how the document should be drafted. In practice, the majority of the ten largest companies in the country publish their Annual Reports, but non-financial disclosures, including governance and ownership structures, are very limited. Only one company posts its Articles of Association on its website, while none discloses the minutes of the general shareholders' meeting or any other information on the board and committee activities. Companies' websites are incomplete and not easily accessible.

The Corporate Governance Standards are voluntary, except for companies in which the Azerbaijani Investment Company (AIC) has made equity investment – however it is not clear how this requirement is monitored - there is no legal requirement for other companies to comply with them. None of the ten largest companies disclose any information about their compliance with the Standards. Companies are required to have independent external auditors and disclose their names. Seven out of the ten largest companies appear to comply but only four companies declare that their auditors are independent. The provision of non-auditing services by the external auditors is restricted, however it does not seem to be well implemented. Further,

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<sup>1</sup> The Law on Securities Market was enacted in May 2015 and entered into effect in July 2015. Among other issues, it prescribes the obligation of listed companies to include governance reports in their annual report and regulates some corporate governance aspects of licensed capital market participants (e.g. investment firms). While acknowledging this legislative novelty, it occurred after the cut-off date of the report and has not been included in the assessment.

there is no requirement for the external auditor to disclose information on the provision of these services. These two shortcomings might undermine the auditor's independence.

### ***Internal Control***

The law requires banks and insurance companies to have internal audit units, and joint stock companies to have external audit bodies. In practice however there is no real assurance of their independence. External auditors are not allowed to provide non-auditing services, and are subject to rotation obligations. However, it seems that these restrictions are not complied with. In some cases, it seems that the same audit firm both prepares and audits accounts. Public interest entities are required to establish audit committees. In turn, companies with more than fifty shareholders and financial institutions are required to set up a "*revision commission*". The Corporate Governance Standards further recommend companies to establish audit committees. There seem to be some confusion across various pieces of legislation between the roles and responsibilities of audit committees and those of revision commissions. Except for the case of the Corporate Governance Standards, the audit committees mentioned in legislation seem to be in practice a revision commission, appointed by and reporting to the general shareholders' meeting. We have doubts about this body's ability to ensure fit-for-purpose internal control systems. In regard to the audit committee recommended by the Corporate Governance Standards, it is suggested that its members might be *outsiders* (i.e., non-board members), which is not in line with best practices. There is no law on whistleblowing protection, but a new law is being drafted. None of the ten largest listed companies discloses having a code of ethics. New regulation on related party transactions has been recently introduced; however it was not possible to assess its implementation. In practice, it seems that boards lack enough independence from majority shareholders to effectively monitor conflicts of interest, even in the case of banks.

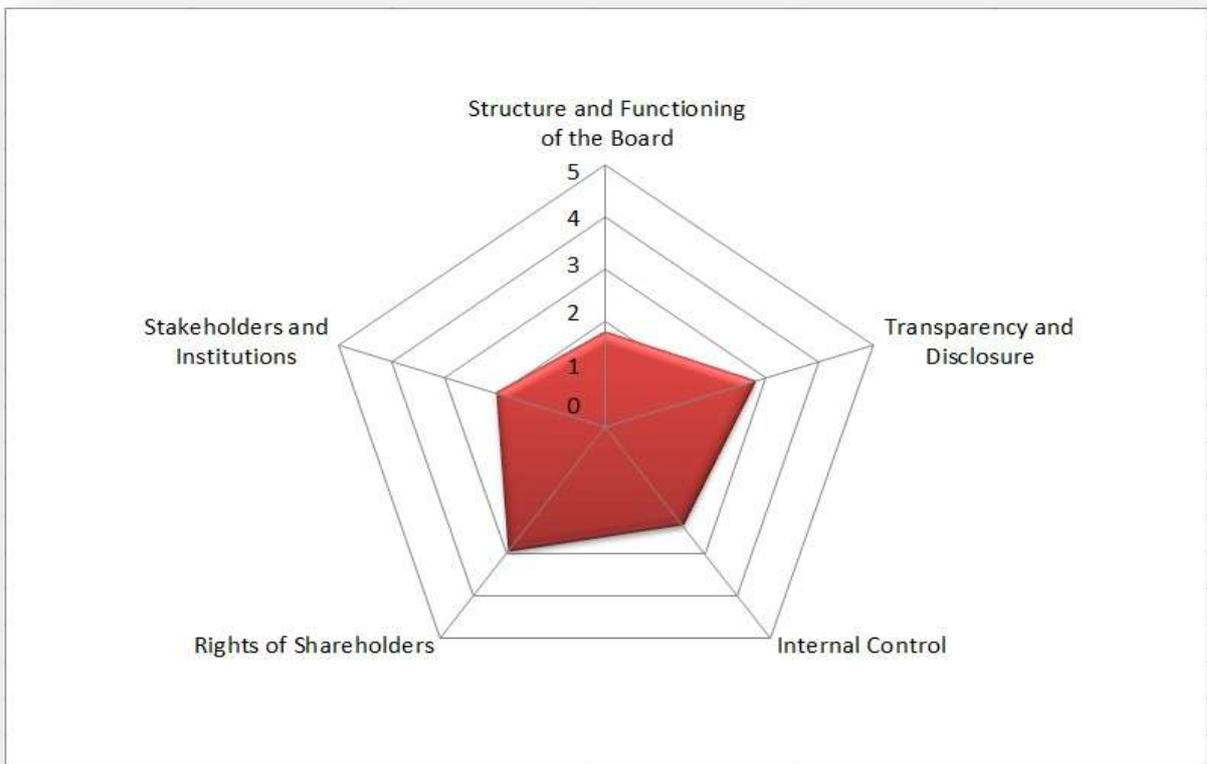
### ***Rights of Shareholders***

Basic shareholders rights are granted by law, and major corporate decisions are subject to supermajority. Shareholders have inspection rights and are entitled to call a shareholders' meeting. However, shareholders do not seem to have the right to ask questions at the general shareholders' meeting (GSM), or to nominate directors. Pre-emptive rights in cases of public offerings have been introduced in 2015. Cumulative voting are not granted by the law. Shareholders are provided with judicial mechanisms to enforce their rights, but shareholders' awareness of them seems to be low. Related party transactions and conflicts of interests are regulated. Regulation on insider trading and self-dealing exists, but it does not seem to be enforced in practice. Large companies are required to keep their shares at a private registry or at the National Depository Centre. Shareholding increases are subject to regulations and in listed companies they must be disclosed. There is no clear legislation on shareholders agreements.

### ***Stakeholders and Institutions***

Overall, the institutional environment promoting corporate governance in Azerbaijan needs to be strengthened. The stock exchange is illiquid and both the exchange and regulator do not seem to have an active role in promoting good governance practices. The websites of the exchange provide some limited financial information; however, neither the stock exchange's nor the regulator's websites provide all regulatory submissions made by listed companies. A Corporate Governance Code exists but it does not appear to be taken as a reference. International audit firms and ratings agencies are present and active in the country. It appears that there are inconsistencies in the legislation, some key corporate governance issues are not regulated, and case law is hardly accessible, even for lawyers. Listed companies do not seem to pay much attention to requests by stakeholders, and international organisation indicators show a framework where corruption is still perceived as a critical problem. It appears that the country has improved significantly in the World Bank's Doing Business ranking, but the indicator focuses primarily on the state of written laws, and does not fully assess how legislation is applied in practice.

## Corporate Governance Legislation and Practices in Azerbaijan



Source: EBRD, Corporate Governance Assessment 2016

Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in best practices and international standards (e.g., OECD Corporate Governance Principles). The fuller the 'web', the closer the corporate governance legislation and practices of the country approximates best practices. Data are still indicative. They will be confirmed after having received public comments.

Key: Very weak: 1 / Weak: 2 / Fair: 3 / Moderately Strong: 4 / Strong to very strong: 5

Key Areas and Rating	Strengths and Weaknesses
<p><b>1. Structure and Functioning of the Board</b> Very Weak</p>	<p>Companies with more than fifty shareholders in Azerbaijan are organised under a two-tier board system where the CEO cannot be chair of the board.</p> <p>Boards do not seem to have any authority over the company's strategic functions, and they are not entitled by law to appoint or dismiss executives. Boards appear to be generally small. Since only one company disclosed the board members' qualifications, we could not assess whether boards have a diversified mix of skills. Gender diversity at the board appears to be very limited.</p> <p>Insurance companies and companies listed on the exchange's Premium Segment are required to have independent directors. The Corporate Governance Standards (i.e., the Corporate Governance Code published in 2011) recommend all companies to do so, but the Standards do not seem to be well implemented as none of the companies in our sample seems to have any independent directors.</p> <p>Public interest entities are required to have an "audit committee" appointed by the general shareholders' meeting (GSM). This body is not a board committee. The Standards recommend the establishment of audit, nomination, remuneration and risk management committees. These committees may be comprised of a minority of non-board members (outsiders), which is not in line with best practices.</p> <p>There is no practice of performing board evaluations or appointing corporate secretaries. The law awards board members with liability and fiduciary duties; however, there is no evidence that the law is well implemented. No case law on these issues seems to exist.</p> <p>We could not determine how boards and committees work in practice, since there is no disclosure on the number of board and committee meetings and activities.</p>
<p><b>1.1. Board Composition</b> Weak/Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>The roles of chair of the board and CEO are separated by law, and the Corporate Governance Standards recommend that the chair of the board should be an independent director.</li> <li>Legal entities cannot serve as board members.</li> <li>All companies adopting the Corporate Governance Standards are recommended to be comprised of individuals with adequate experience and qualifications in the areas of law, finance, auditing, and accounting. In the specific case of banks, board members are required to possess a degree in economics or law. Alternatively, they may have relevant professional experience in company strategy and decision-making.</li> <li>The Corporate Governance Standards recommend that members of audit, nomination, remuneration, and risk management committees should have appropriate professional skills and experience.</li> <li>Companies listed on the stock exchange's Premium Segment are required to have at least one third of their board composed of independent directors. In insurance companies, the board should have at least one "impartial member". The Corporate Governance Standards recommend that the number of independent directors appointed to the board should be enough to let them influence the decision-making processes of the company.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Boards are generally small, with an average of 4.5 members. Evidence has shown that smaller boards tend to perform better, provided that they have the necessary mix of skills and support, such as corporate secretaries. However, in Azerbaijan boards appear to be too small to ensure sufficient diversity of skills and experience and seem to lack adequate support.</li> <li>Only one of the top ten companies discloses the education and qualifications of its board members. This disclosure revealed that board members have a diversified mix of skills, but have no specific experience in auditing, accounting or risk management.</li> <li>The Corporate Governance Standards recommend that audit committees should be chaired by independent directors and, provided that they do not constitute a majority, the standards allow for committee members to be non-board members (outsiders). We have reservations about allowing outsiders to be part of audit committees. It is essential that members sitting in the audit committee and recommending specific actions follow up on such recommendations, reinforcing their positions and the board's 'objective judgement'. Further, we believe that audit committee members should have a thorough understanding of the company's business when performing their duties – outsiders might only have a partial understanding of the firm's activities. Finally, committees that include outsiders might have confidentiality and accountability issues, since 'outsiders' might not be bound by the same duties of loyalty and care required of board members. While it is legitimate that the audit committee might need external advice or expertise on specific issues, it should be able to request such advice without needing to replace the board members with external advisors.</li> </ul>
<p><b>1.2. Gender Diversity at the Board (5.7%)</b> Very Weak</p>	<ul style="list-style-type: none"> <li>Both the law and the Corporate Governance Standards are silent on gender diversity at the board.</li> <li>Only two companies appear to have women in their boards. Among these companies, the average of female representation amounts to 17.14%.</li> <li>In total, there are only two women among 31 board members.</li> <li>The average of female representation on boards of the ten largest listed companies is 5.7%.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>1.3. Independent Directors</b> Very Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Companies listed on the stock exchange's Premium Segment are required to have at least one third of their board composed of independent directors. In insurance companies, boards and audit committees should have at least one "impartial member".</li> <li>The Corporate Governance Standards recommend that the number of independent directors appointed to the board should be enough to let them influence the decision-making processes of the company, and that both the supervisory board and audit committee should be chaired by an independent director.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>The requirement for insurance companies to have 'impartial' members on their board and audit committees is rather vague.</li> <li>The Corporate Governance Standards provide for a definition of independence, but it does not demand independent members to present an independent state of mind; rather, it merely establishes negative criteria that need to be met.</li> <li>None of the companies in our sample —which includes one insurance company— discloses having any independent directors on their boards.</li> <li>There are only two companies currently listed on the stock exchange's Premium Segment and neither of them identifies who are their independent board members.</li> </ul>
<p><b>1.4. Board Effectiveness</b> Weak/Very weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>The Corporate Governance Standards recommend the establishment of audit, nomination, remuneration, risk management committees to support the supervisory board. The Standards further recommend that committee members should have appropriate professional skills and experience.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>The law requires public interest entities – which include, banks, listed and insurance companies – to establish an 'audit committee', which in practice is not a board committee and resembles a "revision commission". We have doubts about the effectiveness of this body (see below).</li> <li>The Corporate Governance Standards recommend that audit committees should be chaired by independent directors and, provided that they do not constitute a majority, the Standards allow for committee members to be non-board members (outsiders). We have reservations about allowing outsiders to be part of audit committees (see above).</li> <li>None of the companies in our sample discloses performing board evaluation or having a corporate secretary. According to our respondents, when a secretary function is created, it is generally performed by a board member or internal auditor; otherwise, the secretary performs only administrative functions.</li> <li>The law and the Corporate Governance Standards are silent on the subject of board and committee meetings. None of the surveyed companies discloses the frequency or attendance of these meetings.</li> </ul>
<p><b>1.5. Responsibilities of the Board</b> Weak/Very Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Fiduciary duties of the supervisory board members were introduced in the Civil Code of 2007, and they include the duties of care and loyalty. Members are further required to act in good faith, and in the best interests of the company and shareholders.</li> <li>Related party transactions (RPT) are regulated by law – related parties are prohibited from voting on these transactions. Some requirements have to be fulfilled for these transactions to be valid. For example, if the value of RPT is equal to 5% or more of the company's assets, the board should seek the opinion of an independent auditor.</li> <li>In the case of banks, a member of the board or committee who has conflicts of interest regarding any issue under discussion should inform the other members about his interests, and should not participate in the decision-making process of said topic.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>The law fails to assign key functions and responsibilities to the board; instead, it allows companies' by-laws to define them. The appointment and dismissal of the members of the management body or the CEO falls under the authority of the GSM, unless otherwise provided by the Articles. This is a major shortcoming, as it might deprive the board of one of its key functions. The Law on Banks clearly endows the supervisory board with the responsibility of overseeing the management body's activities; however, it gives the GSM the ability to ascertain the company's budget. There are no detailed guidelines as to the board's role in defining the company's strategy; in practice, it is unclear whether the shareholders or the supervisory board decide on this matter.</li> <li>The introduction of detailed fiduciary duties in the Civil Code was a step in the right direction; however, these duties seem to remain only on paper, with no judicial practice or case law dealing with the subject.</li> <li>Directors can be held liable for losses caused as a consequence of wrongful behaviour, but no case law exists on the matter.</li> <li>The Corporate Governance Standards recommend boards to focus on the management body's strategy planning, risk management and oversight activities; however, the implementation of its recommendations is very limited.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>2. Transparency and Disclosure</b> Weak/Fair</p>	<p>Public interest entities, including banks and listed companies, are required to prepare their financial statements in accordance with international standards, and most companies seem to comply with this requirement.</p> <p>Joint stock companies are further required to prepare and disclose their annual reports (AR); as of recently this obligation includes non-financial information, however, there is no guidance on how the document should be drafted (some basic requirements have been introduced in 2015 by the Law on Securities Market). In practice, the majority of the ten largest companies in the country publish their AR, but non-financial disclosures, including governance and ownership structures, are very limited. Only one company posts its Articles of Association on its website, while none discloses the minutes of the general shareholders' meeting or any other information on the board and committee activities. Companies' websites are incomplete and not easily accessible.</p> <p>The Corporate Governance Standards are voluntary, except for companies in which the Azerbaijani Investment Company (AIC) has made equity investment – however it is not clear how this requirement is monitored - there is no legal requirement for other companies to comply with them. None of the ten largest companies disclose any information about their compliance with the Standards.</p> <p>Companies are required to have independent external auditors and disclose their names. Seven out of the ten largest companies appear to comply but only four companies declare that their auditors are independent. The provision of non-auditing services by the external auditors is restricted but it does not seem to be always complied with and there is no requirement to disclose information on the provision of these services. These two shortcomings might undermine the auditor's independence.</p>
<p><b>2.1. Non-Financial Information Disclosure</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>Joint stock companies are now required to prepare and disclose their annual reports; in 2015 the Law on Securities Market introduced a requirement for listed companies to include a report on governance in their annual reports; however, there is no guidance on how the document should be drafted.</li> <li>The Corporate Governance Standards recommend companies, when preparing their ARs, to go beyond the legal requirements and provide a description of the business, analysis of financial condition, any material risks. Companies are further recommended to place their annual reports on their website and to release their disclosure policy to the public.</li> <li>The companies that do not submit or prepare annual reports in accordance with the legislation are fined. In 2015, 91 companies were fined in 2015 for this reason.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Seven of the ten largest companies post their ARs on their website. Only one company includes information on its governance and ownership structure.</li> <li>There is no requirement to disclose whether companies comply with the Corporate Governance Standards. None of the ten largest companies in Azerbaijan provides this information.</li> <li>Companies' websites are generally incomplete, and information is difficult to find. Five companies in our sample have updated websites and disclose major shareholder information. None of the companies discloses their major beneficial owners.</li> <li>Information on the board's and committees' activities and members' qualification is especially limited.</li> <li>None of the companies in our sample discloses online the minutes of the general shareholders meeting or transactions in company's shares of supervisory and management boards.</li> <li>The Ministry of Taxation is responsible for maintaining the registries of joint stock companies. Companies are required to submit their Articles to the Ministry and they should be publicly available at registry's website. Only one company in our sample publishes its Articles of Associations on its website.</li> </ul>
<p><b>2.2. Financial Information Disclosure</b> Moderately Strong</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>The law requires public interest entities— including banks, insurance firms and listed companies —to prepare their financial statements in accordance with IFRS, and to publish them and the auditor's opinion on their websites and other media sources.</li> <li>The majority of the companies in our sample seem to comply with these requirements.</li> </ul>
<p><b>2.3. Reporting to the Market and to Shareholders</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>The majority of the ten largest listed companies publish their AR on their websites.</li> <li>Listed companies are required to make timely disclosures when price sensitive events occur.</li> </ul> <p><b>Weaknesses:</b></p>

<b>Key Areas and Rating</b>	<b>Strengths and Weaknesses</b>
	<ul style="list-style-type: none"> <li>• Companies' websites are generally incomplete, and information is difficult to find.</li> <li>• Disclosure of non-financial information is very limited.<sup>2</sup></li> <li>• Failing to publish annual reports is subject to fines, but they are not high enough to deter breaches. Further, fines seem to apply only to the lack of financial information. The regulator has only sanctioned a few companies for breaches of reporting rules over the last five years.</li> </ul>
<p><b>2.4. Disclosure on the External Audit</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Companies are required to disclose the name of their external auditors and the majority of the ten largest listed companies disclose having external auditors and reveal their names. A significant majority of these companies is audited by international audit firms. However, only four declare that their auditors are independent.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• It appears that it is quite common for companies to receive non-auditing services by their external auditors, even though their provision is restricted. Companies are not required to disclose information on non-auditing services provided by their external auditors. None of the ten largest companies discloses this information, nor do they seem to have a policy to deal with the provision of these services.</li> </ul>

<sup>2</sup> Electronic System for Information Disclosure was recently established and is available on: <http://disclosure.az>

Key Areas and Rating	Strengths and Weaknesses
<p><b>3. Internal Control</b> Weak</p>	<p>The law requires banks and insurance companies to have internal audit units, and joint stock companies to have external audit bodies. In practice, there is no real assurance of their independence. External auditors are not allowed to provide non-auditing services, and are subject to rotation obligations. However, it seems that these restrictions are not always complied with. In some cases, it seems that the same audit firm both prepares and audits accounts. Public interest entities —i.e., banks, insurance, listed and large companies— are required to establish audit committees. In turn, companies with more than fifty shareholders and financial institutions are required to set up a “revision commission”. The Corporate Governance Standards further recommend companies to establish audit committees. There seems to be some confusion across various pieces of legislation between the roles and responsibilities of audit committees and those of revision commissions. Except for the case of the Corporate Governance Standards, the audit committees mentioned in legislation seem to be in practice a revision commission, appointed by and reporting to the general shareholders’ meeting. We have doubts about this body’s ability to ensure fit-for-purpose internal control systems. In regard to the audit committee recommended by the Corporate Governance Standards, it is suggested that its members might be outsiders (i.e., non-board members), which is not in line with best practices. There is no law on whistleblowing protection, but a new law is being drafted. None of the ten largest listed companies discloses having a code of ethics.</p> <p>New regulation on related party transactions has been recently introduced; however it is too early to assess its implementation. In practice, it seems that boards lack enough independence from majority shareholders to effectively monitor conflicts of interest, even in the case of banks.</p>
<p><b>3.1. Quality of the Internal Control Framework</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Banks and insurance companies are required to establish an internal audit function reporting to the audit committee. All four largest banks among the top ten largest companies have set up internal audit departments.</li> <li>• Banks are required to establish a standalone compliance function and adopt a code of ethics.</li> <li>• The Corporate Governance Standards have one chapter devoted to internal controls, the internal audit function and risk management strategies. The Standards recommend that the internal audit function should be independent from management and in line with the standards adopted by the International Institute of Internal Auditors.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Internal audit units do not seem to have direct access and to be reporting to the board. The internal audit function is to report to the audit committee; however, this committee does not appear to be a board committee. In general, there seems to be confusions between the roles and responsibilities of audit committees and those of revision commissions. In turn, this may compromise the internal audit function’s effectiveness.</li> <li>• Except for banks, there are no requirements or recommendations for the adoption of a code of ethics, however none of the ten largest companies (the sample includes four banks) discloses having one.</li> <li>• There is no specific law ensuring whistleblowing protection, but current legislation protects persons participating in criminal proceedings, and a new law is being drafted.</li> <li>• The practice of obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation, is not well-established.</li> </ul>
<p><b>3.2. Quality of Internal and External Audit</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Banks and insurance companies are required to set up an internal audit function.</li> <li>• Joint stock companies are required to appoint an independent external auditor, and to submit their annual financial statements for its review. A significant majority of the companies in our survey is audited by international audit firms.</li> <li>• Provision of non-auditing services is restricted by the Law on Auditing Services; however, it is unclear whether this restriction is well implemented.</li> <li>• Corporate Governance Standards recommend that the employee (or an audit partner) of the external auditor is rotated every 3 years.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• The reporting and accountability system to which the audit committee is subject does not ensure its independence and effectiveness (see audit committee’s section below).</li> <li>• There is no disclosure obligation regarding the provision of non-auditing services by the external auditor. The Corporate Governance Standards recommend that it should be avoided, but in practice it appears there are cases where the same audit firm both prepares and audits the accounts. This practice may undermine the auditors’ independence. Additionally, external auditors are not subject to rotation obligations.</li> <li>• External auditors are required to be independent; however, it is not clear who shall determine whether auditors comply with this condition. Four out of the ten largest companies declare that their auditors are independent, but it seems that no real “independence test” is being carried out, even in the case of banks.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>3.3. Functioning and Independence of the Audit Committee</b> Very weak/Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>The Corporate Governance Standards recommend companies to set up an audit committee, which should comprise members who have appropriate professional skills and experience. This body should be responsible for monitoring internal control systems, internal audit activities, financial reporting, external audit, accounting and legal compliance of the company.</li> <li>The Corporate Governance Standards recommend that audit committee should be chaired by an independent director.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Public interest entities, including banks, insurance, listed and large companies, are required to establish an audit committee. In turn, companies with more than fifty shareholders and all financial institutions are required to set up revision commissions. The various acts referring to audit committees and revision commissions in Azerbaijan adopt different language. This creates confusions about the roles and responsibilities of audit committees, and those of revision commissions. The audit committees mentioned in Azerbaijani legislation seems to be, in practice, revision commissions, with members appointed by and reporting to the general shareholders' meeting and not the board. We have doubts about the revision commission's ability to ensure fit-for-purpose internal control systems.</li> <li>The Corporate Governance Standards allow for audit committee members to be non-board members (outsiders), provided that they do not constitute a majority. We have reservations about allowing outsiders to be part of audit committees (see above).</li> <li>When looking at companies' disclosures, it seems that at least five companies in our sample established a revision commission, which some of them call "audit committee". In general, it is very difficult to understand how audit committees or revision commissions are structured. Disclosure of the composition, reports and number of meetings of companies' audit committee or revision commissions is extremely limited.</li> </ul>
<p><b>3.4. Control over Related Party Transactions and Conflict of Interest</b> Fair/Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>RPT and conflicts of interest are regulated by law. Parties with interests in a particular transaction must immediately notify the supervisory board about the nature and scope of their interests. RPT involving executive members must be disclosed to and approved by the supervisory board. If a transaction involves a value that exceeds 5% of the company's assets, it may only be executed with the approval of the general shareholders' meeting. Information must be posted on the company's website, and should be disclosed to the regulator and the media. Related parties that fail to comply with these obligations may be held liable for losses caused to the company.</li> <li>The Central Bank of Azerbaijan has issued detailed RPT regulations for banks.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Despite the fact that there are current regulations addressing RPT, it seems that, in practice, they are not well established. Companies are required to prepare their financial reports in line with IFRS, however disclosure on related party transactions is often incomplete. As companies do not disclose their beneficial owners, there is also no assurance that information on RPTs is being adequately disclosed.</li> <li>It seems that there are no specific rules restricting the use company business opportunities by insiders or their involvement with competitors. Related loans are allowed.</li> <li>In practice, boards may lack sufficient independence from controlling owners to effectively monitor conflicts of interests, even in the case of banks.</li> <li>It appears that there are no material sanctions for breaching rules on disclosure of conflicts of interest; enforcement appears to be limited to warnings.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>4. Rights of Shareholders</b> Fair</p>	<p>Basic shareholders rights are granted by law, and major corporate decisions are subject to supermajority.</p> <p>Shareholders have inspection rights and are entitled to call a shareholders' meeting. However, shareholders do not seem to have the right to ask questions at the general shareholders' meeting (GSM), or to nominate directors.</p> <p>Pre-emptive rights in cases of public offerings have recently been introduced. Cumulative voting are not granted by the law. Shareholders are provided with judicial mechanisms to enforce their rights, but shareholders' awareness of them seems to be low.</p> <p>Related party transactions and conflicts of interests are regulated by law. Regulation on insider trading and self-dealing exists, but it does not seem to be enforced in practice.</p> <p>Large companies are required to keep their shares at a private registry or at the National Depository Centre. Shareholding increases are subject to regulations and in listed companies, they must be disclosed.</p> <p>There is no clear legislation on shareholders agreements.</p>
<p><b>4.1. General Shareholders' Meeting (GSM)</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Shareholders representing 10% of the share capital have the right to call a GSM.</li> <li>• The GSM announcement and agenda are required to be sent to shareholders at least 45 days before the meeting. We have not been informed of any complaints over the accessibility of GSM locations or conditions over the past five years.</li> <li>• Shares carry proportional voting rights.</li> <li>• The law entitles shareholders to request the addition of items to the agenda; this is also recommended by the Corporate Governance Standards.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Voting at the GSM by proxy is allowed; however, electronic voting and voting by post are not allowed by law.</li> <li>• Shareholders are not granted the explicit right to ask questions at the GSM.</li> <li>• It is unclear how board and audit committee members are nominated. It seems that, in practice, the GSM does not play an effective role in the nomination of members.</li> <li>• The law does not provide for cumulative voting or proportional representation mechanisms. The Corporate Governance Standards only provide some guidelines on cumulative voting, but it is not clear if this recommendation is implemented in practice.</li> </ul>
<p><b>4.2. Protection against Insider Trading and Self-dealing</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Insider trading is prohibited and may be punished with imprisonment for up to two years.</li> <li>• The stock exchange is required to report to the regulator all transactions which may constitute insider trading.</li> <li>• It appears that board members, senior managers and controlling shareholders are required to disclose transactions of their company's shares.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• It was not possible to understand how many insider trading cases, if any at all, have been initiated or concluded in Azerbaijan.</li> <li>• None of the ten largest companies discloses transactions by insiders involving the company shares.</li> <li>• Conflicts of interest and related-party transactions are regulated by law, but these rules do not seem to be well implemented.</li> </ul>
<p><b>4.3. Minority Shareholders Protection and Shareholders' Access to Information</b> Fair</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Minority shareholders have the right to call a general shareholders' meeting.</li> <li>• Shares carry proportional voting rights.</li> <li>• Major corporate changes require supermajority at the GSM. Minority shareholders may block major corporate changes with a 33%+1 vote.</li> <li>• Shareholders have general inspection rights and violation or unlawful restriction of shareholder rights is subject to fines.</li> <li>• Pre-emptive rights in public offering have recently been introduced.<sup>3</sup></li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Disclosure of non-financial information is generally poor.<sup>4</sup></li> <li>• Most of the largest companies disclose their financial statements, but not non-financial information.</li> <li>• The law allows companies to establish voting caps to the number of votes that a shareholder can exercise.</li> <li>• Shareholders may bring derivative claims; however, it seems that shareholders' awareness of this right is rather low, and enforcement can be difficult in practice. No case law exists on this matter.</li> <li>• Cumulative voting, proportional representation or similar devices are not provided by law. Only the Corporate Governance Standards recommend the use of cumulative voting. This is a major shortcoming considering that</li> </ul>

<sup>3</sup> Law on Securities Market.

<sup>4</sup> Electronic System for Information Disclosure was recently established and is available on: <http://disclosure.az>

<b>Key Areas and Rating</b>	<b>Strengths and Weaknesses</b>
	ownership is highly concentrated in Azerbaijan.
<b>4.4. Registration of Shareholdings</b> Moderately strong	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Companies with more than 20 shareholders are required to keep their shares at a private registry or at the National Depository Centre, the latter of which seems to act as depository and registry simultaneously.</li> <li>• The free transferability of shares cannot be restricted.</li> <li>• Significant shareholding increases, defined as higher than 20% of the share capital, must be approved by the anti-monopoly authority. For banks, there are further requirements to be met in cases of increases to 20%, 33% and 50% of the share capital. For listed companies, shareholders that reach 5%, 10%, 25%, 50% or 70% of share ownership must inform the issuer within four trading days. Upon receipt, the issuer must disclose this information to the public within three trading days.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Shareholder agreements do not need to be disclosed and it is not clear whether these agreements are enforceable in practice.</li> </ul>

Key Areas and Rating	Strengths and Weaknesses
<p><b>5. Stakeholders and Institutions</b> Weak</p>	<p>Overall, the institutional environment promoting corporate governance in Azerbaijan needs to be strengthened.</p> <p>The stock exchange is illiquid and both the exchange and regulator do not seem to have an active role in promoting good governance practices. The websites of the exchange provide some limited financial information; however, neither the stock exchange's nor the regulator's websites provide all regulatory submissions made by listed companies.</p> <p>The Corporate Governance Standards were developed in 2011. In 2012, the Ministry of Economy issued the "Methodology of the Assessment of the Establishment of the Corporate Governance in Companies in Accordance with the Azerbaijan Corporate Governance Standards". In October 2014, the Standards have been declared mandatory for all companies where the Azerbaijani Investment Company (AIC) has made equity investment (however it is not clear how this requirement is monitored). For all other companies, the Standards are voluntary.</p> <p>International audit firms and ratings agencies are present and active in the country. It appears that there are inconsistencies in the legislation, and case law is hardly accessible, even for lawyers. Some key corporate governance issues are not regulated.</p> <p>Listed companies do not seem to pay much attention to requests by stakeholders, and international organisation indicators show a framework where corruption is still perceived as a critical problem. It appears that the country has improved significantly in the World Bank's Doing Business ranking, but the indicator focuses primarily on the state of written laws, and does not fully assess how legislation is applied in practice.</p>
<p><b>5.1. Corporate Governance Structure and Institutions</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• International audit firms have a material presence in the country.</li> <li>• International ratings agencies are relatively active within the country; three among the ten largest companies have been rated by international ratings agencies.</li> <li>• There are two listing tiers at the Baku Stock Exchange: the Primary Market Segment and the Standard Market Segment. Additionally, there is an Alternative Market Segment for shares and bonds not meeting the requirements of first two markets. To be listed in the Prime Market Segment, companies need to comply with higher non-financial disclosure standards than those of the Standard Market Segment.</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• The Baku Exchange is the main local stock exchange in Azerbaijan. Its market capitalisation seems to be around 14% of the GDP and it seems that the volume of trades is very low.</li> <li>• It appears that neither the stock exchanges' nor the regulator's website provides all regulatory submissions by listed companies. However, the stock exchange's website has limited financial reports for thirty-nine issuers.</li> <li>• Rulings of regulatory agencies are not publicly available.</li> <li>• International law firms have a limited presence in the country, but their presence seems to be growing. This is hoped to improve awareness of corporate governance issues.</li> </ul>
<p><b>5.2. Corporate Governance Code</b> Weak</p>	<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• The Azerbaijan Corporate Governance Standards are based upon OECD Principles of Corporate Governance and were released in 2011. The Standards are addressed to all commercial institutions.</li> <li>• In 2012 the Ministry of Economy issued the "Methodology of the Assessment of the Establishment of the Corporate Governance in Companies in Accordance with the Azerbaijan Corporate Governance Standards" (Decree № 77, 13/07/2012). In 2013, pursuant to the Methodology, the Ministry also performed a corporate governance assessment on how 33 selected companies comply with the Standards. The results of the assessment are posted on the Ministry website.</li> <li>• In October 2014, the Standards have been declared mandatory for companies where the Azerbaijani Investment Company (AIC) has made equity investment, however it is not clear how this requirement is monitored</li> </ul> <p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• The Corporate Governance Standards are voluntary for all companies other than companies in which the AIC has made equity investment and are not mentioned in the listing rules of the Baku Stock Exchange or elsewhere. For the time being, the Standards are being implemented under a 'testing regime'. Discussions are being held to determine whether the Standards should be implemented under a 'comply or explain' basis in the future.</li> <li>• The Standards do not seem to be taken as a reference by companies and – apart from the evaluation undertaken by the Ministry of Economy in 2013 - there is no authority active in monitoring how the Standards are implemented.</li> <li>• Judicial practice on many corporate governance issues is very limited. There is no case law referring to the Standards.</li> </ul>

<b>Key Areas and Rating</b>	<b>Strengths and Weaknesses</b>
<p><b>5.3. Institutional Environment</b> Weak</p>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Several inconsistencies were found among laws, regulations and the Standards, such as the audit committee and the revision commission.</li> <li>• <a href="#">According to the 2015 EBRD Assessment on Accessibility of Court Decisions</a>, Case law is hardly accessible for the general public, even for lawyers. One of the major issues identified in that assessment was the lack of prompt publication of court decisions.</li> <li>• The Baku Stock Exchange does not seem to be very active in promoting corporate governance. The Standards are voluntary, and are not mentioned in the listing rules of the Baku Stock Exchange or elsewhere.</li> <li>• The securities market regulator does not appear to be active in promoting good corporate governance practices; however, a recent 2015 State Committee for Securities report indicates that investigations and administrative penalties have increased.</li> <li>• Indicators provided by international organisations rank Azerbaijan poorly with regard to corruption perceptions. Azerbaijan performs relatively well in the World Bank Doing Business ranking, but it does not fully consider how laws are implemented in practice.</li> </ul>